

**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)

**REPLY BRIEF OF THE UTILITY REFORM NETWORK**

Dated: May 19, 2020

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## **I. INTRODUCTION**

The Utility Reform Network (“TURN”) files this reply brief in response to the opening briefs filed on April 21, 2020. TURN finds that the opening brief of the Small LECs does not provide any credible support for their position that imputation should not be pursued by the Commission. While TURN’s opening brief anticipated many of the issues raised by the Small LECs and other parties, in this reply brief TURN will address specific arguments raised by the Small LECs, as well as Public Advocates and Mr. Kalish. While this reply addresses many of the topics in the common briefing outline and discussed in the opening briefs, TURN does not address each and every issue raised by parties in their briefs. To the extent that TURN’s reply brief does not address specific issues raised by a party, this should not be taken as a concession of the issue by TURN.

Based on TURN’s review of the arguments leveled by Small LECs in opposition to imputation, there is no doubt that this Commission stands on solid legal and policy ground as it adopts TURN’s imputation proposal. While Public Advocates supports imputation, TURN disagrees with the specifics of Public Advocates’ proposal. Likewise, while Mr. Kalish’s recommendations are intended to improve outcomes associated with the CHCF-A program, his proposals suffer from infirmities that contradict federal law and lead to outcomes that do not benefit ratepayers either in Small LEC areas or more broadly in California. The bulk of this reply will address the opening brief of the Small LECs. The Small LECs’ arguments confuse the issues facing this Commission and distort TURN’s proposal. As this reply brief will make clear, the record supports TURN’s imputation plan, which will ensure that the Commission complies with overarching state and federal universal service objectives and statutory mandates.

## **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. Maturity of Broadband Deployment**

In TURN’s opening brief, TURN analyzed the conclusions that can be drawn from the comprehensive study of the maturity of broadband deployment in the Small LECs’ service areas.<sup>1</sup> Dr. Roycroft’s study exposed key concerns associated with broadband deployment and

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<sup>1</sup> TURN Opening Brief at 5-10.

adoption in Small LEC service areas. TURN believes that the results of Dr. Roycroft's study demonstrate a market failure that exacerbates the digital divide.<sup>2</sup> 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.<sup>3</sup> 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.<sup>4</sup>

### **B. Small LECs Provide an Incomplete Picture of the Maturity of Broadband**

In their opening brief, Small LECs provide only a high-level view of the status of broadband *deployment* in Small LEC service areas.<sup>5</sup> Small LECs say nothing about broadband *adoption*, thus overlooking the key element of market failure associated with the broadband services provided by Small LEC ISP affiliate operations. There is no question that relatively low-speed broadband is widely available in Small LEC service areas.<sup>6</sup> However, ISP affiliates of the Small LECs have priced all but the lowest speeds out of the reach of consumers residing in Small LEC service areas, who have relatively lower incomes, as compared to consumers in California's urban areas.<sup>7</sup>

While Small LECs tout the progress regarding broadband deployment, progress which TURN's witness Dr. Roycroft acknowledged,<sup>8</sup> Small LECs also gloss over differences evident in Small LEC service areas as compared to urban areas. The digital divide is a significant problem in Small LEC service areas, as reflected in broadband speeds available to consumers in urban areas of the state.<sup>9</sup> Dr. Roycroft explains that broadband adoption in Small LEC service areas indicates that there are significant shortfalls in achieving statutory objectives of promoting

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<sup>2</sup> TURN Opening Brief at 8.

<sup>3</sup> TURN Opening Brief at 8. Ex. TURN-1-C (Roycroft Confidential Opening) at 9, 58-59. Ex. LEC-9 (Aron Public Opening) at 49-50.

<sup>4</sup> TURN Opening Brief at 8.

<sup>5</sup> Small LECs Opening Brief at 15.

<sup>6</sup> Small LECs Opening Brief at 15.

<sup>7</sup> EX. LEC-11 (Lehman Public Opening) at 9. Ex. Cal Adv- 40C (Parker Confidential Opening) at 1-13-15.

<sup>8</sup> Ex. TURN-1-C (Roycroft Confidential Opening) at 38.

<sup>9</sup> Ex. TURN-1-C (Roycroft Confidential Opening) at 34-35.

“customer access to advanced services and deployment of broadband-capable facilities in rural areas that is reasonably comparable to that in urban areas.”<sup>10</sup>

The data reveal market failure and a significant digital divide. Small LECs indicate that 74.2 percent of their 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. An astounding 96.6 percent of Small LEC broadband subscribers purchase broadband at speeds below the FCC's long-standing, and now dated, 25/3 Mbps standard.<sup>11</sup>

To address this market failure, TURN proposes that the Small LECs be allowed to opt into an imputation compliance plan, under which companies with ISP affiliates that are earning excessive returns will reduce broadband rates, and potentially increase broadband speeds in lieu of reduced CHCF-A draws.<sup>12</sup> Small LECs do not address this alternative compliance plan in their opening brief, other than to state that the plan would potentially extend the time necessary to complete a rate case.<sup>13</sup> TURN concedes that there would likely be some additional effort necessary to implement the optional compliance plan, however, the benefits to the customers of the Small LECs' ISP affiliates would be substantial. Taking steps to close the digital divide may take some extra work, but in TURN's opinion, the importance of promoting broadband adoption outweighs the costs of a Small LEC designing a compliance plan for the Commission to review.

### **C. Small LECs Finally Concede the True Relationship Between CHCF-A and Investment**

At the hearings Small LEC witness Mr. Duval testified that CHCF-A cannot be linked to Small LEC investments:

CHCF-A is not specifically defined to fund any particular investment. It provides revenue to recover the intrastate revenue requirement of the Independent Small LEC, and that's the end of it.<sup>14</sup>

However, Small LECs note in their opening brief that in Phase 2 of this proceeding the evidence regarding broadband deployment “shows material improvements, *spurred by continued support from the CHCF-A through the most recent round of rate cases.*”<sup>15</sup> Small LECs continue:

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<sup>10</sup> Pub. Util. Code §275.6(c)(5).

<sup>11</sup> Ex. TURN-1-C (Roycroft Confidential Opening) at 57, emphasis in the original.

<sup>12</sup> Ex. TURN-1 (Roycroft Public Opening) at 24-27.

<sup>13</sup> Small LECs' Opening Brief at 38.

<sup>14</sup> TR 930.

<sup>15</sup> Small LECs' Opening Brief at 15, emphasis added.

“Further investment will be needed to deliver 25/3 to all reasonable locations, which necessitates ongoing cost recovery, *including CHCF-A support.*”<sup>16</sup> Thus, by Small LECs’ own admission, ratepayer support through CHCF-A is contributing to broadband investment and deployment in Small LEC service areas. The nexus between broadband deployment supported by CHCF-A and the broadband imputation is important. By Small LECs’ own admission, the investment needed to enable broadband services offered by their ISP affiliates are supported by CHCF-A and ratepayer funding has enabled the business models of the ISP affiliates. Given the direct linkages now conceded by Small LECs between CHCF-A and broadband investment, broadband imputation is necessary to strike the appropriate balance between ratepayer support for broadband, Small LEC broadband infrastructure deployment, and ISP affiliate broadband service provision.<sup>17</sup>

#### **D. Small LECs’ Statements Regarding Fiber Deployment Are Not Supported by The Record**

In an attempt to dissuade the Commission from implementing TURN’s imputation proposal, Small LECs paint a rosy picture of the prospects for broadband deployment in their service areas when they state that, by the time the next rate cases are completed, customer expectations and regulatory requirements “will necessitate fiber-to-the-premise architecture in substantially all locations.”<sup>18</sup> While TURN would certainly welcome progress toward upgraded broadband infrastructure, the record in this proceeding does not support the proposition that the Small LECs plan on investing in or deploying all-fiber networks in the timeframe that Small LECs suggest. In fact, the references to the record on this matter offered by the Small LECs to support their fiber-to-the-premise claim do not identify a single specific date, but instead offer various vague aspirational statements from Small LEC witnesses regarding fiber deployment.<sup>19</sup>

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<sup>16</sup> Small LECs’ Opening Brief at 15, emphasis added.

<sup>17</sup> TURN Opening Brief at 17.

<sup>18</sup> Small LECs’ Opening Brief at 16.

<sup>19</sup> See footnote 105 in Small LECs’ Opening Brief, which reads: “*See* RT at 1416:1-5 (Boos) (“We’re looking ahead, too, and we don’t believe that a 25/3 network is going to be adequate, and we believe the FCC’s going to increase that requirement, and so we’re trying to anticipate that.”); see also Phase 1 Exh. 11 (Thompson Opening) (engineering expert confirming that “[a]s the need for increased speeds continues, all wireline providers will eventually install FTTP, which is the most cost-effective way to provide wireline services from a long-term perspective when considering the capital expenditures, scalability factors, broadband capabilities, and operational expenses involved.”); RT at 1362:5-6 (McNally) (in response to a question about upgrading Sierra’s network: “Our plan is to build fiber to the

The lack of a timeline is also consistent with information TURN received in the discovery process. Regarding future plans for fiber deployment, each of the Small LECs produced a discovery response that stated:

To the extent possible, [each Small LEC] believes it is important to advance fiber further into the network on an incremental basis over a period of years. This step-by-step approach to construction ensures a prudent use of resources that recognizes [each Small LEC] limited capital and the impacts on ratepayers, while ensuring that the customer benefits of fiber deployment can be spread as widely as possible amongst the customer base as the network evolves.<sup>20</sup>

Furthermore, rather than the all-fiber network that Small LECs describe in their opening brief, discovery responses indicate that Small LECs have no plans to upgrade some customers to fiber, even in the long run.<sup>21</sup>

Thus, while TURN certainly encourages the Small LECs to build networks that are capable of delivering broadband speeds to their customers that are comparable to those in urban areas, TURN also encourages the deployment of broadband networks that are cost effective, resilient, and which provide consumers with the opportunity to purchase affordable services. TURN believes that a more balanced approach to broadband deployment will generate more consumer benefits, and that the promises of “all fiber” networks should not mislead the Commission into believing that fiber is a cure-all for the broadband adoption problems that are evident in Small LEC service areas. All-fiber networks will not do as much good to bridge the digital divide if the broadband services sold by the Small LECs reflect current ISP affiliate pricing practices, resulting in broadband rates that are unaffordable, or if the networks are unreliable during times of emergency.

