BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking into the Review of the California High Cost Fund-A Program.	R.11-11-007

REPLY BRIEF OF

CALAVERAS TELEPHONE COMPANY (U 1004 C)
CAL-ORE TELEPHONE CO. (U 1006 C)
DUCOR TELEPHONE COMPANY (U 1007 C)
FORESTHILL TELEPHONE CO. (U 1009 C)
KERMAN TELEPHONE CO. (U 1012 C)
PINNACLES TELEPHONE CO. (U 1013 C)
THE PONDEROSA TELEPHONE CO. (U 1014 C)
SIERRA TELEPHONE COMPANY, INC. (U 1016 C)
THE SISKIYOU TELEPHONE COMPANY (U 1017 C) AND
VOLCANO TELEPHONE COMPANY (U 1019 C)
("INDEPENDENT SMALL LECS")

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I. INTRODUCTION.

In accordance with the modified procedural schedule established in Administrative Law Judge ("ALJ") McKenzie's March 17, 2020 Email Ruling, the Independent Small LECs hereby submit their reply brief addressing the legal and factual issues in other parties' opening briefs.[1] This reply brief utilizes the common briefing outline agreed upon during the last day of hearings.

Under the guise of "reform," the California Public Advocates Office ("Cal Advocates"), The Utility Reform Network ("TURN"), and Mr. Kalish propose fundamental changes to the California High Cost Fund A ("CHCF-A") program and radical expansions of rate-of-return regulation to broadband services and Internet Service Providers ("ISP") that the Commission plainly does not regulate. These proposals strike at the heart of a successful universal service program that has helped ensure connectivity, affordability, and public safety in some of California's most vulnerable rural communities. If implemented, these recommendations would destabilize a group of small, community-focused service providers, harm rural ratepayers, and reverse the progress toward bridging the digital divide that the CHCF-A has enabled.

The opening briefs confirm Cal Advocates' and TURN's enthusiasm for dramatic change, but the factual and legal underpinnings of their proposals remain absent. Cal Advocates would raise rates on consumers, strip rural ISPs of all profits, punish companies for the endemic broadband adoption challenges in their areas, and cap recoverable expenses based on national metrics that ignore the costs of doing business in rural California. These proposals may reduce CHCF-A contributions by a few cents a year, but they lack connection to legitimate policy objectives. TURN focuses chiefly on broadband imputation, but it relies on repudiated theories about "free rides" and "excessive profits" and an unsupported narrative that imputation will advance broadband adoption. TURN cannot resolve the central problem with imputation – it either unlawfully subjects ISPs to rate-of-return regulation or it strips regulated public utilities of funding that is legally necessary to fulfill their revenue requirements. Neither TURN's exaggerated interpretation of *Mozilla v. FCC* nor Cal Advocates' novel reading of Public Utilities Code Section 275.6 can evade these legal constraints.[2]

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[1] The Independent Small LECs are the following small, rural telephone companies: Calaveras Telephone Company (U 1004 C), Cal-Ore Telephone Co. (U 1006 C), Ducor Telephone Company (U 1007 C), Foresthill Telephone Co. (U 1009 C), Kerman Telephone Co. (U 1012 C), Pinnacles Telephone Co. (U 1013 C), The Ponderosa Telephone Co., (U 1014 C), Sierra Telephone Company, Inc. (U 1016 C), The Siskiyou Telephone Company (U 1017 C), and Volcano Telephone Company (U 1019 C).

[2] Mr. Kalish largely parrots Cal Advocates' and TURN's views. He offers only tangential references to

Cal Advocates' and TURN's proposals are especially misguided in light of the profound financial and public safety threats that Californians are experiencing as part of the COVID-19 crisis. This is not a time to arbitrarily cut funding for socially beneficial programs, nor is it the time to experiment with unproven ratemaking tools. Rather, the Commission should recognize the critical role that these rural companies play and help secure their operational foundations for the difficult times ahead. The Commission should reject calls for a transformation of the CHCF-A and focus instead on streamlining the rate case process, restoring balance to the Commission's ratemaking standards, and preserving flexibility to address individual company circumstances.

II. PROCEDURAL HISTORY AND FACTUAL BACKGROUND.

The Independent Small LECs' opening brief supplied a history of the CHCF-A, extensive background regarding the companies, and a survey of legislative and regulatory developments that contextualize this proceeding. Two additional preliminary subjects merit discussion here.

A. Parties Misconstrue the Legislative History Surrounding SB 379.

Several of the most radical proposals in this proceeding rest upon a misinterpretation of Public Utilities Code Section 275.6 and the bill that led to its current language, SB 379 (Fuller 2012). In particular, TURN and Cal Advocates cite extensively to Section 275.6(c)(7), suggesting that it was enacted to facilitate broadband imputation.[3] They make the same argument as to Section 275.6(e), even though it is a purely informational requirement in a different section of the statute from the ratemaking directives.[4] There is no evidence that the Legislature intended to authorize broadband imputation, and the Commission should reject these revisionist attempts to imbue SB 379 with new meaning eight years after the fact.

Cal Advocates cites to the Legislative history underlying SB 379 to suggest that sub-section (c)(7) was added to address concerns about unregulated ISP revenues.[5] In reality, this provision, which reflects the truism that CHCF-A support cannot be "excessive," was a response to fears about the budgetary effects of including broadband-capable facilities in rate base.[6] At

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the record, focusing instead on false innuendos and unfounded accusations.

[3] *See Cal Adv OB* at 10; s*ee also TURN OB* at 3 and 12; *Kalish OB* at 3-4.

[4] Both the text itself and the underlying Legislative history confirm that the function of Section 275.6(e) is to require companies to "provide information;" it serves no other purpose. *See* SB 379 (Fuller 2012), *August 20, 2012 Senate Committee Analysis* at 4 (sub-section (e) "requires companies to provide the CPUC information."). TURN also cites to Section 275.6(f) as support for imputation, but that provision is just standard language confirming that the CHCF-A is a "fee," rather than a "tax," under state law.

[5] *See Cal Adv OB* at 10-11.

[6] Sub-section (c)(7) was not designed to enable broadband imputation; as the Assembly Committee analysis confirms; it was added to "address the cost concerns raised by the stakeholders." SB 379 (Fuller 2012), *June 18, 2012 Assembly Committee Analysis* at 5 (describing the "compromise" leading to (c)(7)).

the time, some parties argued that the fund could balloon because of the addition of sub-section (c)(6).[7] This fear never materialized, and the CHCF-A has remained stable since 2012.[8] But the addition of sub-section (c)(7) had nothing to do with ushering in broadband imputation, nor is it a justification for other dramatic ratemaking changes that parties attempt to read into its text.[9]

B. Mr. Kalish Presents a False Picture of the Evidentiary Hearings and Grossly Mischaracterizes the Extent of Confidential Information in the Record.