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home.”); RT at 1509:1-15 (Boos) (explaining that speeds of 25/3 Mbps could not be achieved over copper, and necessitated fiber).”

<sup>20</sup> Small LECs response to TURN Phase 2 Data Request 1.4(a)-(c). These responses are found in Ex. TURN-1-C (Roycroft Public Opening) at Roycroft Appendix 2 (Non-Confidential) NC0030-NC0050.

<sup>21</sup> “In some limited cases, fiber investments may be too costly to reasonably pursue. In addition, some customer locations are so close to the central office that they can be feasibly served with copper drops.” Small LECs response to TURN Phase 2 Data Request 1.4(a)-(c). See Ex. TURN-1 (Roycroft Public Opening) at Roycroft Appendix 2 (Non-Confidential) NC0030-NC050.

### **E. Small LECs' Lack of Support for Low-Income Broadband Is Unreasonable**

Small LECs argue that Public Advocates' proposal to link CHCF-A with support for low-income broadband services is inappropriate.<sup>22</sup> TURN notes that the testimony of Small LECs' own witness, Dr. Lehman, supports the proposition that the affordability of broadband services in Small LEC service areas is a significant problem.<sup>23</sup> Dr. Roycroft agreed with Dr. Lehman's assessment, noting that "most of the counties in which Small LEC service areas are located are below the statewide average median income, with some, like Modoc, Tehama, and Tulare, showing a substantial deficiency."<sup>24</sup> Furthermore, Small LEC witness Mr. Boos stated that he would be "happy to look at something" like a low-income broadband offering, however, only if the Small LEC customers were to receive support from the Lifeline Fund.<sup>25</sup> While TURN supports the Commission's consideration of Lifeline support for broadband on a statewide basis, with the proper funding base for the expanded subsidy, the extremely high broadband prices and extremely low broadband quality in Small LEC service areas<sup>26</sup> suggests that a targeted response is also needed in addition to a statewide evaluation of access to broadband by low income households. While TURN's optional compliance plan offers the Small LECs the opportunity to better serve their low-income customers, TURN believes that it is reasonable for this Commission to require, as a condition of receiving CHCF-A support, that each Small LEC ISP affiliate offer affordable broadband to low income customers.<sup>27</sup> TURN also believes that it is appropriate to consider the impact of reduced broadband rates on CHCF-A draws, with reduced broadband revenues being offset with CHCF-A draws. This outcome could easily be addressed through TURN's imputation plan.

Yet, while low income broadband plans in Small LEC areas will help meet the Commission's policy goals, it is also important for this Commission to consider the funding of all of its universal service programs—end-user surcharge assessment of voice services and associated services. This basis for satisfying statutory universal service objectives is not sustainable as intrastate voice revenues shrink and broadband is now an essential service that

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<sup>22</sup> Small LECs' Opening Brief at 18.

<sup>23</sup> EX. LEC-11 (Lehman Public Opening) at 9.

<sup>24</sup> Ex. TURN-2 (Roycroft Public Reply) at 51-52.

<sup>25</sup> TR 1487.

<sup>26</sup> Ex. TURN-1 (Roycroft Public Opening) at 8 and 49.

<sup>27</sup> Ex. TURN-2 (Roycroft Public Reply) at 5-53. Public Advocates' Opening Brief at p. 18-19.



enables voice communication and a vast array of other services that are critical for workforce participation, access to healthcare, access to education, access to governmental services, and social connections and interaction. Given that CHCF-A now supports broadband services and could be used to support low income pricing for standalone broadband services, TURN urges the Commission to consider ways to assess broadband services to equitably generate the funding necessary to support CHCF-A and other programs.

#### **F. State Specific Broadband Performance Metrics Are Reasonable and Should Be Adopted by The Commission**

Small LECs argue that imposing broadband performance measures on the Small LECs would constitute an illegal attempt to regulate information services.<sup>28</sup> Small LECs also argue that there is no support in the record for such a proposal. TURN disagrees on both counts. First, as TURN noted in its opening brief, the *Mozilla* decision confirms that this Commission is not barred from addressing broadband regulation under state laws.<sup>29</sup> Certainly, the California Legislature, by crafting Section 275.6, places broadband squarely under state law, as that law charges this Commission with the promotion of “advanced services and deployment of broadband-capable facilities in rural areas,” and also instructs the Commission to “include all reasonable investments necessary to provide for the delivery of high-quality voice communication services and the deployment of broadband-capable facilities in the rate base of small independent telephone corporations.”<sup>30</sup> Certainly, these provisions of state law are sufficient for this Commission to take the kind of action envisioned in the *Mozilla* decision regarding the enforcement of state laws that address broadband.

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<sup>28</sup> Small LECs’ Opening Brief at 21.

<sup>29</sup> TURN Opening Brief at 30, citing to *Mozilla Corp. v. Federal Communications Commission et al.* 940 F.3d 1 (2019) (hereinafter *Mozilla*).  
[https://www.cadc.uscourts.gov/internet/opinions.nsf/FA43C305E2B9A35485258486004F6D0F/\\$file/18-1051-1808766.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/FA43C305E2B9A35485258486004F6D0F/$file/18-1051-1808766.pdf)

<sup>30</sup> Pub. Util. Code §275.6(c)(5) and (6). See, also, Pub. Util. Code §281(a), applying surcharge funding to, “encourage deployment of high-quality advanced communications services to all Californians that will promote economic growth, job creation, and the substantial social benefits of advanced information and communications technologies.” And see, Pub. Util Civil Code §3100 et seq. added by Stats. 2018 Ch. 976, Sec. 1 (California Internet Consumer Protection and Net Neutrality Act of 2018 supported by the police powers of the State of California to protect consumers that are “increasingly dependent on an open and neutral Internet.”)

Second, TURN's witness Dr. Roycroft offered testimony regarding the appropriateness of broadband performance measures linked to receipt of CHCF-A funding.<sup>31</sup> Dr. Roycroft testified that when crafting performance measures, the Commission should not implement a one-size-fits-all approach.<sup>32</sup>

Certainly, Small LECs are aware that the record includes Dr. Roycroft's testimony as well as Small LEC witness Mr. Duval's testimony. Mr. Duval addresses this issue in his reply testimony.<sup>33</sup> However, Mr. Duval's response to Dr. Roycroft's proposal for performance evaluation associated with receipt of CHCF-A support is anything but convincing. Instead, Mr. Duval attempts to distract the Commission from the issue at hand, by presenting the companies' federal reporting requirements regarding broadband deployment, hardly a substitute for meaningful monitoring and measurement of performance.<sup>34</sup> Mr. Duval even chafes at reporting deployment data annually;<sup>35</sup> but under cross examination had to admit that the Small LECs are required to file some information on newly deployed broadband on an annual basis.<sup>36</sup> Given that Small LECs are generating annual information to submit to the FCC, this Commission should not have to wait five years for broadband deployment data or performance measurements from the Small LECs. This Commission should adopt specific broadband performance measures associated with CHCF-A funding and receive the requested data from the Small LECs annually along with deployment data to ensure that ratepayer monies distributed to the Small LECs through CHCF-A are appropriately utilized.

#### **G. Public Advocates' "87% Or Greater" Adoption Target Should Not Be Adopted**

TURN does not agree with Public Advocates' proposal to only approve broadband deployment projects in Small LEC rate cases if the Small LEC has achieved 87% or greater broadband adoption.<sup>37</sup> While TURN believes that Small LECs should be required to increase broadband adoption, TURN believes that the 87% or greater approach is not an appropriate framework to achieve this objective as it could discourage broadband investment by disallowing

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<sup>31</sup> Ex. TURN-1 (Roycroft Public Opening) at 73-74.

<sup>32</sup> Ex. TURN-1 (Roycroft Public Opening) at 73-74.

<sup>33</sup> Ex. LEC-2 (Duval Public Reply) at 64-65.

<sup>34</sup> Ex. LEC-2 (Duval Public Reply) at 64.

<sup>35</sup> Ex. LEC-2 (Duval Public Reply) at 64.

<sup>36</sup> TR 1008.

<sup>37</sup> Public Advocates Opening Brief at 16-18.

new broadband projects in rate base, especially for those Small LECs that have yet to achieve significant deployment at speeds of 10Mbps or more.<sup>38</sup> TURN notes that Public Advocates indicates that they have not conducted any analysis of the impact of suspension of CHCF-A support on either the operations of the Small LECs or their ability to achieve the 87 percent adoption target.<sup>39</sup> Nor have they considered how to apply this proposal in areas where alternative broadband providers may impact Small LEC adoption numbers.<sup>40</sup> TURN believes that Public Advocates' proposal is at cross purposes when it comes to closing the digital divide—lower broadband rates make sense, but consumers residing in the Small LECs' service area should have access to broadband speeds that are reasonably comparable to those being utilized in urban areas.<sup>41</sup>

#### **IV. BROADBAND IMPUTATION**

*Scoping Memo, Issues (1)(C), (1)(D), Hearing Issue (2)*

##### **A. Retail Imputation**

TURN's imputation model utilizes a "pro forma" approach and treats each individual Small LEC and its ISP affiliate operations in the regulated service territory as one company. The analysis will be conducted when establishing Small LEC draws from CHCF-A during the rate case process. The rate case process will continue to examine the intrastate operations of the Small LEC but will now include the operations of the ISP affiliate. The ISP affiliates' investment, expenses, and revenues will be treated as intrastate during the rate case for purposes of viewing the company's integrated operations, and the intrastate rate of return will then be based on the evaluation of the integrated operations of the Small LEC and its ISP affiliate.<sup>42</sup> TURN's imputation approach counts all revenues, investments, and expenses for both entities and adjusts CHCF-A draws based on the combined results of operations for each Small LEC and its ISP affiliate.

TURN's imputation proposal will appropriately balance the interests of Small LEC shareholders and the ratepayers that contribute to CHCF-A, while continuing to promote

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<sup>38</sup> Ex. TURN-2 (Roycroft Public Reply) at 56-57 (Public Advocates' proposal uses an overall average benchmark at 10 Mbps finding that most LECs have already reached this benchmark).

<sup>39</sup> Ex. TURN-2 (Roycroft Public Reply) at 56.

<sup>40</sup> Ex. TURN-2 (Roycroft Public Reply) at 58-59.

<sup>41</sup> Ex. TURN-2 (Roycroft Public Reply) at 58.

<sup>42</sup> Ex. TURN-1 (Roycroft Public Opening) at 14-15.

broadband investment in Small LEC service areas.<sup>43</sup> If adopted, TURN's proposal would not conflict with federal, state, and constitutional law, nor would TURN's imputation proposal violate basic jurisdictional separations and cost recovery principles.<sup>44</sup> TURN's imputation proposal works within the established rate-of-return framework that is required for the Small LECs under Section 275.6.<sup>45</sup> TURN's imputation proposal would correct existing distorted economic outcomes.<sup>46</sup> Whether as a matter of law or as a matter of public policy and consumer welfare, broadband imputation can and should be adopted by the Commission.

### *1. Legality of Broadband Imputation*

In D.14-12-084 the Commission settled the matter of whether it has the authority to impose broadband imputation, “we do not accept the Small ILECs’ narrow reading of Section 275.6 and agree with ORA and TURN that the legislature did not intend to limit the Commission’s ratemaking authority on this issue.”<sup>47</sup> Nothing in the intervening six years has changed the validity of this conclusion. Small LECs, however, continue to grasp at straws in an effort to convince the Commission that it does not have the authority to balance the interests of Small LEC shareholders and California ratepayers. For example, Small LECs erroneously state that TURN's imputation proposal will regulate Internet access service.<sup>48</sup> This is simply not the case. TURN's proposal, consistent with this Commission’s statutory authority, utilizes a pro forma approach to acknowledge ISP affiliate revenues so as to ensure that CHCF-A is providing the appropriate level of support to the Small LECs. Application of TURN's proposal in no way regulates the pricing plans or terms and conditions of Internet access service. Furthermore, contrary to Small LEC claims that TURN's proposal will result in a shortfall in intrastate revenue requirement,<sup>49</sup> imputation under TURN's proposal allows the Small LEC to have the opportunity to fully meet the revenue requirement. This point will be discussed further below.

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<sup>43</sup> Ex. TURN-1 (Roycroft Public Opening) at 18-20.

<sup>44</sup> Ex. TURN-2 (Roycroft Public Reply) at 63-66 (noting that TURN’s proposal preserves federal and state separations, in part because ISP revenues are unregulated and thus are not included in interstate ratemaking).

<sup>45</sup> Ex. TURN-1 (Roycroft Public Opening) at 14, 16-17.

<sup>46</sup> Ex. TURN-1 (Roycroft Public Opening) at 17-18.

<sup>47</sup> D. 14-12-084 at 21-22.

<sup>48</sup> Small LECs Opening Brief at 22-23, “These imputation proposals would involve regulation of ISPs and an assertion of ratemaking authority over Internet access service.” See also, 26 “Section 706 does not provide the Commission with authority to regulate Internet access service.”

<sup>49</sup> Small LECs Opening Brief at 23.

## 2. *The Mozilla Decision Does Not Preempt This Commission’s Authority to Impose Imputation*

Small LECs argue that imputation intrudes upon the FCC's interstate regulatory authority associated with the FCC's designation of broadband ISPs as “information service” providers, as mandated in the FCC's *Restoring Internet Freedom Order*.<sup>50</sup> However, as TURN discusses in its opening brief, the *Mozilla* decision states that, by designating broadband ISPs as information service providers, the FCC placed broadband outside of the FCC's jurisdiction. As a result of reclassification, the *Mozilla* decision concludes that the FCC has no express authority over broadband, “Nor did Congress statutorily grant the Commission freestanding preemption authority to displace state laws even in areas in which it does not otherwise have regulatory power.”<sup>51</sup> The Court also found that the FCC could not rely on ancillary authority under Title I to preempt states because regulating broadband is no longer “reasonably ancillary to the Commission’s effective performance of its statutorily mandated responsibilities” as the Commission disavowed itself of that responsibility.<sup>52</sup> Thus, addressing broadband imputation will not intrude on the FCC's “turf” as the FCC's *Restoring Internet Freedom Order* has placed broadband Internet access out of the bounds of the FCC's authority.

Small LECs also raise the issue of preemption.<sup>53</sup> While Small LECs note that the *Mozilla* decision settled the general preemption matter by concluding that the FCC cannot broadly preempt all state and federal regulation,<sup>54</sup> Small LECs go on to claim that the D.C. Circuit Court of Appeals decision leaves “conflict preemption” in place as that court addressed only “the narrow question of whether the FCC has statutory authority to broadly preempt all state and local regulations of broadband in advance, without a specific statute or regulation to evaluate under conflict preemption principles.”<sup>55</sup> TURN agrees that the *Mozilla* decision resulted in the rejection of the FCC's decision to impose broad preemption. However, on the matter of conflict preemption, Small LECs lose sight of the context of key issues raised in *Mozilla*. In the *Mozilla*

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<sup>50</sup> Small LECs Opening Brief at 23, citing to *In the Matter of Restoring Internet Freedom*, WC Docket No. 17-108, Report and Order, et al., FCC 17-166 (rel. Jan. 4, 2018) (“*Restoring Internet Freedom Order*”).

<sup>51</sup> *Mozilla* at 125.

<sup>52</sup> *Mozilla* at 124-125, citations omitted.

<sup>53</sup> Small LECs Opening Brief at 23.

<sup>54</sup> Small LECs Opening Brief at 23. See *Mozilla* at 121.

<sup>55</sup> Small LECs Opening Brief at 23.

proceeding, the FCC argued that its broad preemption directive should be left intact because “conflict preemption would lead to the same result.”<sup>56</sup> However, the *Mozilla* decision noted that there was no way to determine whether conflict preemption and the FCC's broad preemption directive would overlap in the manner suggested by the FCC as this is a fact-based question and, “We have long recognized that ‘whether a state regulation unavoidably conflicts with national interests is an issue incapable of resolution in the abstract,’ let alone in gross.”<sup>57</sup>

The Small LECs’ argument is premature and overstates the Mozilla Court’s holding. The fact that the D.C. Court of Appeals left in place the *potential* for conflict preemption does not automatically result in the preemption of the state law that gives this Commission authority to administer CHCF-A. The FCC has not addressed the issue of broadband imputation and TURN’s imputation proposals preserve federal ratemaking processes and jurisdictional separations; as a result, there has been no “actual preemption of a specific state regulation.” Furthermore, Section 275.6 in no way “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” Rather, Section 275.6 is consistent with the Section 706 of the federal Communications Act, which specifies that state commissions may employ “*other regulating methods that remove barriers to infrastructure investment.*”<sup>58</sup> Small LECs now concede that CHCF-A is essential to support their investment in advanced telecommunications services,<sup>59</sup> indicating harmony between Section 275.6 and the Congressional direction contained in Section 706. This Commission’s authority to administer a state universal service program that supports the deployment of broadband facilities in rural areas is entirely consistent with federal universal service objectives. TURN's imputation proposal supports both this state’s statutory objectives and Congresses’ direction regarding the deployment of advanced telecommunications services.

### 3. *Imputation Is Consistent with Rate-Of-Return Regulation*

Small LECs also argue that the “regulatory intent and practical effect of imputation, . . . is to subject the ISP to “rate of return” regulation.”<sup>60</sup> Contrary to Small LECs argument, TURN’s

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<sup>56</sup> *Mozilla* at 135.

<sup>57</sup> *Mozilla* at 136-137.

<sup>58</sup> Section 706 of the Telecommunications Act of 1996, emphasis added. This section of the Act is Codified at 47 U.S. Code § 1302.

<sup>59</sup> Small LECs Opening Brief at 15.

<sup>60</sup> Small LECs Opening Brief at 25.

imputation proposal does not place the ISP affiliate under rate-of-return regulation as no price controls are imposed on the ISP affiliates.<sup>61</sup> TURN's proposal utilizes a pro forma approach to account for the impact of ISP revenues on the integrated operations of the Small LEC and its ISP affiliate to adjust the size of CHCF-A draws. This approach is consistent with Section 275.6(b)(3) which indicates that the Commission can include "other revenue sources" to develop a rate design to meet a Small LEC's revenue requirement.

On the matter of rate-of-return regulation, however, Small LECs cannot get away from the fact that the Small LEC and its ISP affiliate are integrated operations with common ownership. Small LEC witnesses readily concede that the Small LEC and its ISP affiliate are owned by the same individuals and operate on an integrated basis.<sup>62</sup> Small LECs assert that under imputation "the common owners of the telephone companies and the ISPs would experience these profit restrictions collectively, an effect that mimics the imposition of rate-of-return regulation on both entities."<sup>63</sup> If this statement is true, it is also true that *absent imputation* that the owners of the Small LECs who have ISP affiliates that are earning high profit margins experience these high returns "collectively,"<sup>64</sup> and that the objectives of the rate-of-return framework that the Statute indicates must be in place for the Small LECs to receive CHCF-A support is being subverted. Imputation will correct the imbalance that is observed in the

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<sup>61</sup> TR at 1779:11-24 (Roycroft).

<sup>62</sup> Ex. TURN-1 (Roycroft Public Opening) at 10, 28-33. See also, Ex. LEC-9 (Aron Public Opening) at 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 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." TR 1779:17-24.