Mr. Kalish offers a provocative account of the evidentiary hearing, but his impressions are not grounded in reality.[10] He alleges a lack of accountability and complains of mysteries regarding the sponsorship of information.[11] Nothing supports these assertions.[12] The Independent Small LECs provided the testimony of four company witnesses and three experts, whose submissions included extensive amounts of the "raw data" that Mr. Kalish claims was missing.[13] Mr. Kalish also offers hyperbolic statements about the extent of confidential information in the record, but his account is dishonest.[14] He refused to sign a typical Non-Disclosure Agreement ("NDA") with the companies, even though he was offered one nearly six months before hearings. Naturally, this limited his access to confidential information, which was his choice. Still, Mr. Kalish heard all of the testimony at hearings, including confidential statements, because he signed a limited NDA for that purpose on the first hearing day. The notion that the hearings were "obscured by Small LEC confidentiality claims" is simply false.[15]

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[7] The Commission had argued that "the combination of less FCC funding and SB 379 could double the amount of subsidies that the small independent telephone companies may request from the CHCF-A program." *Id.*; *see also* SB 379 (Fuller 2012), *August 8, 2012 Assembly Committee Analysis*, at 1-2 (noting "cost pressure . . . to the CHCF-A due to incorporation of broadband as an allowable cost.").
[8] *See* LEC-4 (Boos Opening) at 8-9, Att. C.
[9] *See Cal Adv OB* at 10-11, 21, 24, 30-31. Indeed, Commission's arguments against SB 379 uniformly recognized the Commission's "limited jurisdiction over broadband services" and that it "cannot take into account revenues from these unregulated services when determining local rates." SB 379 (Fuller 2012), *August 8, 2012 Assembly Committee Analysis*, at 3. Cal Advocates and TURN now claim that (c)(7) was added to appease their concerns, but their own actions prove otherwise. Section (c)(7) was added in June 2012, yet the Commission, DRA (now Cal Advocates), and TURN remained opposed to the bill despite the change. The same is true of Public Utilities Code Section 275.6(e), which was added in August 2012.
[10] *Kalish OB* at 1-2.
[11] Mr. Kalish may have believed that the hearings would be an open-ended inquisition into companies' "business operations" or the "preparers" of documents, but this is not the function of evidentiary hearings. Hearings exist to test proffered evidence sponsored by witnesses on topics that are within scope.
[12] Kalish's only support for his perceptions is four transcript cites where company witnesses deferred to others. Three of these instances involved questions beyond the scope of the witnesses' testimony. *See* RT at 1409:9-13, 1425:8-10, 1559:17-25 (Boos). The fourth was an honest inability to recall a technical detail that is nevertheless evident from the document under discussion. RT at 1930:12-20 (Votaw).
[13] *See, e.g.,* LEC-2-C (Duval Reply) at 67-68, Exhs. A-D. The companies answered hundreds of data requests, and each response indicates which company was responding. *TURN OB* at 1; *see also* TURN-1-C (Roycroft Opening), Apps. 2, 3) (reflecting 424 pages of responses).
[14] *Kalish OB* at 1, 8.
[15] *Kalish OB* at 8. Out of more than 39,000 lines in the transcript, only 54 are confidential. Of the 83

III. BROADBAND DEPLOYMENT AND SUBSCRIPTION IN INDEPENDENT SMALL LEC TERRITORIES [SCOPING MEMO (1)(A), (1)(E), 1(F), (9); HEARING (1), (3), (4), (5)].

A. The Independent Small LECs Fully Complied With Requests For Information In The Scoping Ruling And The Ruling Setting Hearings.

The evidentiary record contains information responsive to each of the five questions in the September 12, 2019 Ruling Setting Hearings, the vast majority of which resides in testimony sponsored by Mr. Duval and Dr. Roycroft.[16] The location of each responsive item, as of the start of the hearings, was set forth in the "Index to Appendix" attached to the Independent Small LECs' January 23, 2020 *Motion for Leave to Introduce Information*.[17] As the hearings progressed, even more responsive information was produced.[18] Contrary to Cal Advocates' and Mr. Kalish's claims, there were no material gaps in the evidentiary record or irregularities in the presentation of evidence.[19] Notably, TURN makes no such argument, in recognition of the hundreds of pages of responsive materials that the companies provided and the cooperation that occurred with TURN to present the information in a fulsome and non-duplicative manner.[20] The evidentiary record speaks for itself, and it negates the allegations of deficiency.

Neither Cal Advocates nor Mr. Kalish identifies a material omission in the response to the Commission's questions, and there is none. Cal Advocates claims that certain "subscribership data" was not provided, but it cites to a page of the Ruling Setting Hearings that does not mention "subscribership data," and none of the questions in the ruling use that term.[21] Cal Advocates also criticizes the form of the deployment data, but that is a substantive dispute

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exhibits in the record, only 30 are confidential. Of those 30, the vast majority of the contents are public with the exception of Exhibits LEC-13-C and TURN-3-C, which contain highly sensitive ISP financials.

[16] *Ruling Setting Hearings* at 1-3. A limited amount of responsive information was supplied in Mr. Boos's testimony. LEC-2-C (Boos Opening), Attachment D.

[17] *Motion for Leave to Introduce Information*, Index to Appendix (reflecting location of information responsive to the *Ruling Setting Hearings* at the time of the hearings).

[18] *See, e.g.* LEC-13-C, LEC-18, LEC-20, LEC-23, LEC-24-C, LEC-26, LEC-37. The evidentiary record evolved during the hearings, but the basic factual information pertinent to the Commission's questions was known in advance of the hearings, included with testimony, and served on all parties who were authorized to receive the information. *Motion for Leave to Introduce Information*, Index to Appendix.

[19] *Cal Adv OB* at 13; *see also Kalish OB* at 1.

[20] TURN and the Independent Small LECs may not agree on the logical inferences or policy conclusions to be drawn from the evidence, but they collectively provided all information necessary to address the Commission's factual questions, except to the limited extent that the information was unavailable. TURN supplied the responsive data, but Mr. Duval incorporated it by reference in his testimony and was available to address its substance. This was explained in testimony and on the record several times. *See* LEC-1 (Duval Opening) at 76:19-21, 78:3-5; RT at 912:12-23 (Mailloux).

[21] If Cal Advocates is referencing the "percentage of customers [who] receive broadband service" in Question 5(b), that information is in Appendix 3 to Dr. Roycroft's testimony, on pages C0067-C0082. *See also TURN OB* at 8, Table 3 (reflecting subscribership data provided by the companies).

regarding the relevance of "service drop" data, not a question of compliance.[22]

The allegations about factual deficiencies appear to stem from suspicion about the dispersal of responsive information amongst testimony from the companies and TURN.[23] These arguments are presented in bad faith, as the rationale for this approach has been explained on at least five different occasions.[24] As noted during the hearings, TURN issued data requests substantially replicating the questions in the Ruling Setting Hearings, and "there was knowledge between the Independent Small LECs and TURN as to what TURN was going to submit in its opening testimony" and the companies "didn't duplicate that" factual information.[25] TURN confirmed these facts on the record.[26] There is nothing unusual about coordination amongst parties to avoid duplication, streamline presentations, and promote judicial economy.[27]

B. The Record Reflects The Need For Further Deployment Of Broadband-Capable Facilities In Independent Small LEC Territories And Continued High-Cost Support For Those Investments.

One of the Commission's chief goals in this proceeding was to measure the state of broadband deployment in Independent Small LEC territories. That goal has been achieved. Based on the raw data supplied with the companies' testimony and in Dr. Roycroft's analysis, the record contains sufficient information to reach factual findings about the speeds that are available in these areas as of September 2019. TURN notes that its data are more recent and comprehensive than the Mission Consulting study, and the Independent Small LECs agree.[28]

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[22] Cal Advocates complains that the information responsive to Question 1 of the Ruling Setting Hearings does not use the "definition of availability" that it claims is "used by either the Commission or the FCC." *Cal Adv OB* at 14. This appears to be a reference to the Form 477 "10 business day" standard, but Question 1 does not direct the parties to submit data in this form. *Ruling Setting Hearings* at 1 (no format is specified for "broadband deployment" information, and a question is posed about whether the Form 477 data should be "determinative"); *see Ind. Small LECs OB* at 16-18.
[23] *Cal Adv OB* at 13-14; *Kalish OB* at 1.
[24] The manner in which the questions in the Ruling Setting Hearings were addressed on the record was explained in Independent Small LECs' opening testimony, the Independent Small LECs' reply testimony, the Motion for Leave to Introduce Information, the discussions about the introduction of the "compendium" during the hearings, and in the Independent Small LECs' opening briefs. LEC-1 (Duval Opening) at 75:10-83:9; LEC-2 (Duval Reply) at 68:16-69:19 and Exhibit D; *Motion for Leave to Introduce Information* at 2:13-5:5; RT at 904:13-914:21 (Duval); *Ind. Small LECs OB* at 14-75.
[25] RT at 911:26-912:5 (Rosvall).
[26] RT at 912:15-23 (Mailloux) ("before we filed our opening and reply testimony, we had to notify the Small LECs what confidential information we would be including. So we did have a good meet-and-confer process at that time to give them the list of the discovery responses and requests that we included in Dr. Roycroft's testimony, which allowed the Small LECs not to duplicate at that time.").
[27] To the extent that Cal Advocates has concerns about the dispersed nature of the evidence amongst various witnesses, it should be noted that Cal Advocates opposed a motion from the Independent Small LECs that would have resolved this concern by consolidating responsive data in a "compendium" for ease of reference. RT at 904:19-907:18 (Rosvall), 907:21-909:3 (Choe).
[28] *TURN OB* at 5-6. As the companies previously noted, Table 4 of Dr. Roycroft's reply testimony contained a calculation error with respect to deployment percentages and contains inaccurate counts for

The companies also agree with TURN's basic factual findings regarding deployment, which depict a group of small, rural telephone companies in the midst of a transition toward fiber to the premises and a struggle to keep up with federal broadband capability benchmarks.[29] As TURN observes, the companies have improved broadband speeds and made gains in broadband deployment over time, but they have only deployed 25/3 to a little over 50% of their service areas.[30] The Independent Small LECs also agree that there continues to be a digital divide between urban and rural areas of California, which is why support from the CHCF-A remains critical to these rural service territories.[31] Cal Advocates takes a myopic view, focusing on deployment at the antiquated 10/1 Mbps level to argue that the Commission should deprioritize broadband deployment and focus on adoption.[32] However, as both TURN and the Independent Small LECs recognize, depriving the companies of sufficient funding would only further the digital divide and injure universal service goals.[33] The Commission should be guided by these basic facts and areas of agreement between TURN and the companies in analyzing these issues.[34]

Volcano. *Ind. Small LECs OB* at 14, n. 99. Subject to these corrections, the Independent Small LECs do not dispute TURN's overall depiction of the companies' broadband deployment and subscription.

[29] *TURN OB* at 6-7.

[30] *Id.*

[31] *Id.* at 6-8; *see* LEC-3 (McNally Reply) at 9:1-10:4 (explaining the need to upgrade Sierra's network over time to meet evolving regulatory standards and customer demands); LEC-8 (Votaw Reply) at 8:14-22 (Ducor's recently completed rate case recognized the need for Ducor's "forward-looking" fiber deployment projects to provide more reliable service than is available through copper infrastructure).

[32] *Cal Adv OB* at 17-18. The FCC moved beyond the 10/1 Mbps standard more than five years ago, and Cal Advocates' own witnesses have acknowledged that 25/3 is the prevailing standard in California. *See In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability, GN Docket No. 14-126, 2015 Broadband Progress Report,* FCC 15-10 (rel. Feb. 4, 2015) at ¶¶ 26-27; *In the Matter of Connect America Fund*, WC Docket No. 10-90, *Report and Order, et al.*, FCC 18-176 (rel. Dec. 13, 2018) (*"ETC Reform Order"*), at ¶104; RT at 2116:23- 25 (Hoglund). Cal Advocates also provides misleading information about the extent of 25/3 deployment, implying that some companies' fulfillment of interim federal deployment benchmarks makes 25/3 ubiquitously available. *Cal Adv OB* at 17-18. This is incorrect, as the record shows.

[33] TURN-2 (Roycroft Reply) at 58:12-15 ("Public Advocates' proposal is at cross purposes when it comes to closing the digital divide."); LEC-5 (Boos Reply) at 4:5-13, 22:9-13; LEC-8 (Votaw Reply) at 8:22-24. Dr. Roycroft notes several other problems with Cal Advocates' uninformed proposal, which would harm the rural consumers. TURN-2 (Roycroft Reply) at 56:12-59:11.

[34] While the Independent Small LECs do not dispute TURN's overall factual findings regarding the raw data, the companies do dispute many of TURN's inferences from those data. In particular, the data do not point to a "market failure," as TURN suggests; they confirm the intrinsic challenges of infrastructure deployment in rural areas. Without "rural to rural" comparisons, which TURN did not perform, there is no way to credibly conclude that the market is failing.

C. The Commission's Ratemaking Decisions Should Rely on Precise Information About Facilities Deployment, Not Subjective Form 477 Data.

The Commission's ratemaking and policy decisions should rely on the best available information about the actual capabilities of companies' networks, not subjective judgments about what "could be served" within 10 business days. As the record demonstrates, the most precise measure of broadband capabilities at a specific location is whether facilities exist from the central office to a given customer location that would allow the customer to obtain Internet access at a given speed.[35] For a loop to be fully connected, there must be a service drop to the customer premise.[36] Especially in rural areas, there may be customer locations that physically could be connected within 10 business days if service drops were installed, but installing these additional facilities could be costly, and would require cost support.[37] If requests for enhanced broadband service were placed on a wider scale, such as might occur when customers are "sheltered in place" during a pandemic, the "10 business day" timeframe would become unsustainable and meaningless, as companies can only fulfill so many requests within 10 days.[38]

Cal Advocates asks the Commission to ignore these distinctions and rely exclusively on Form 477 data "to make policy decisions."[39] The Independent Small LECs have never advocated for the elimination of existing broadband reporting, and the companies agree that the collection of "10 business day" information through the Form 477 and parallel California reporting process should continue to be one data point in assessing broadband deployment generally. To the extent that cross-company and historical trending information is important, these reports can serve that purpose, just as Cal Advocates suggests.[40] However, the material limitations and inherent imprecision in the Form 477 data should be recognized, and these data

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[35] *See* LEC-1 (Duval Opening) at 77:6-8 ("it would be more precise to focus on whether there is a service drop connected"); *see also Ind. Small LECs OB* at 17.

[36] Mr. Kalish's brief presents a misunderstanding of the function of "service drop" data. *Kalish OB* at 7. He argues that "service drop availability" does not capture "subscribers" and does not show "the amount of actual FTTH." *Id.* Concerns about "subscribership" data are misplaced in this context, as both the Form 477 and the more accurate service drop information are measurements of deployment, not adoption. However, his claim that service drop data does not address the presence of fiber is inaccurate. If the drop consists of fiber, and the remaining facilities back to the central office are fiber, then this fact would be available from the data that the Independent Small propose to use in rate cases.

[37] LEC-3 (McNally Reply) at 4:13-19. Regardless of whether a location can be served within 10 business days, if it takes additional investment to connect that location, rate base would have to be adjusted to ensure that proper support for investment is provided. *See* Pub. Util. Code § 275.6(b)(2). The Commission should not adopt a definition of "served" that chronically understates rate base.

[38] RT at 1911:3-5 (Votaw) ("[I]f I get hit with a lot of customer requests for service, there's no way I can get it done in 10 days.").

[39] *Cal Adv OB* at 16.