<sup>63</sup> Small LECs Opening Brief at 25-26.

<sup>64</sup> This point was conceded by Dr. Aron at the hearing TR 1647 (Aron):

Q: And there do you see that the Independent Small LECs there, do you see that you state that the Independent Small LECs and their affiliates have the same owners, and those owners are affected by financial losses regardless of which firm records the losses on its books?

A: I do.

Q: So, Dr. Aron, if I were to change one word in that statement and instead the statement read: The Independent Small LECs and their affiliates have the same owners, and those owners are affected by financial gains regardless of which firm records the gains on its books, would that still be a true statement?

A: Yes.

operations of the Small LEC and their ISP affiliates and adjust CHCF-A draws to ensure that the Small LECs have an opportunity to earn a reasonable return on investment.<sup>65</sup>

*4. TURN's Imputation Proposal Results in Regulated Rate Design Equaling Revenue Requirement*

Small LECs claim that TURN's broadband imputation proposal will result in an "unlawful disconnect" as Small LECs allege that the regulated rate design for each Small LEC that will not equal its revenue requirement.<sup>66</sup> Small LECs also claim that broadband imputation will result in the Commission setting a revenue requirement and then refusing to fill it.<sup>67</sup> This is simply not true and Small LECs slip into obfuscation on this matter. To support these claims, Small LECs point to Mr. Duval's "modified 'results of operations' calculation" that was presented in his reply testimony.<sup>68</sup> Small LECs go on to assert that "no party has rebutted Mr. Duval's calculations."<sup>69</sup> This is also not true as TURN challenged and refuted Mr. Duval's calculations during the hearings.

To unwind Small LECs' obfuscations, one must examine the hearing transcript and parse Mr. Duval's "modified 'results of operations'" calculations that appear in Exhibit LEC-13-C, which is an appendix to Mr. Duval's reply testimony.<sup>70</sup> Mr. Duval's Exhibit LEC-13-C contains ten pairs of pages that reflect two separate and conflicting versions of operating results for each of the Small LECs. While Mr. Duval has labeled each of the ten pairs of pages as "TURN Imputation Proposal 2018 ISP Revenue Requirement,"<sup>71</sup> Mr. Duval incorrectly identifies

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<sup>65</sup> Ex. TURN-1 (Roycroft Public Opening) at 15.

<sup>66</sup> Small LECs Opening Brief at 27.

<sup>67</sup> Small LECs Opening Brief at 27.

<sup>68</sup> Small LECs Opening Brief at 27-28. Mr. Duval's "modified 'results of operations' calculation" is shown in Ex. LEC-2-C (Duval Confidential Reply) at Exhibit A.

<sup>69</sup> Small LECs Opening Brief at 28.

<sup>70</sup> See Ex. LEC-2-C (Duval Confidential Reply) at Exhibit A. Mr. Duval's initial submission of his 241-page Exhibit A did not number the pages of the exhibit. At the request of TURN Small LECs added Bates Stamp number to Exhibit A. TURN refers to those Bates Stamp numbers in the following discussion of Mr. Duval's Exhibit A.

<sup>71</sup> See Ex. LEC-2-C (Duval Confidential Reply) at Exhibit A. The relevant pages corresponding to Small LEC rates of return are: Duval-Confidential Exh. 0008 and Duval-Confidential Exh. 0009 (Calaveras); Duval-Confidential Exh. 0020 and Duval-Confidential Exh. 0021 (CAL-ORE); Duval-Confidential Exh. 0032 and Duval-Confidential Exh. 0033 (Ducor); Duval-Confidential Exh. 0044 and Duval-Confidential Exh. 0045 (Foresthill); Duval-Confidential Exh. 0056 and Duval-Confidential Exh. 0057 (Kerman); Duval-Confidential Exh. 0068 and Duval-Confidential Exh. 0069 (Pinnacles); Duval-Confidential Exh. 0080 and Duval-Confidential Exh. 0081 (Ponderosa); Duval-Confidential Exh. 0092 and Duval-



TURN's imputation proposal as appearing on the even numbered pages. On the even numbered pages in Exhibit LEC-13-C Mr. Duval displays an "imputation" summary that, contrary to TURN's imputation approach, fails to address ISP revenues, expenses, and investment. With this incomplete picture of imputation, the results shown on those even-numbered pages appear to show that some of the Small LEC will not earn their authorized rate of return under TURN's imputation proposal.<sup>72</sup> Under TURN's actual imputation proposal, this is simply not the case.

It was established during the hearings that the even-numbered pages in Mr. Duval's Exhibit LEC-13-C do not reflect TURN's imputation proposal. Rather, TURN's imputation proposal is in fact correctly shown on the relevant odd-numbered pages in Exhibit LEC-13-C.<sup>73</sup> This fact was made clear during Mr. Rosvall's cross examination of Dr. Roycroft:

Q: So I can name all the pages, if it's needed. But, yes, I'm talking about the ones that say, "TURN Imputation Proposal" in 13-C.

A: Okay. So I believe that those are 008 and 009, 020, 021, 032, 033, 044, 045, 056, 057, 068, 069, of course, 80 and 81, and 92, 93, 104, 105, 116 and 117. Is that what we're talking about?

Q: So that was great. It probably saved us 15 minutes. So yes. And my question, again, is: Have you reviewed those, and are they a correct reflection of TURN's proposal, forgetting about all the other sheets that may be in here, just those ones?

A: No. Only the odd-numbered pages are a correct reflection. So of all those pages that I cited, starting with 009 and up through 0117, those are the ones that correctly reflect. The other page, which is also labeled "TURN Imputation Proposal," does not.

Mr. Duval also conceded under cross examination by Ms. Mailloux that of the relevant paired pages in Exhibit LEC-13-C, only the odd-numbered pages correctly reflect TURN's imputation proposal. Mr. Duval further conceded that TURN's imputation proposal results in the

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Confidential Exh. 0093 (Sierra); Duval-Confidential Exh. 0104 and Duval-Confidential Exh. 0105 (Siskiyou); and Duval-Confidential Exh. 0116 and Duval-Confidential Exh. 0117 (Volcano).

<sup>72</sup> Because TURN's imputation proposal allows for Small LECs with ISP affiliates that earn negative returns to receive increased CHCF-A draws, some of the *even-number pages* in Mr. Duval's Exhibit A show a Small LEC earning above its authorized return under TURN's proposal. This outcome is also incorrect. TURN's imputation proposal results in each Small LEC revenue requirement reflecting only the opportunity to earn the authorized return.

<sup>73</sup> See Ex. LEC-2-C (Duval Confidential Opening) at Exhibit A, pages Duval-Confidential Exh. 0009 (Calaveras), Duval-Confidential Exh. 0021 (Cal-Ore), Duval-Confidential Exh. 0033 (Ducor), Duval-Confidential Exh. 0045 (Foresthill), Duval-Confidential Exh. 0057 (Kerman), Duval-Confidential Exh. 0069 (Pinnacles), Duval-Confidential Exh. 0081 (Ponderosa), Duval-Confidential Exh. 0093 (Sierra), Duval-Confidential Exh. 0105 (Siskiyou), and Duval-Confidential Exh. 0117 (Volcano).

Small LEC's rate of return being the same value before and after imputation, i.e., consistent with giving the Small LEC a reasonable opportunity to earn its authorized return.<sup>74</sup>

Q: Okay. Thank you. I think you just answered this question. But back to the exhibit, page 21, we're still on Cal-Ore. And we're using Cal-Ore as an example.

But can you confirm for me that on this page, page 21, in addition to including the adjusted California High Cost Fund-A draw for Cal-Ore, it also includes Cal-Ore ISP affiliates' revenues and expenses and includes the ISP affiliates' net investment in rate base?

A: Yes. Page 21 -- Bates stamp page 21 does include those items.

Q: Okay. And then on this Bates stamp page 21, it shows the results of TURN's imputation proposal as applied to Cal-Ore -- because we were just talking about that?

A: Correct. And that's on line 7.

Q: And that TURN's proposal by accounting for both the Small LEC and ISP affiliate operations generates the rate of return being the same before and after imputation.

Is that true?

A: That's true . . .

Q: Right. Okay.

But is it your understanding of TURN's proposal that there's no change in the intrastate rate of return?

A: That's my understanding, yes.<sup>75</sup>

Thus, as is illustrated by Small LECs' own witness, Mr. Duval, TURN's imputation proposal results in the Small LECs having the opportunity to recover its revenue requirement.<sup>76</sup>

Small LECs also argue that the Commission cannot lawfully adopt a regulated rate design that depends on an infusion of unregulated revenues.<sup>77</sup> Dr. Roycroft explained, again under cross examination by Mr. Rosvall, that one need not formally account for a payment of ISP net profits to the Small LEC from the affiliate, as the companies have the same owners. Thus, it is

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<sup>74</sup> The quoted line of cross examination focuses on page 0021, which shows TURN's imputation proposal as applied to Cal-Ore.

<sup>75</sup> TR 1026-1027. In this exchange Ms. Mailloux questions Mr. Duval regarding information shown on Duval-Confidential Exh. 0020 and Duval-Confidential Exh. 0021 for Cal-Ore.

<sup>76</sup> Ex. LEC-2-C (Duval Confidential Opening) at Exhibit A, pages Duval-Confidential Exh. 0009 (Calaveras), Duval-Confidential Exh. 0021 (Cal-Ore), Duval-Confidential Exh. 0033 (Ducor), Duval-Confidential Exh. 0045 (Foresthill), Duval-Confidential Exh. 0057 (Kerman), Duval-Confidential Exh. 0069 (Pinnacles), Duval-Confidential Exh. 0081 (Ponderosa), Duval-Confidential Exh. 0093 (Sierra), Duval-Confidential Exh. 0105 (Siskiyou), and Duval-Confidential Exh. 0117 (Volcano).

<sup>77</sup> Small LECs' Opening Brief at 29.

not necessary for the ISP affiliate to transfer funds to the Small LEC—for each Small LEC and its ISP affiliate the revenues go into the “same pocket.”

Q: I see. But, you did clarify that the -- the ISPs themselves don't actually pay that money to the telephone companies. Right?

A: That's correct. However, the owners of the companies essentially have one pocket into which the revenues flow from both sides of their operation, and there's not a need to take it from one pocket to the next if I'm the owner.<sup>78</sup>

Thus, the record clearly demonstrates that TURN's imputation proposal will appropriately reconcile revenue requirement and rate design and give each Small LECs a reasonable opportunity to earn its authorized rate of return.

Small LECs also attempt to convince the Commission that Section 275.6 prohibits this Commission from considering broadband revenues when calculating the revenue requirement.<sup>79</sup> This is simply not the case. Section 275.6(b)(3) and (b)(4) clearly identify “other revenue sources” as being fair game for the evaluation of rate design and the establishment of the revenue requirement. When read as a whole, Section 275.6 clearly supports the Commission’s ability to utilize information on ISP affiliate revenues<sup>80</sup> to administer a rate-of-return framework that appropriately considers other revenue sources that the Small LECs enjoy.

##### 5. *Small LECs’ Reliance on Brooks-Scanlon Is Misplaced*

In an attempt to demonstrate that TURN's imputation proposal is inconsistent with Supreme Court precedent Small LECs point to *Brooks-Scanlon Co. v. Railroad Comm’n of Louisiana*.<sup>81</sup> However, Small LECs’ reference to *Brooks-Scanlon* is not on point. In that case the U.S. Supreme Court considered whether a lumber company (Brooks-Scanlon) could be compelled by the Railroad Commission of Louisiana to operate a railroad subsidiary at a loss.<sup>82</sup> The U.S. Supreme Court concluded that “A carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage,” and that the “constitutionality of a rate is shown to depend upon whether it yields to the parties concerned a

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<sup>78</sup> TR 1816-1817.

<sup>79</sup> Small LEC Opening Brief at 29.

<sup>80</sup> Pub. Util. Code §275.6(e).

<sup>81</sup> *Brooks-Scanlon Co. v. Railroad Comm’n of Louisiana*, 251 U.S. 396 (1920). Hereinafter “*Brooks-Scanlon*.”

<sup>82</sup> *Brooks-Scanlon* at 398.

fair return.”<sup>83</sup> These passages clearly indicate why TURN's imputation proposal does not run afoul of *Brooks-Scanlon*. TURN's imputation plan does not compel any element of the Small LECs' business to operate at a loss.<sup>84</sup> In fact, TURN's imputation proposal results in increased CHCF-A draws for those Small LECs which have affiliates that are currently operating at a loss, and allows for a risk differential when the Commission considers the operations of the ISP affiliate.<sup>85</sup> As a result, the “fair return” identified in *Brooks-Scanlon* is part and parcel of TURN's imputation proposal.<sup>86</sup>

#### 6. *Alleged Distortions Associated with Imputation Do Not Exist*

Small LECs claim that imputation will “encourage price manipulation and cost-cutting measures that could threaten broadband service quality.”<sup>87</sup> To support this claim Small LECs offers a string of contradictory statements from various Small LEC witnesses. For example, Small LECs point to Mr. Boos who indicated that he would raise prices in response to imputation. However, Mr. Boos also states that ISP affiliates ability to raise prices “would be limited based on ‘competitive forces’ and the income demographics of Ponderosa’s service territory.”<sup>88</sup> Small LECs then point to Mr. Boos and Mr. Votaw to support the proposition that expense reduction strategies could diminish “customer service, maintenance and responsiveness.”<sup>89</sup> However, Small LECs temper this possibility by noting that “these measures would be somewhat limited, as the unregulated ISPs are ‘already efficient operation[s]’ that ‘already [have] incentives to reduce expenses to the extent reasonable.’”<sup>90</sup> Thus, Small LECs do not offer convincing support for their claims. Small LECs are also critical of TURN's proposed modification to the “means test” to discourage broadband price increases.<sup>91</sup> However, Small LECs ultimately concede that the “means test” element of the CHCF-A annual filing process is a “longstanding regulatory mechanism[], designed to disincentivize over-earning. . .”<sup>92</sup> TURN's

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<sup>83</sup> *Brooks-Scanlon* at 399.

<sup>84</sup> Ex. TURN-1 (Roycroft Public Opening) at 15; TR 1767:8-9.

<sup>85</sup> Ex. TURN-2 (Roycroft Public Reply) at 18, 21, 23.

<sup>86</sup> Ex. TURN-1 (Roycroft Public Opening) at 15.

<sup>87</sup> Small LECs' Opening Brief at 31.

<sup>88</sup> Small LECs Opening Brief at 31.

<sup>89</sup> Small LECs Opening Brief at 31.

<sup>90</sup> Small LECs Opening Brief at 31.

<sup>91</sup> Small LECs Opening Brief at 31 and 38.

<sup>92</sup> Small LECs Opening Brief at 74.

modification to the “means test” will simply utilize the existing mechanism to ensure that broadband rate increases are similarly disincentivized.

### *7. Disaffiliation Threats Are Not Credible*

TURN has explained the significant problems with Small LEC claims that imputation will lead to disaffiliation.<sup>93</sup> In their opening brief the Small LECs posit that it would make economic sense for a Small LEC like Ponderosa to sell its ISP affiliate as it would take an extended time frame, measured in thousands of years, for Ponderosa to earn as much profit under TURN's imputation proposal.<sup>94</sup> Given that TURN's imputation proposal would allow the ISP affiliate an opportunity to earn a reasonable return on its investments, TURN appreciates Small LECs' Ponderosa example as it provides a clear illustration of the magnitude of the excessive profits earned by some ISP affiliates. However, Small LECs' Ponderosa example completely excludes from consideration the negative impacts of disaffiliation that Dr. Roycroft<sup>95</sup> and Dr. Aron<sup>96</sup> discuss. There are significant negative consequences for the Small LECs arising from disaffiliation. These factors would also have to be considered by the Small LECs and it is clear that the negative impact of disaffiliation will be substantial and would include stripping the ISP affiliate and the Small LEC from several significant cost synergies that arise from joint operations and would also create a barrier for the Small LECs to offer retail broadband and to meet their FCC broadband targets for universal service funding.<sup>97</sup>

Small LECs' Ponderosa example also overlooks the fact that 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.<sup>98</sup> Small LECs' Ponderosa “thousands of years” example can be ignored by the Commission as it completely fails to address the downsides of disaffiliation for both the Small LEC and for the potential sale price of an ISP affiliate.

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<sup>93</sup> TURN Opening Brief at 22-29. See also, Ex. TURN-2 (Roycroft Public Opening) at 4-10 and 29-36.

<sup>94</sup> Small LECs Opening Brief at 34.

<sup>95</sup> Ex. TURN-2 (Roycroft Public Reply) at 5-10 and 27-36.

<sup>96</sup> Ex. LEC-9 (Aron Public Opening) at 35-42.

<sup>97</sup> Ex. TURN-2 (Roycroft Public Reply) at 7-9.

<sup>98</sup> Ex. TURN-2 (Roycroft Public Reply) at 9.

Furthermore, as admitted by Dr. Aron, the disaffiliation threat is only valid for those Small LEC ISP affiliates that are profitable in the first place,<sup>99</sup> thus leaving five of the ten of the ISP affiliates free from the disaffiliation incentives due to their lack of profitability.<sup>100</sup> For those ISP affiliates that are profitable, that the forgone synergies from disaffiliation are substantial is also recognized by Dr. Aron who testifies that “the ability of the independent Small LEC and the ISP affiliate to share the expenses of certain resources creates efficiencies that would be lost if the ISP affiliate disaffiliates from the independent Small LEC.”<sup>101</sup> Dr. Aron also argues that the operational synergies of the Small LECs and their ISP affiliates are substantial and efficiency losses from disaffiliation would be harmful to the profitability of both the Small LEC and its ISP affiliate.<sup>102</sup>

The best that the Small LECs do to support the disaffiliation argument is to point to Small LEC witness assertions “that, in the long run, a sale of the ISP would be preferable to retaining the business under an imputation policy.”<sup>103</sup> As noted by the legendary economist John Maynard Keynes, “But this long run is a misleading guide to current affairs. In the long run we are all dead.”<sup>104</sup> What might happen in the long run is not a guide here either. Small LECs presented no evidence that the benefits of disaffiliation exceeded the costs of disaffiliation, rather, it is the reverse. Dr. Aron testifies that “The ability of the independent Small LEC and the ISP affiliate to share the expenses of certain resources creates efficiencies that would be lost if the ISP affiliate disaffiliates from the independent Small LEC.”<sup>105</sup> Furthermore, instead of providing reports of plans to sell their ISP affiliates, Small LEC witnesses explained how they would operate under an imputation environment (cutting costs and attempting to increase efficiencies).<sup>106</sup>

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<sup>99</sup> Ex. LEC-9 (Aron Public Opening) at 35.

<sup>100</sup> “Five of the 10 ISPs are either unprofitable, barely profitable, or inconsistently profitable.” Small LECs Opening Brief at 5.

<sup>101</sup> Ex. LEC-9 (Aron Public Opening) at 35.

<sup>102</sup> “By operating independently, they would not have the opportunity to effectively share personnel, expertise, and other resources across businesses or coordinate their operations to the same degree as the companies currently do under common ownership. . .” Ex. LEC-9 (Aron Public Opening) at 41.

<sup>103</sup> Small LECs Opening Brief at 32, footnote 197.

<sup>104</sup> John Maynard Keynes, *A Tract on Monetary Reform* (1923), Ch. 3, p. 80.

<sup>105</sup> Ex. LEC-9 (Aron Public Opening) at 35.

<sup>106</sup> Ex. LEC-7 (Votaw Public Opening) at 14; Ex. LEC-4 (Boos Public Opening) at 23.