[40] *Id.*

should not control ratemaking decisions, which should be based on what networks can *actually deliver* through existing facilities. Reliance on the "10 business day" standard in the ratemaking context could lead to inaccurate presumptions that facilities exist, when in fact, they do not.[41]

D. Cal Advocates Fails To Resolve The Insurmountable Legal And Policy Problems With Its Low-Income Broadband Proposal.

The Independent Small LECs agree with Cal Advocates that the affordability of broadband services is important,[42] but they oppose the unlawful proposal to require their affiliate ISPs to offer broadband services at confiscatory rates. Affordability of broadband services and subscription implicate a diverse web of policy concerns; the issue should be viewed on a statewide basis and evaluated in the Commission's ongoing LifeLine proceeding.[43]

Cal Advocates fails to address the binding federal law precluding this Commission from regulating broadband rates. By contrast, TURN is "generally supportive" of the "idea" of low-income broadband, but does not suggest that Cal Advocates' proposal would be legal, recognizing that the Commission does not regulate these rates.[44] Cal Advocates erroneously suggests that state law requires "affordable broadband," but Cal Advocates' own citations refute its claim.[45] As the California Supreme Court has noted, "the words of a statute, as the most reliable indicator of legislative intent . . . must be construed in context, and statutes must be harmonized, both internally and with each other."[46] Section 275.6 has more than twenty references to "small independent telephone corporations" and only one informational reference to affiliate ISPs, so it cannot be read to authorize ISP rate regulation. Moreover, the legislative history expressly acknowledges that "the revenue a company or an affiliate earns from providing Internet access service . . . is under the jurisdiction of the FCC."[47] The broader statutory context further confirms the inaccuracy of Cal Advocates' interpretation. SB 379 was signed on the

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[41] *See Ind. Small LECs OB* at 17, n. 111.
[42] *Ind. Small LECs OB* at 18, 20. Many affiliate ISPs have voluntarily offered low-income broadband programs during the pandemic, which cannot be sustained without cost recovery or government support.
[43] The recent Scoping Memo in the LifeLine proceeding includes this issue and the Independent Small LECs support its consideration there. R.20-02-008, *Scoping Memo and Ruling* at 5-6. *See* TURN-2 (Roycroft Reply) at 53:8-11 (This "would generate benefits for consumers and promote economic development, both in urban and rural areas.").
[44] *TURN OB* at 34-35; TURN-1 (Roycroft Opening) at 23:7-9.
[45] *Cal Adv OB* at 18; *Ind. Small LECs OB* at 9-10, 19; *see also* Section II(B), *supra*. Cal Advocates cites to Section 275.6(a) for the proposition that "[t]he Commission has an obligation to ensure the affordability of voice and broadband service" in managing the CHCF-A. It also invokes Section (c)(3) to imply that the Commission must ensure affiliate ISP rates are "just and reasonable" and "reasonably comparable to rates charged to customers of urban telephone corporations." Neither provision refers to "broadband services" or ISPs; each mentions only "small independent telephone corporations."
[46] *Tuolumne Jobs & Small Bus. Alliance v. Sup. Ct.*, 59 Cal.4th 1029, 1037 (2014).
[47] SB 379 (Fuller 2012), *August 28, 2012 Senate Committee Analysis* at 2.

same day as SB 1161, a bill which broadly exempted ISPs from Commission regulation.[48] It is implausible that the Legislature would exempt all ISPs from regulation in passing SB 1161, only to impose rate regulation on the Independent Small LECs' affiliates via an unspoken exception in SB 379. If the Legislature had intended this, it would have said so directly.[49]

In addition to being legally barred, Cal Advocates' proposal is a flawed public policy. Mr. Ahlstedt's comparisons to larger carriers' low-income broadband programs are irrelevant. These carriers are far larger, with economies of scale that can absorb significant discounts that would cause the much smaller affiliate ISPs to operate at a loss.[50] Further, the large carriers adopted these programs voluntarily or as part of merger conditions.[51]

Cal Advocates' argument about the impact of unfunded low-income broadband is misleading. It mischaracterizes a generic statement by Dr. Aron to imply that its proposal would increase broadband subscribership and revenues.[52] Dr. Aron stated generally that "if prices were lower, people would buy more; but, we don't know how much more. . . ."[53] However, the relevant transcript portions reveal that Dr. Aron was responding to an "incomplete hypothetical . . . in the abstract" by TURN's attorney asking if it would be "socially harmful" for the Commission to allow affiliate ISPs to lower prices "that still remain above the incremental costs [incurred] by the ISP affiliate"[54] Her response did not address the impacts of Cal Advocates' proposal on affiliate ISP revenue.[55] In fact, Cal Advocates' proposal would require the ISPs to offer broadband at prices that are substantially below cost, so, regardless of whether revenue goes up or down, profits would be negative. Cal Advocates also misstates Mr. Duval's testimony to leverage its incorrect claim that a portion of the $42 consumer broadband only line

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[48] SB 1161 (Padilla 2012) (adopting former Public Utilities Code Section 710).
[49] Cal Advocates' claim that the CHCF-A is not a "mandatory program" does not salvage the Commission's lack of jurisdiction. *Cal Adv OB* at 19. It is mandatory for the Commission to administer the program "to provide universal service rate support to small independent telephone corporations in amounts sufficient to meet the revenue requirements." Pub. Util. Code § 275.6(a). However, as a practical matter, company participation in the program is not "voluntary" because they could not reasonably meet their revenue requirements without support. RT at 1090:13-1091:3 (Duval).
[50] RT at 2092:7-2093:22 (Ahlstedt) (AT&T has over 1 million access lines; larger companies are better able to achieve economies of scale than smaller companies); LEC-8 (Votaw Reply) at 10:2-5, 10:12-15.
[51] LEC-5 (Boos Reply) at 22:25-23:1.
[52] *Cal Adv OB* at 20.
[53] RT at 1679:22-27 (Aron).
[54] RT at 1678:11-1681:4 (Aron); *see also* RT at 1701:21-1702:11 (Aron).
[55] Dr. Aron clarified that no analysis has been done in this proceeding to estimate how much lowering pricing would encourage broadband adoption as opposed to other policy measures such as education and computer literacy. RT at 1678:28-1681:4 (Aron).

("CBOL") rate is supported by federal funds.[56] Mr. Duval testified that this rate is the tariffed wholesale benchmark rate and the telephone company receives federal universal support only for costs *above* this rate.[57] Cal Advocates further claims that the Independent Small LECs did not quantify the impact of this proposal,[58] but Mr. Duval showed that the proposal would reduce the ISP affiliate net revenues by almost $3.7 million, making several companies unprofitable.[59]

IV. BROADBAND IMPUTATION [SCOPING MEMO (1)(C), (1)(D), HEARING (2)].

A. Retail Imputation.

1. The Proponents of Imputation Have No Defense to Federal and State Jurisdictional Restrictions.

Cal Advocates does not address the federal and state jurisdictional barriers to imputation; instead, it incorrectly assumes that the Commission already has authority to pursue this policy based on statements in the Phase 1 Decision.[60] But the Commission did not impose imputation in Phase 1, so the Commission's statements are pure dicta, and have no precedential value.[61] The Commission's conclusions on pure matters of law are not entitled to deference.[62] This is especially true here, where the Commission's legal conclusion in 2014 was based on a different legal and factual landscape, and the legal issue directly implicates federal law.[63] Since the Phase 1 decision was issued, two significant Federal Communications Commission ("FCC") orders relating to the classification and regulation of broadband services were issued,[64] and parties' proposals have changed. The Commission must apply the current law to the current facts.