#### 8. *The Commission Must Carefully Monitor Any Disaffiliation Attempts*

In its opening brief, TURN discussed Dr. Aron’s proposal that a Small LEC and its ISP affiliate could skirt the affiliate transaction rules and enter into “arm's length relationships with the LEC that still allow them to have cooperative business arrangements.”<sup>107</sup> TURN noted that this tactic would likely run afoul of the FCC's affiliate transaction rules, if not antitrust laws.<sup>108</sup> In their opening brief, Small LECs double down on Dr. Aron’s potentially illegal proposal and identify new ways that the Small LECs could game the system to ensure that California ratepayers continue to pay more than is reasonable to support some of the Small LECs through CHCF-A. For example, Small LECs inform the Commission that: “Owners of ISPs in contiguous exchanges, such as Ponderosa and Sierra, *could sell their ISPs to each other, thereby remaining in the ISP business but removing both ILECs from the imputation model.*”<sup>109</sup> Alternatively, Small LECs posit another tortured scenario to continue to draw excessive support from CHCF-A at levels that are not justified by the operating results of the Small LEC and its ISP affiliate: “An ISP could be *sold to a trusted employee*, such as one of the current company managers, giving the owners a high level of confidence that *mutually beneficial coordination between the disaffiliated entities could be maintained.*”<sup>110</sup> Small LECs argue that either of these actions could be pursued because “There are no regulatory restrictions on these disaffiliation strategies, as the ISPs are unregulated.” Not quite. Affiliate relationships between telephone companies and their affiliates are in fact regulated. This was explained by Small LEC witness Mr. Duval.<sup>111</sup> These companies have regulatory obligations that are specifically designed to prevent the type of illegal gaming that Dr. Aron and the Small LECs suggest.

The Small LECs should be careful not to escalate their imputation avoidance work arounds to the extent that they begin to sound like fraud. Small LECs have entered into a regulatory contract with this Commission and the California ratepayers under Section 275.6 that requires full disclosure of information—neither CHCF-A nor rate-of-return regulation can function without access to comprehensive and reliable information about the operations of the

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<sup>107</sup> TR 1671 (Aron).

<sup>108</sup> TURN Opening Brief at 28.

<sup>109</sup> Small LEC Opening Brief at 33, emphasis added.

<sup>110</sup> Small LEC Opening Brief at 33, emphasis added.

<sup>111</sup> Ex. LEC-1 (Duval Public Opening) at 17-18 (explaining how Part 32 imposes a uniform system of accounts to, in part, allow federal and state regulators to monitor affiliate transactions).

Small LECs and their ISP affiliates. There is no question that Small LECs must operate under rate-of-return regulation to receive CHCF-A support,<sup>112</sup> and that Section 275.6(e) has empowered this Commission to have full disclosure of information regarding the operations of Small LEC ISP affiliates. The Small LECs now advance a plan to obfuscate the relationship between a Small LEC and its ISP affiliate. Small LECs have a duty under Section 275.6(e) to disclose facts, and this Commission must be vigilant to ensure that the Small LECs do not conceal the facts of their true ISP operations by engaging in “paper” disaffiliations in order to mislead the Commission when determining the appropriate level of support from CHCF-A.

In light of the potential plans of the Small LECs, TURN reiterates that the Commission has a statutory duty to collect information regarding Internet access revenues unless the Commission is confident that the Small LEC is no longer engaged in any element of the provision of unregulated Internet access service. The Commission should fully investigate any disaffiliation, sale, or transfer of ISP affiliate assets to ensure that the Small LECs are not concealing the true operations of their ISP affiliates so as to continue to enjoy ratepayer-provided subsidies through CHCF-A at the expense of California ratepayers.<sup>113</sup>

## **B. Imputation Is A Necessary and Appropriate Element for Small LEC Rate Cases**

### *1. Imputation Will Not Unduly Complicate Rate Cases*

Small LECs argue that imputation will result in “dramatic” increases in the complexity of rate cases.<sup>114</sup> The record in this proceeding has demonstrated that the Small LECs and their ISP affiliates operate as integrated entities. The companies sell their services from the same web site.<sup>115</sup> Most of the ISP affiliates have no direct employees, instead sharing employee resources with the affiliated Small LEC.<sup>116</sup> Dr. Aron testifies 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.<sup>117</sup> Thus, the same individuals perform duties for both the Small LEC and its ISP

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<sup>112</sup> Cal. Pub. Util. Code §275.6(c)(2).

<sup>113</sup> TURN Opening Brief at 28-29.

<sup>114</sup> Small LECs Opening Brief at 35-36.

<sup>115</sup> Ex. TURN-2 (Roycroft Public Reply) at 11-12.

<sup>116</sup> Ex. LEC-9 (Aron Public Opening) at 37.

<sup>117</sup> Ex. LEC-9 (Aron Public Opening) at 37.



affiliate, using the same equipment and offices and they share common family ownership and investors.<sup>118</sup>

As a result, imputation will not create a significant regulatory burden. The accounting foundation to address the resources shared by the Small LEC and its ISP affiliate has already been established through mechanisms such as the FCC's Part 32 affiliate transaction rules<sup>119</sup> and the ongoing rate case process. Certainly, following the implementation of imputation there will be incremental additions to the rate case process. However, this Commission's obligation under the Statute to regulate recipients of CHCF-A support is not conditional on the level of work to carry out this obligation.<sup>120</sup> That framework is sufficient and appropriate to ensure that CHCF-A support is "not excessive so that the burden on all contributors to the CHCF-A program is limited."<sup>121</sup>

*2. Rate-Of-Return Regulation and Imputation Are Compatible with Expense-Intensive Businesses and Those with Complicated Pricing Plans*

Small LECs argue that rate-of-return regulation is not sufficient to address "expense-intensive businesses" such as ISP affiliates.<sup>122</sup> The "expense-intensive" issue is a red herring. As pointed out by Dr. Roycroft, rate-of-return regulation has a history of dealing with expense intensive businesses, and he explained how to address situations where rate-of-return regulation is in place for an expense-intensive business:

Even if a firm is expense intensive, rate-of-return regulation can easily address that issue through adjustments in the cost of capital. For firms that actually have low net investment to expense ratios, the increase in insolvency risk arises due to the fact that relatively small unexpected changes in expenses could result in revenues insufficient to compensate shareholders. . . .

[E]ven if one were to ignore the fact that the Small LEC and its ISP affiliate operate as an integrated entity and do not face insolvency risk, the regulatory solution to situations where insolvency risks exist is to adjust the rate of return permitted on the associated investment.<sup>123</sup>

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<sup>118</sup> Ex. TURN-1 (Roycroft Public Opening) at 38. Ex. TURN-2 (Roycroft Public Reply) at 27-35. Ex. LEC-9 (Aron Public Opening) at 37-42.

<sup>119</sup> Ex. LEC-1 (Duval Public Opening) at 17-18.

<sup>120</sup> Cal. Pub. Util. Code, §275.6(e).

<sup>121</sup> Cal. Pub. Util. Code, §275.6(c)(7).

<sup>122</sup> Small LECs Opening Brief at 36.

<sup>123</sup> Ex. TURN-2 (Roycroft Public Reply) at 38-39.

Small LEC also claim that the “dynamic nature of the broadband market” would hinder ISP revenue projections associated with the application of rate-of-return regulation to their operations. Data supplied from the Small LECs does not show wild swings in either revenues or costs associated with ISP affiliate operations.<sup>124</sup> ISP affiliate revenues increase from just under \$16 million in 2013 to just over \$22 million in 2018. ISP affiliate costs, including interest and taxes increase from just over \$14 million in 2013 to \$18.6 million in 2018. Changes of this magnitude can easily be addressed when making projections.

Small LECs assert that TURN’s proposal to track ISP affiliate broadband price increases would further complicate the rate setting process.<sup>125</sup> Presumably Small LECs know the prices they charge for the broadband services, or at least have access to their own web sites to be able to determine just what those prices are. Likewise, Dr. Aron has confirmed that Small LECs have billing systems that are shared with the ISP affiliates,<sup>126</sup> and it must then be the case that those billing systems contain the rates they charge their ISP customers. These facts support the proposition that reporting information on broadband price changes will not burden the Small LECs.

### **C. Broader Policy Goals Continue to Support Imputation**

#### *1. Small LECs’ Imputation “Cost-Benefit” Analysis Falls Flat*

Section IV(a)(5) of the Small LECs’ opening brief claims that TURN’s imputation proposal “cannot survive a cost-benefit analysis.”<sup>127</sup> However, this section of the Small LECs’ opening brief does not attempt a legitimate cost-benefit analysis. Rather, Small LECs advance unsupported arguments regarding the motivation for TURN’s imputation proposal,<sup>128</sup> and otherwise attempt to muddy the waters regarding the importance of this Commission abiding by the statutory mandate to ensure that CHCF-A support “is not excessive.”<sup>129</sup>

The core of the Small LECs’ purported cost-benefit analysis is the size of the savings associated with the imputation proposal. Rather than conducting a legitimate cost-benefit analysis, the Small LECs instead describe a fallacy of composition by making the following

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<sup>124</sup> Ex. TURN-1 (Roycroft Public Opening) at 13.

<sup>125</sup> Small LECs Opening Brief at 38.

<sup>126</sup> Ex. LEC-9 (Aron Public Opening) at 36.

<sup>127</sup> Small LECs Opening Brief at 39.

<sup>128</sup> Small LECs Opening Brief at 39-40.

<sup>129</sup> Cal. Pub. Util. Code §275.6(c)(7).

claim: because the impact of correcting excessive ISP earnings on customer bills is small, it must be the case that the general impact is also small.<sup>130</sup> Small LECs argue that estimates of cost savings for ratepayers for imputation “would ‘save’ CHCF-A contributors less than a penny on a \$25 phone bill, or approximately 10 cents a year.”<sup>131</sup> However, Small LECs’ argument is irrelevant in the context of the statutory framework that governs how CHCF-A is administered. Section 275.6(c)(7) specifies that the Commission should ensure that CHCF-A support “is not excessive.” The Statute also indicates that the Commission must apply rate-of-return regulation. Rate-of-return relies on measures that are quite specific. For example, TURN notes that when calculating the revenue requirement and CHCF-A draws in their Advice Letters, Small LECs specify values down to the penny.<sup>132</sup> This suggests that these companies have concerns regarding the difference of a penny as they calculate their CHCF-A draws. Certainly, this is a case where “what is sauce for the goose is sauce for the gander”—ratepayers deserve the same level of precision in accounting for CHCF-A as do the companies that receive CHCF-A support.

The argument that imputation will only save a “few cents” on customer bills is also a slippery slope. Following the Small LECs’ logic, needlessly assessing ratepayers “an additional penny or two” beyond today’s assessment will still be reasonable. This is not the case. This Commission has an obligation to ensure that the assessment supporting CHCF-A is no more than is needed to ensure the Small LECs have an opportunity to earn a reasonable return on their investment.<sup>133</sup>

Further illustrating the fallacious nature of the “few cents” argument, the record shows that California ratepayers have provided to the Small LECs excessive support that sums up to \$11 million in overpayment of the past six years.<sup>134</sup> Imputation will remedy this systemic imbalance moving forward. Under TURN’s imputation proposal the Small LEC and its ISP affiliate will continue to benefit from the economies of scope that are available today, and these companies will be allowed the opportunity to earn a reasonable return on their investments.

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<sup>130</sup> Small LECs Opening Brief at 40.

<sup>131</sup> Small LECs Opening Brief at 40.

<sup>132</sup> See, for example, Calaveras Telephone Company’s September 14, 2018 Advice Letter filing; Cal-Ore Telephone Company’s September 14, 2018 Advice Letter filing.

<sup>133</sup> Pub. Util. Code §275.6.

<sup>134</sup> Ex. TURN-1 (Roycroft Public Opening) at 27.

## 2. *TURN Has Advanced A Consistent Position in This Proceeding*

Small LECs assert that TURN has offered “shifting policy justifications” for broadband imputation.<sup>135</sup> The record in this proceeding demonstrates that this is simply not the case. TURN’s motivation for proposing imputation continues to be rooted in the unbalanced process associated with NECA Tariff No. 5 rates, which does not contribute to the substantial cable and wire facilities that contribute to overall loop costs.<sup>136</sup> Small LECs even attempted to rebut this continuing element of TURN’s position in this case in their 2019 opening testimony, with Mr. Boos specifically referencing the sections of Dr. Roycroft’s 2014 testimony that contain Small LECs’ admission that NECA Tariff No. 5 rates do not contribute to the recovery of substantial loop costs.<sup>137</sup> TURN also has consistently taken issue with the current 75 percent intrastate/25 percent intrastate allocation of the remaining costs of providing local loops, which recover the costs of the electronics needed to deliver broadband facilities.<sup>138</sup> The combined impact of these artifacts of federal ratemaking is an outcome where Small LEC ISP affiliates pay interstate NECA Tariff No. 5 wholesale rates that are substantially below the cost of service, with the shortfall being recovered from intrastate ratepayers, CHCF-A, and federal universal service support mechanisms.<sup>139</sup>

While the distorted outcomes associated with NECA Tariff No. 5 apply to all Small LECs, TURN has continually pointed out that the impact is not uniform. Some Small LEC ISP affiliates earn substantial profits due to low NECA Tariff No. 5 rates.<sup>140</sup> However, disparities among the Small LECs lead others to have experienced negative profits.<sup>141</sup> TURN’s imputation

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<sup>135</sup> Small LECs Opening Brief at 43.

<sup>136</sup> See Dr. Roycroft’s July 11, 2014 Phase 1 testimony at 17-18, which quotes Small LECs’ response to TURN’s Phase 1 data request Set 13, request 4.

<sup>137</sup> Ex. LEC-4 (Boos Public Opening) at 18.

<sup>138</sup> TR 978-979 (Duval).

<sup>139</sup> “As I noted, this intrastate loop component is the 75% of the cost of broadband-capable local loops used solely in the provision of voice and jointly in the provision of voice and broadband that is assigned to intrastate in the cost separations process, which I discussed previously. HCLS provides funding in the amount of 65% of the Independent Small LECs’ costs between 115% and 150% of the National Average Cost per Loop, and funding in the amount of 75% of the Independent Small LECs’ costs above 150% of the National Average Cost per Loop. . . . The remainder of the 75% of the cost of the broadband-capable local loop must be recovered from intrastate sources, including basic local rates, custom calling features, and CHCF-A.” Ex. LEC-1 (Duval Public Opening) at 29-30.

<sup>140</sup> For differences in NECA Tariff No. 5 rates see Ex. LEC-2 (Duval Public Reply) at 20.

<sup>141</sup> Ex. TURN-1 (Roycroft Public Opening) at 17.

proposal is not “one size fits all” and allows for increase CHCF-A draws for those Small LECs which experience higher costs and lower customer density, which is more likely to lead to negative return on ISP investment.<sup>142</sup>

Beyond offering an imputation proposal in 2019 that is virtually identical to TURN's 2014 imputation plan (again demonstrating the consistency of TURN's position), TURN has also responded to the questions posed by the Commission in this proceeding that have appropriately asked the parties to consider key issues, entirely consistent with the Statute, associated with broadband deployment and adoption. The results of TURN's research into the issue of broadband “maturity” that was requested in the September 12, 2019 ALJ ruling led TURN to propose an alternative imputation compliance plan for the Small LECs that would result in lower broadband rates and potentially higher broadband speeds for Small LEC customers.<sup>143</sup> This expansion in TURN’s recommendations, however, continues to be rooted in TURN's imputation framework.

### 3. *The Digital Divide Should Be Considered in An Evaluation Of CHCF-A*

Small LECs are also critical of TURN’s evaluation of the digital divide: “In Phase 2, TURN’s ‘free ride’ concept also sublimated into rhetoric surrounding efforts to bridge the ‘digital divide.’”<sup>144</sup> Small LECs err on this point. TURN did not offer rhetoric associated with the digital divide, rather, TURN offered detailed economic analysis.<sup>145</sup> Furthermore, it was not TURN, but the Commission, in light of statutory mandates, that appropriately directed the focus of Phase 2 of this proceeding to broadband deployment and the digital divide. Section 275.6(c)(5) states that when administering CHCF-A the Commission *shall* “Promote customer access to advanced services and deployment of broadband-capable facilities in rural areas *that is reasonably comparable to that in urban areas*, consistent with national communications policy.” Appropriately, the September 12, 2019 ALJ ruling requested information on the status of broadband maturity and deployment in Small LEC service areas.<sup>146</sup> TURN completed the requested evaluation of the maturity of broadband deployment in Small LEC service areas and

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<sup>142</sup> Ex. TURN-1 (Roycroft Public Opening) at 12.

<sup>143</sup> Ex. TURN-1 (Roycroft Public Opening) at 24-26.

<sup>144</sup> Small LECs Opening at 41.

<sup>145</sup> Ex. TURN-1 (Roycroft Public Opening) at 28-71.

<sup>146</sup> See questions 1-5 in the Administrative Law Judges’ Ruling Setting Hearing Dates and Issues for Hearing, September 12, 2019.

found glaring differences in broadband availability between California’s urban areas and Small LECs’ service territories. TURN also found striking problems with broadband adoption in Small LEC service areas, which TURN believes are caused by the deployment of low quality and high-priced broadband, as compared to the broadband that is available in urban areas of the state.<sup>147</sup> That this deficiency contributes to a digital divide, there can be no doubt. Small LECs have had ample opportunity to challenge TURN’s analysis, but they failed to take advantage of those opportunities in testimony or during cross examination. No Small LEC witness challenged Dr. Roycroft’s key conclusions based on his analysis of broadband deployment and adoption in Small LEC service areas:

The data reveal market failure and a significant digital divide. Small LECs indicate that 74.2 percent of their 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. An astounding 96.6 percent of Small LEC broadband subscribers purchase broadband at speeds below the FCC's long-standing, and now dated, 25/3 Mbps standard.<sup>148</sup>

While Small LECs are critical of TURN's focus on the digital divide in their opening brief, even Small LECs own witnesses raised the importance of CHCF-A with regard to closing the digital divide:

I am not aware of industry or regulatory developments that render the CHCF-A obsolete or suggest that it requires major reform. Rather, trends in recent years make the CHCF-A and rate-of-return regulation more important than ever. As bandwidth-intensive applications continue to proliferate, broadband-capable connections become more essential every day. In areas where broadband access disparities are creating “haves” and “have nots,” the ramifications of the “digital divide” are becoming more and more severe.<sup>149</sup>

Now on brief, Small LECs say that TURN’s evaluation of digital divide is some sort of opportunistic and inappropriate expansion of the scope of this proceeding. Certainly, the Commission should ignore Small LECs’ criticism of the Commission’s efforts to ensure that CHCF-A is effectively utilized to close the digital divide, as directed by the California Legislature.

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<sup>147</sup> Ex. TURN-1 (Roycroft Public Opening) at 7, 41, 42, 53, 57, 58, 67.

<sup>148</sup> Ex. TURN-1 (Roycroft Public Opening) at 57, emphasis in the original.

<sup>149</sup> Ex. LEC-4 (Boos Public Opening) at 9. See also, Ex. LEC-5 (Boos Public Reply) at 4; and Ex. LEC-8 (Votaw Public Reply) at 3.