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[56] *Cal Adv OB* at 20.
[57] RT at 973:26-975:25 (Duval); *see also* 978:6-18 (Duval) (the ISP pays the full cost of the portion of the local loop used in the provision of broadband assigned to interstate jurisdiction and no universal service funding helps to recover that cost).
[58] *Cal Adv OB* at 20.
[59] LEC-2 (Duval Reply) at 24:25-26:5; *see also* LEC-4 (Boos Reply) at 22:16-23:1; LEC-8 (Votaw Reply) at 4:10-15, 10:17-28.
[60] *Cal Advocates OB* at 20 (citing D.14-12-084 (the "Phase 1 Decision") at 93, COL 1-3); *see also TURN OB* at 31; *Kalish OB* at 8.
[61] *Independent Small LECs OB* at 12, n. 75.
[62] *See Brown v. Fair Political Practices Com.*, 84 Cal.App.4th 137, 150 (2000); *Tower Lane Properties v. City of Los Angeles*, 224 Cal.App.4th 262, 276 (2014).
[63] *Tulare Pediatric Health Care Center v. State Dept. of Health Care Services*, 41 Cal.App.5th 163, 170 (2019) (a state agency's interpretation of federal law gets no deference) (*citing Orthopaedic Hosp. v. Belshe*, 103 F.3d 1491, 1495 (9th Cir. 1997)).
[64] *See 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*") at ¶ 20 ("[w]e reinstate the information service classification of broadband Internet access service."), *vacated in part on other grounds by Mozilla*, 940 F.3d 1, 35 (D.C. Cir. 2019) (upholding "information service" classification); *In Matter of Protecting and Promoting the Open Internet*, GN Docket No. 14-28, *Report and Order on Remand*, FCC 15-24 at ¶¶ 431-432 (rel. February 26, 2015) (deemed broadband service exclusively interstate, adopted a forbearance policy as to regulating retail broadband service, and barred the states from any contrary regulatory activities). The Title II reclassification of broadband service in the *Open Internet Order* was abrogated by the *Restoring Internet Freedom Order.*

Cal Advocates and TURN both cite to various provisions of Public Utilities Code Section 275.6 to support their positions that the Commission should impute interstate, unregulated broadband revenues in determining the Independent Small LECs' intrastate revenue requirement.[65] Neither party explains how their proposals would be permissible under state law statutes clearly restricting the Commission's jurisdiction to "public utilities."[66] As discussed in the Independent Small LECs' opening brief, none of the subsections of Section 275.6 expand the Commission's jurisdiction over interstate, unregulated broadband services or ISP affiliates; rather this statute is clearly focused on ratemaking for "telephone corporations" and intrastate telecommunications services.[67] Cal Advocates cites to Legislative history, but the cited material undermines its argument by confirming that the Commission "does ***not*** include in the rate calculation the revenue a company or an affiliate earns from providing Internet access service, which is under the jurisdiction of the FCC."[68]

TURN advances on an overly broad construction of the D.C. Circuit Court of Appeals *Mozilla* decision to argue that this Commission has jurisdiction to impute broadband revenues.[69] As TURN correctly notes, *Mozilla* vacated "the FCC's attempt to broadly preempt all elements of state regulation that were inconsistent with the FCC's deregulatory approach."[70] While the D.C. Circuit Court of Appeals vacated that portion of the *Restoring Internet Freedom Order* attempting to broadly preempt all state regulation of broadband "in the abstract," it preserved the conflict preemption doctrine relating to a "specific state regulation" that *under the circumstances of a particular case* stands as an obstacle to the accomplishment and execution of Congress's full purposes and objectives.[71] Here, the proposed imputation proposals would impose common carrier rate-of-return regulation on the companies' ISP affiliates' unregulated, interstate broadband services. This would defeat the purpose of the FCC's reclassification of broadband services as Title I information services.[72] TURN argues that conflict preemption can be avoided

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[65] *Cal Advocates OB* at 21-22, 10; *TURN OB* at 31, 12.
[66] *Ind. Small LECs OB* at 24, n. 149; *see also Richfield Oil Corporation*, 54 Cal. 2d 419, 436 (1960); *Television Transmission v. Pub. Util. Comm'n.*, 47 Cal.2d 82, 84 (1956).
[67] *Ind. Small LECs OB* at 9-10; *see also supra*, §§ III(B), III(D).
[68] SB 379 (Fuller 2012), *August 28, 2012 Senate Committee Analysis* at 2 (emphasis added).
[69] *TURN OB* at 29-30.
[70] *Id*. at 30; *Mozilla Corp. v. FCC*, 940 F.3d 1, 35 (D.C. Cir. 2019).
[71] *Mozilla*, *supra*, 940 F.3d at 81.
[72] *Ind. Small LECs OB* at 24-26; *see also Geier v. American Honda Motor Co*., 529 U.S. 861, 875 (2000) (preempting state tort claims because the claims interfered with federal objectives).

because its proposal does not regulate the affiliate ISPs.[73] TURN is wrong. The intent and the effect of TURN's imputation proposal are to subject the affiliate ISPs to rate of return regulation.[74] Even if TURN's proposal were construed to suggest that the ISP retains its profits, it would result in a rate design that falls short of the companies' revenue requirements, in violation of Public Utilities Code Section 275.6(b)(4) and constitutional takings authorities.[75]

The *Mozilla* court's recognition of states' abilities to continue to enforce "a wide variety of state laws"[76] does not grant this Commission authority to impose rate of return or economic public utility style regulations on ISPs. Rather, the quoted statement refers to generally applicable commercial consumer protection statutes, or similar generally applicable state laws.[77] While TURN also refers to the state's authority to advance universal service policies,[78] imputing unregulated, interstate broadband revenues would be the equivalent of illegal state regulations that tax or impose a surcharge on interstate revenues.[79]

TURN also relies upon Public Utilities Sections 701 and 709 to support its jurisdictional argument.[80] However, the Commission's general authority to regulate public utilities cannot be bootstrapped into regulatory authority over broadband. Section 701 confers authority on the Commission to "do all things . . . necessary and convenient in the exercise of [its] power and jurisdiction," but that jurisdiction remains limited to "public utilities" and intrastate services and does not include broadband services. The California Supreme Court has rejected "a construction of section 701 that would confer upon the Commission powers contrary to other legislative directives, or to express restrictions placed upon the Commission's authority by the Public Utilities Code."[81] Likewise, Section 709 merely reflects aspirational statements of Legislative

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[73] *TURN OB* at 30-31.
[74] *Ind. Small LECs OB* at 25 -26.
[75] *See Ind. Small LECs OB* at 30, n. 180.
[76] *TURN OB* at 30.
[77] *Restoring Internet Freedom Order* at ¶196 ("We appreciate the many important functions served by our state and local partners, and we fully expect that the states will 'continue to play their vital role in protecting consumers from fraud, enforcing fair business practices, for example, in advertising and billing, and generally responding to consumer inquiries and complaints' within the framework of this order."); *Mozilla, supra*, 940 F.3d at 81.
[78] *TURN OB* at 30.
[79] *AT&T v. Eachus*, 174 F.Supp.2d 1119, 1122-1124 (D. Or. 2001) (striking down state universal surcharge as contradictory to 47 U.S.C. § 254(f) because it was imposed on interstate services); AT*&T Corp. v. Pub. Util. Comm'n of Tex.,* 373 F.3d 641, 647 (5th Cir. 2004) (holding that § 254(f) preempts the state from assessing state USF fees against combined intra — and interstate revenues).
[80] *TURN OB* at 31-32.
[81] *Assembly v. Public Utilities Comm'n.*, 12 Cal.4th 87, 103 (1995) ("Whatever may be the scope of regulatory power under this section, it does not authorize disregard . . . of express legislative directions to it, or restrictions upon its power found in other provisions of the act or elsewhere in general law."); *see*

intent to guide the exercise of authority within the Commission's jurisdiction.[82] References to "the development and deployment of new technologies," "remov[ing] barriers to open and competitive markets," and promoting "the ubiquitous availability of a wide choice of state-of-the-art services" cannot be read to expand the Commission's jurisdiction over broadband services.[83] Courts have recognized that such policy statements "do not create 'statutorily mandated responsibilities,'"[84] or confer regulatory jurisdiction where it is lacking.

2. The Policy Arguments Offered in Support of Imputation are Disjointed, Implausible, and Speculative.

The proponents of broadband imputation struggle to find a coherent policy basis for their recommendations. Cal Advocates, TURN, and Mr. Kalish share a desire to reduce the CHCF-A by capturing ISP revenues,[85] but their opening briefs reflect a post-hoc effort to retrofit a policy that lacks a proper evidentiary foundation. These arguments fall into three main thematic areas, each of which is discounted by the Independent Small LECs' opening brief and the record itself.

First, these parties argue that "times have changed" such that intrastate ratemaking must encompass ISP operations.[86] While rhetoric about "change" is superficially attractive, the connective tissue in this syllogism is missing. Most of the Independent Small LECs have been in operation for a century or longer, and change has been a consistent feature of the industry during that time.[87] While technologies have evolved, the high-cost characteristics of the Independent Small LECs' service territories persist, and the challenge of keeping rural communities connected remains.[88] Similarly, universal service funding has continued to focus on supporting healthy telecommunications *networks*, no matter how the *utilization* of those networks may change.[89] For decades, federal and state policy has excluded non-regulated services from

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also BNSF Railway Co. v. Public Utilities Comm'n., 218 Cal. App. 4th 778, 784-785 (2013) (*citing Assembly*, *supra*, 12 Cal.4th at 103).

[82] Pub. Util. Code § 709 (referring to "policies for telecommunications in California.").

[83] *See, e.g.,* Pub. Util. Code § 709(c), (g).

[84] *Comcast Corp. v. FCC*, 600 F.3d 642, 644 (D.C. Cir. 2010) (citation omitted).

[85] *Cal Adv OB* at 21-22, 24-25; *TURN OB* at 12-14; *Kalish OB* at 3-4, 10-12.

[86] *Kalish OB* at 4 ("Times have changed; technology has changed"); *TURN OB* at 11 ("telecommunications technology has changed"). Cal Advocates offers parallel arguments about the alleged "maturity" of Independent Small LEC networks, but it fails to establish a nexus between deployment data and broadband imputation. *Cal Adv OB* at 22. As discussed above, Cal Advocates' "maturity" conclusion is also factually incorrect. *See* Section III(B).

[87] Switching technology began with live operators, and then evolved to toward step-switches, analog switches, digital switches, and now soft-switches. Some early voice signals were transmitted over barbed wire, then copper, and now increasingly fiber. *See, e.g.,* D.16-12-025 at 14-24; D.06-03-025 at 105.

[88] RT at 1357:2-19 (McNally) (noting the high cost of deployment in Sierra's service territory and the challenge of closing the "digital divide").

[89] In 2011, federal high-cost support mechanisms shifted to focus on broadband-capable facilities rather

regulated cost recovery mechanisms, while still supporting the regulated networks over which such services travel.[90] Within this context, observations about the broadband capabilities of telecommunications networks and the existence of affiliated ISPs are not novel developments.[91] The Commission should not to be a weathervane for whichever way regulatory winds are blowing; hollow assertions about "change" cannot justify broadband imputation.

Second, TURN, Cal Advocates, and Mr. Kalish suggest that imputation is necessary to remedy purported inequities in the current regulatory paradigm. The most pervasive flavor of this argument is the claim that the affiliate ISPs make "excessive profits."[92] The record evidence contradicts this characterization, and instead shows that half of the ISPs struggle to earn any profits, while the other half earns small to modest profit margins that cannot be viewed as "excessive."[93] Even though it has been dispelled numerous times, TURN also regurgitates its "free ride" argument.[94] At its core, TURN's "free ride" assertions reflect a lack of acceptance of federal cost separations requirements and an attempt to manipulate intrastate ratemaking to counteract the 75% allocation of loop costs to the intrastate jurisdiction.[95] As the Independent Small LECs have explained, this jurisdictional allocation is part of a balanced system of trade-

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than on voice services. *In the Matter of Connect America Fund*, WC Docket No. 10-90, *Report and Order, et al.*, FCC 11-161 (rel. Nov. 18, 2011) ("*USF/ICC Transformation Order*"), App. A at 423 (amending 47 C.F.R. Section 54.7 to include "plant elements" that "provide access to advanced telecommunications and information services"); *see id.* at ¶ 208 ("we are funding a broadband-capable voice network"). The 2012 revisions to Public Utilities Code Section 275.6 parallel this trend. *See* Pub. Util. Code § 275.6(c)(6); SB 379 (Fuller 2012), *August 30, 2012 Senate Floor Analysis* at 2 ("This bill modifies the [CHCF-A] program to align [with] the [FCC's] modification of the federal universal service program to allow high-cost support for . . . broadband-capable facilities in rural areas."). TURN and Cal Advocates suggest that the support for broadband facilities necessitates the inclusion of ISP revenue in regulated ratemaking, but neither the federal nor the state authorities permit this inferential leap. *TURN OB* at 12-13; *Cal Adv OB* at 21-22.

[90] *See* 47 C.F.R. § 64.901 (outlining cost assignments between regulated and non-regulated operations).

[91] The record shows that the Independent Small LEC ISP affiliates have been operating for approximately 15 to 20 years, and the costs of those businesses have been separated from regulated operations during that time, in accordance with Part 64 of the FCC's rules. TURN-1 (Roycroft Opening), Appendix 2, NC0083-NC0093; *see also* 47 C.F.R. § 64.901 (addressing cost assignments between regulated and non-regulated operations). Before there were ISPs, long distance company affiliates were using local exchange networks, paying for such access, and separating their costs from regulated local exchange operations for cost recovery. *See* D.04-12-022 at 5-6. These relationships are not new, and existing rules exist to ensure that only regulated costs are covered by regulated revenues.

[92] *See TURN OB* at 3, 13; *see also Cal Adv OB* at 21-22; *Kalish OB* at 9.

[93] *See Ind. Small LECs OB* at 5, n. 31.

[94] *TURN OB* at 15-16. This argument ignores the large wholesale payments that ISPs must make to participate in the "ride." *See Ind. Small LECs OB* at 40-41.

[95] TURN admits that it is advancing broadband imputation in part to "address the underlying unfairness of ISP affiliates failing to contribute to loop cost recovery." *TURN OB* at 16. To be clear, the "unfairness" that TURN perceives is a straightforward consequence of federal law, which TURN overtly seeks to circumvent through imputation.

offs between the federal and state jurisdictions.[96] Even if TURN disagrees with this balance, it is not a legitimate objective to undermine federal policy through imputation.