#### *4. Alternative Imputation Proposals Have Fatal Flaws*

Public Advocates argues that the Commission should apply imputation to only those ISP affiliates that have positive net revenues, arguing that imputation of negative net incomes would lead to a “perverse incentive” to not control expenses.<sup>150</sup> TURN does not agree with Public Advocates’ assessment of this matter. It is important to note that Public Advocates’ perspective is equally applicable to the situation where positive net incomes are imputed, so Public Advocates’ proposed moratorium on imputing for ISP affiliates with negative net incomes would not be sufficient to address the incentive problem they perceive.<sup>151</sup> Furthermore, given that the imputation framework requires the auditing of ISP affiliate expenses,<sup>152</sup> the ability of ISP affiliates to inflate those expenses will be limited. Dr. Roycroft also noted that two factors work against incentives for ISP affiliates to be less efficient under TURN’s imputation proposal, which TURN recommends be applied to all ISP affiliates. The first is regulatory lag. Under TURN’s imputation framework Small LEC ISP affiliates can improve profitability by increasing efficiency and reducing costs between imputation events.<sup>153</sup> Secondly, TURN’s imputation proposal requires auditing the operations of the ISP affiliates to ensure that reasonable expenses are counted in the calculation of net incomes. These two factors work to promote the efficient operations of the ISP affiliates. The Commission should reject Public Advocates’ proposal.

On the matter of wholesale imputation, TURN supports neither Public Advocates’ nor Mr. Kalish’s proposal to impute wholesale broadband revenues.<sup>154</sup> As Dr. Roycroft explained, the interstate operations of the Small LECs are regulated by the FCC.<sup>155</sup> The outcome of the interstate rate setting process for the Small LECs is NECA’s Tariff No. 5, which classifies participating companies’ services, such as DSL access service, into “rate bands” based on the cost studies submitted by the telephone companies, and establishes prices for the interstate services that are consistent with satisfying the interstate revenue requirement of the participating telephone company.<sup>156</sup>

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<sup>150</sup> Public Advocates Opening Brief at 23.

<sup>151</sup> Ex. TURN-2 (Roycroft Public Reply) at 62.

<sup>152</sup> Ex. TURN-2 (Roycroft Public Opening) at 9.

<sup>153</sup> Ex. TURN-2 (Roycroft Public Reply) at 62.

<sup>154</sup> Public Advocates Opening Brief at 24-25. Kalish Opening Brief at 10-12.

<sup>155</sup> Ex. TURN-2 (Roycroft Public Reply) at 64.

<sup>156</sup> Ex. TURN-2 (Roycroft Public Reply) at 64.

If wholesale broadband revenues were imputed for intrastate ratemaking purposes the Small LECs would not be allowed the opportunity to earn their authorized interstate return.<sup>157</sup> TURN does not believe that it is appropriate or reasonable for the wholesale DSL revenues to be counted in both that intrastate and interstate revenue requirements, as Public Advocates propose. Both sides of the jurisdictional division governing the Small LECs have regulatory oversight.<sup>158</sup> The regulation of the intrastate and interstate operations should each allow the Small LECs an opportunity to earn a reasonable return associated with the respective jurisdictional investments. In summary, the jurisdictional separations process creates boundaries that should not be violated for the imputation process, and the Commission should not impute interstate revenues, as those revenues are addressed by the FCC when it establishes the interstate revenue requirement for the Small LECs.

#### **D. Conclusion—The Commission Should Adopt Turn’s Imputation Proposal**

In summary on the matter of Small LECs’ opening brief on the matter of imputation, TURN sees nothing that undermines TURN’s recommendations. Issue 1(c) of the Fourth Amended Scoping Memo posed the question "In light of the Study and subsidies for broadband deployment, should the Commission impute broadband revenues towards the intrastate revenue requirement?" The record clearly shows that answer is "yes." The cost of broadband plant is now included in each of the Small LECs' intrastate rate bases. It is therefore just and reasonable for the Commission to take broadband revenue into consideration as one of the “other revenue sources” that Section 275.6(b)(3) specifies when determining intrastate revenue requirement and CHCF-A draws for the Small LECs, as is explicitly required by state statute. TURN's imputation proposal reasonably balances the interests of ratepayers that support CHCF-A and the owners of the Small LECs. Small LECs have provided no credible reasons to delay imputation any further.

### **VIII. MODIFICATIONS TO THE RATE CASE PROCESS**

*Scoping Memo, Issues (2)(B)(I), (2)(B)(IV), (8)*

#### **A. The Commission Should Not Limit the Number of Data Requests**

Small LECs propose to limit the number of data requests in rate cases to 300. TURN does not agree with this limitation as it will hinder the parties’ ability to gather essential

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<sup>157</sup> Ex. TURN-2 (Roycroft Public Reply) at 65.

<sup>158</sup> Ex. TURN-2 (Roycroft Public Reply) at 65.



information, and needlessly complicate the ratemaking process. Discovery is a necessary component of rate cases and other regulatory proceedings. Regulated firms have access to extensive information about their operations and financials, and absent thorough discovery other parties are at a decided disadvantage. It is TURN's experience that regulated companies may be reluctant to fully respond to discovery requests, leading to the need for follow-up discovery requests. If there were a hard limit on the number of requests, then regulated firms could game the constraint by forcing opposing parties to ask repeatedly for information, until the 300 request cap is reached.

Small LECs' proposal would also complicate matters by introducing ambiguity as to what exactly a "data request" is. For example, in this proceeding TURN responded to numerous Small LEC discovery sets, including Small LECs' Phase 2, fourth set. Small LECs' fourth set had 60 items that were labeled as "data requests," however, those data requests consisted of 170 subparts. Drawing the line between what is a "data request" and what is a "subpart" is an area that is ripe for controversy. For example, the requesting party could game the data request limit system by placing large number of questions as subparts of a single data request. Alternatively, a responding party could argue that legitimate subparts were actually separate "data requests" so as to artificially limit the number of questions to which they would respond. The Commission should deny the Small LECs' request. However, if the Commission decides to adopt the Small LECs' proposed limit, it should be prepared to face expanded disagreements surrounding discovery issues. TURN believes it is best not to impose discovery limits.

## **IX. BASIC SERVICE RATES AND OTHER END USER RATE PROPOSALS**

### *Scoping Memo, Issue (4)*

#### **A. The Commission Should Reject Public Advocates' Proposal to Impose A Price Cap**

Public Advocates' propose to impose an automatic "price cap" rate increase mechanism for basic telephone service customers. However, it is not clear to TURN what problem Public Advocates are attempting to remedy. It does not appear that there is a problem with vast distances between the position of parties in a rate case proceeding that would justify automating basic rate design in a manner that all but assures rate increases. Rather, Public Advocates' witness Mr. Ahlstedt indicates that with regard to rate setting, "historically, parties' positions

have been relatively similar.”<sup>159</sup> Furthermore, Public Advocates’ examples of differences among the parties on rate setting issues do not point to a process that results in widely disparate proposals from the parties. Examples offered by Public Advocates include one where the parties proposed *the same rates*, and another where there was a \$1 per month difference between the parties’ proposals.<sup>160</sup> It is TURN’s experience that differences of this magnitude in the rate setting process are relatively small. Furthermore, in contradiction to Public Advocates’ recommendation, their witness Mr. Ahlstedt states that he believes that using a price cap could increase litigation surrounding rate increases, and that a price cap is ultimately is redundant:

Conversely, treating inflation as a cap on rate increases could result in litigation including lengthy testimony by parties. Furthermore, the Commission has already established the \$30-\$37 all-inclusive range of reasonableness, so there is no need to establish another cap.”<sup>161</sup>

TURN agrees with Mr. Ahlstedt’s statement on these points and TURN does not believe that Public Advocates’ proposed price cap will have any beneficial impact on the efficiency of the rate setting process governing the Small LECs.

Dr. Roycroft testified that the price cap mechanism proposed by Public Advocates is not reasonable and reflected a misunderstanding of the price index that was proposed to limit the retail rates of the Small LECs.<sup>162</sup> Public Advocates’ witness Mr. Ahlstedt attributed the GDP-CPI to NECA,<sup>163</sup> however, Dr. Roycroft emphasized that the GDP-CPI is not a telephone company price index, nor is it created by NECA.<sup>164</sup> Dr. Roycroft also testified that Mr. Ahlstedt is mistaken when he states that the GDP-CPI is “updated annually by NECA.”<sup>165</sup>

In addition, an inflation-adjusted rate that happens to fall within the Commission’s \$30-\$37 range does not result in a just and reasonable outcome. Ordering paragraph 9 in D.14-12-084, which established the \$30-\$37 ranges also states: “Actual rates will be set in the individual General Rates Cases of the Small Incumbent Local Exchange Carriers.” This indicates that rate-of-return regulation in General Rate Cases, not price cap regulation, would continue to be used to

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<sup>159</sup> Ex. Cal Adv-1 at page 3-2.

<sup>160</sup> Ex. Cal Adv-1 at page 3-2.

<sup>161</sup> Ex. Cal Adv-1 at page 3-3.

<sup>162</sup> Ex. TURN-2 (Roycroft Public Reply) at 68-70.

<sup>163</sup> Ex. TURN-2 (Roycroft Public Reply) at 68.

<sup>164</sup> Ex. TURN-2 (Roycroft Public Reply) at 67.

<sup>165</sup> Ahlstedt Direct Testimony, page 3-3.

establish rates. Public Advocates’ proposal would guarantee basic service rate increases regardless of the facts associated with establishing the revenue requirement. A general rate case could result in circumstances where there was no need for basic rate increases, or even the need for basic rate reductions, but under Public Advocates’ proposal, basic rates would still rise. This outcome cannot be viewed as just and reasonable.<sup>166</sup>

Finally, TURN also notes that the Fourth Amended Scoping Memo states: “Under Pub. Util. Code § 275.6, I have preliminarily determined that being subject to rate-of-return regulation is a prerequisite for CHCF-A eligibility.” This conclusion is consistent with §275.6 (a), which states: “The commission shall exercise its regulatory authority to maintain the California High-Cost Fund-A Administrative Committee Fund program (CHCF-A program) to provide universal service rate support to small independent telephone corporations *in amounts sufficient to meet the revenue requirements established by the commission through rate-of-return regulation* 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.” (Emphasis added.) These statements do not support the application of a price cap for the Small LECs’ basic rates.

Dated: May 19, 2020

Respectfully submitted,

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<sup>166</sup> Ex. TURN-2 (Roycroft Public Reply) at 70.