Third, TURN argues that imputation can be used as a tool to advance socially optimal policy outcomes, including enhanced efficiency, facilities deployment, and broadband adoption.[97] These goals are laudable, but their relationship to imputation is illusory. TURN's "efficiency" claim relies on testimony from Mr. Boos and Mr. Votaw, who acknowledged that there may be marginal opportunities to "generate profits between imputation calculations."[98] Rather than supporting TURN's premise, these witnesses describe a desperate and ultimately failing effort to generate small earnings within an imputation model designed to strip them of all meaningful profits.[99] TURN's "deployment" argument is equally misguided, as TURN offers no explanation for how imputation would increase investment incentives. Instead, TURN admits the central flaw in its reasoning, which is that "ISP affiliate investments are very small."[100] Likewise, imputation is likely to stifle deployment by any telephone company with a profitable ISP, as the effect of imputation is to reduce available capital by reducing the CHCF-A.[101] Finally, TURN suggests that imputation will facilitate adoption, based on the premise that ISPs will be compelled to lower their prices to avoid the confiscatory effects of imputation. However, this argument depends on carriers selecting the "alternative compliance option,"[102] and there is no evidence that any carrier would pursue that course.[103]

3. TURN's Skepticism About Disaffiliation is Contrary to the Evidence.

As the record shows, the ultimate consequence of broadband imputation would be the disaffiliation of at least every profitable ISP affiliate, to the detriment of rural communities.

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[96] *See Ind. Small LECs OB* at 42.
[97] *TURN OB* at 16-22.
[98] *Id*. at 16.
[99] *See* LEC-7 (Votaw Opening) at 14:3-9; LEC-4 (Boos Opening) at 23:1-17.
[100] *TURN OB* at 19. It is well established that ISPs are expense-intensive companies that are not motivated by "return on investment." *Ind. Small LECs OB* at 5, 36-37. TURN's imputation model would provide only the most infinitesimal of returns to the ISPs. *Ind. Small LECs OB* at 34, n. 208-209.
[101] *See*, *e.g.,* LEC-4 (Boos Opening) at 25:10-14 (imputation would chill broadband deployment).
[102] TURN's principal imputation proposal would have no effect on adoption. Its claim of improvement in adoption relies upon carriers agreeing to price decreases under the "alternative." *See* TURN-1 (Roycroft Opening) at 9:30-10:1, 10:29-32, 28:4-6; TURN-2 (Roycroft Reply) at 27:26-28:7. TURN's "optional" compliance plan is no less confiscatory than its main proposal. *See Ind. Small LECs OB* at 38, 41-42.
[103] TURN's attempt to use broadband imputation to increase adoption is not only a fundamental deviation from any conceivable reading of the statutory authority; it is a reductive approach to a complex societal problem that should not be approached by leveraging punitive reductions in high-cost support. A more collaborative approach that involves cooperation from all stakeholders and an appreciation for the full range of social, cultural and demographic factors that impact adoption would be more appropriate. *See* LEC-10 (Aron Reply) at 29-30.

TURN devotes several pages of its brief to disputing this inevitable result, but TURN largely repeats Dr. Roycroft's testimony, which the Independent Small LECs have already addressed in their opening brief.[104] TURN does not argue that the ISP affiliates *cannot* disaffiliate; rather, it suggests that the companies *will not*, even though the company witnesses consistently testified that disaffiliation would be their likely long-term response to imputation,[105] and even though Dr. Aron explained that a rational business owner would pursue exactly this course.[106]

TURN advances a parade of horribles that it claims would befall the companies if they disaffiliate, but TURN confuses the effects of disaffiliation with the effects of imputation.[107] The imputation policy is the root cause of the incentive to disaffiliate, as it would limit ISPs to nominal profits if they remain affiliated.[108] A loss of synergies and reduced local touch are unfortunate byproducts of imputation, but these are harms to society, not barriers to disaffiliation.[109] Without its ISP affiliate, each standalone telephone company would still be able to sell wholesale DSL transmission service without restriction to the new, independent ISP.[110] Any inefficiencies that the telephone company may experience would be addressed through the regulated ratemaking process, in which ratepayers or CHCF-A contributors would be the ultimate losers from these higher expenses.[111]

From the disaffiliated ISP's perspective, the risks of inefficiency are speculative,[112] and none of them could outweigh the crushing loss of profit opportunities that is certain to occur if the ISP remains affiliated and accepts imputation. The disaffiliated ISP may also derive economies of scale from its new owner and it would remain free to coordinate with the telephone

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[104] *TURN OB* at 22-29; *Ind. Small LECs OB* at 32-35.
[105] Nowhere does TURN suggest that disaffiliation would be illegal, and Dr. Roycroft admitted on cross-examination that it is permissible. RT at 1830:3-12. (Roycroft).
[106] RT at 1644:13-27 (Aron).
[107] *TURN OB* at 25-26.
[108] The Independent Small LECs provided a powerful example of how destructive imputation would be to ISP profits, and how much more attractive a sale would be if ISPs can no longer derive meaningful profits. *Ind. Small LECs OB* at 34. There is no defense to this comparison.
[109] LEC-9 (Aron Opening) at 53 ("Because the separation of the ISP and Independent Small LEC extinguishes the efficiencies of common ownership and likely terminates the local touch that these companies provide, separation is harmful to society and consumers.").
[110] RT at 1670:25-1671:13 (Aron); *see also* LEC-9 (Aron Opening) at 48; LEC-10 (Aron Reply) at 39.
[111] *Ind. Small LECs OB* at 35, n. 212. TURN also overstates the level of synergies that are possible in the current regulatory environment. For example, TURN assumes that the "ability to jointly market retail and broadband services" would be lost, but the record shows that the Commission has discouraged joint marketing, outright barring it in two recent rate cases. *TURN OB* at 25; *see* LEC-17 (Foresthill Decision D.19-04-017) at OP 7; *see also* D.16-06-053 at OP 8 (applying similar prohibition to Kerman).
[112] *See* LEC-9 (Aron Opening) at 44-45 (efficiencies could be available under new ownership scenarios).

company on how to best serve customers.[113] TURN's oblique references to affiliate transaction rules and unsupported allegations of antitrust limitations have no relevance;[114] there is nothing illegal about companies cooperating at arms' length for their mutual benefit.[115]

Ultimately, TURN offers yet another regulatory solution to the potential for disaffiliation, suggesting "[i]n the event that any Small LEC would disaffiliate in light of imputation, . . . the Commission should open an investigation into the Small LEC's operational practices."[116] This argument is either a sign that TURN lacks conviction in its position or an implicit admission of TURN's true agenda, which is to rate-regulate ISPs and force them to stay affiliated. Either way, the notion that imputation would require a new enforcement tool is further proof of its perversity.

4. Part 36 Jurisdictional Separations Factors Should Be Applied to Any Imputation Amounts Incorporated Into Intrastate Rate Design.

Both TURN and Cal Advocates propose to treat affiliate ISP profits as regulated revenue, but their imputation proposals fail to jurisdictionally separate the imputation amounts. This material omission renders their imputation models internally inconsistent and contrary to the reasoning that underlies their recommendations. If the Commission adopts retail imputation, it should apply Part 36 factors to the ISP net profits and exclude amounts derived from facilities that are 100% interstate, just as it does in regulated telephone company ratemaking.

Mr. Duval explained the importance of observing Part 36 principles, even if the Commission incorrectly attributes the ISP net profits to the telephone company.[117] Absent such separations, the ISP portion of TURN's "pro forma" would be 100% intrastate, while the telephone company financials would be divided amongst interstate and intrastate jurisdictions. This outcome would undercut TURN's pledge to conduct the "pro forma" on an "integrated"

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[113] *Ind. Small LECs OB* at 34, n. 211.

[114] *TURN OB* at 28-29. TURN raises the specter of antitrust, but provides no supporting legal citation or explanation. *Id.* at 28. TURN also presents a straw man formulation of Dr. Aron's testimony, claiming that she suggested companies could adopt a "just a little bit affiliated" approach. *Id.* Dr. Aron offered no such statement. Moreover, state and federal affiliate transaction rules would have no bearing on interactions between a disaffiliated ISP and the telephone company for the simple reason that they would not be affiliates. The FCC citation provided by TURN is irrelevant to what Dr. Aron described, which is merely a cooperative business arrangement between two unaffiliated entities. *Id.* at 28, n. 134; *see* RT at 1671:3-17 (Aron) ("And by the way, it's possible that they could develop . . . arm's length relationships with the LEC that still allow them to have cooperative business arrangements. It would certainly be in the LEC's interest for the ISP to succeed, because the ISP is using the LEC's network. So I would expect that there would be interest on both sides and retaining efficiencies to the extent they can legally do so.").

[115] As Dr. Aron explained, "the way firms interact with each other" can involve "coopetition," where "firms that have aligned interests participate with each other to the benefit of consumers, not to their detriment." RT at 1724:1-10 (Aron).

[116] *TURN OB* at 28.

[117] LEC-1 (Duval Opening) at 16:4-17:5.

basis and to preserve the "process that exists for small telephone companies . . . for the purpose of calculating the pro forma."[118] Ignoring jurisdictional separations would also create the absurdity that ISP profit would be counted as *entirely intrastate* even where the underlying loop used to provide the service is *entirely interstate*.[119] This result conflicts with TURN's and Cal Advocates' arguments, which focus on the use of loop facilities that impacts the CHCF-A.[120]

TURN attempts to counter the need for a Part 36 adjustment to the imputation amounts by highlighting Mr. Duval's statement that "Part 36 doesn't apply to [retail broadband revenues] today." However, this observation only proves that no Part 36 adjustment is happening in the current regulatory paradigm, one in which ISP operations are categorically unregulated and imputation does not occur. If imputation were implemented and administered through the "pro forma" that TURN proposes, jurisdictional adjustments would become essential.[121]

B. Wholesale Imputation.

1. Cal Advocates' Arguments Cannot Overcome the Fundamental Legal and Ratemaking Problems with Wholesale Imputation.

The opening briefs reflect strong opposition to wholesale imputation. TURN offers a compelling indictment of this proposal, paralleling the Independent Small LECs' analysis.[122] TURN correctly explains that "the jurisdictional separations process creates boundaries that should not be violated for the imputation process."[123] Likewise, wholesale imputation would lead to massive shortfalls in cost recovery, such that "the Small LECs would not be allowed the opportunity to earn their authorized interstate return."[124] As TURN observes, "[t]he wholesale DSL revenues cannot be counted in both . . . intrastate and interstate revenue requirements."[125]

Cal Advocates offers no legal authorities to support its argument except for the same incorrect interpretation of Public Utilities Code Section 275.6(c)(7), which neither mentions

[118] TURN-1 (Roycroft Opening) at 14:21 ("the intrastate rate of return will then be based on the integrated operations of the Small LEC and its ISP affiliate"); RT at 1802:13-19 (Roycroft) (confirming on cross-examination existing ratemaking processes would be preserved in calculating the "pro forma"); *see also* TURN-1 (Roycroft Opening) at 15:1-2 (stating that the preparation of the "pro forma" would involve "no formal modification to any cost allocation or interstate ratemaking procedures."); RT at 1783:18-1784:6 (explaining that the "pro forma" would be a part of the rate case and mimic its structure).

[119] LEC-1 (Duval Opening) at 21:16-17 (broadband only lines are 100% interstate).

[120] *See* CalAdv-1 (Ahlstedt Opening) at 1-1:16-19; *TURN OB* at 15-16.

[121] If disparate jurisdictional separations practices were applied to the telephone company and the ISP in the same "pro forma," it would inject yet another dimension of unresolved complexity into the proposal.

[122] *TURN OB* at 32-33.

[123] *Id.* at 33.

[124] *Id.; see also Ind. Small LECs OB* at 45-46; *see also Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (state allocation of costs in setting retail electricity rates frustrated federal regulation by possibly preventing the utility from recovering the costs of paying the FERC-approved wholesale rate).

[125] *Id.*

wholesale imputation nor provides authority to re-appropriate interstate revenues.[126] If Cal Advocates' expansive reading of this statute were correct, the Commission could ignore all jurisdictional boundaries and impute revenues from services regulated by the FCC or other state commissions. This interpretation would undermine basic principles of federalism and regulatory comity and contradict the express limitations of the Commission's enabling statutes.[127] It is inconceivable that the California Legislature would bury a jurisdictional loophole of this magnitude in the seventh "sub-section of a sub-section" of a small telephone company ratemaking statute, especially since the provision does not say what Cal Advocates suggests.[128]

Cal Advocates' policy arguments are equally bankrupt. Citing no evidence, Cal Advocates claims that "intrastate ratepayers are forced to pay for a share of the Small ILECs' broadband loop cost."[129] This is a false premise, discredited by Mr. Duval's testimony and the operation of federal law, which ensures the proper separation and assignment of loop costs between broadband and voice operations.[130] Cal Advocates also asserts that "intrastate ratepayers . . . bear a disproportionate amount of the cost of broadband plus voice loops," but this view is grounded in a refusal to accept federal cost assignments, which nevertheless remain the law.[131] As Mr. Duval explained, the 75% intrastate allocation of multi-use loops is offset to a large extent by the receipt of federal high-cost support for intrastate revenue requirement.[132] Even if the Commission believed that the FCC's jurisdictional separations or cost recovery rules

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[126] *Cal Adv OB* at 24.

[127] *See* Pub. Util. Code §§ 202 (restricting Commission jurisdiction over matters of interstate commerce), 234(a) (the definition of "telephone corporation" limited to operations "within this state").

[128] *See Jurcoane v. Sup. Ct.*, 93 Cal.App.4th 886, 893 (2001) ("[W]e must construe statutes to ensure reasonable, not absurd, results, consistent with overall legislative intent."); *Isobe v. Unemployment Ins. Appeals Bd.*, 12 Cal.3d 584, 590-591 (1974) (statutes relating to the same subject should be construed together to harmonize and achieve a uniform and consistent legislative purpose).

[129] *Cal Advocates* at 24. Cal Advocates continues to advance the misguided premise that "California ratepayers have funded the Small ILECs' broadband capable networks through the CHCF-A program." As Section 275.6(b)(5) makes clear, the CHCF-A only provides support for returns on investment, not the investment itself. Pub. Util. Code § 275.6(b)(5) (revenue requirement only includes "return on rate base," not rate base itself); *see also* LEC-1 (Duval Opening) at 13:27.

[130] *See* LEC-1 (Duval Opening) at 29:9-10 ("none of the cost of the broadband capable loop is included in the intrastate revenue requirement or recovered through intrastate revenue sources").

[131] *Cal Adv OB* at 25; *see* 47 C.F.R. §§ 36.154(c) (confirming 25% assignment of cable and wire facilities to interstate), 36.155(a) (confirming direct assignment of "wideband" loop cost).

[132] *See* LEC-1 (Duval Opening) at 29:28-30:15 (explaining trade-off between intrastate separations shift and federal high-cost recovery through HCLS); *see generally Ind. Small LECs OB* at 42, n. 258. Cal Advocates' claim that the "primary cost is the electronics," not the "loop itself" is also misleading. *Cal Adv OB* at 25 (citing RT at 978:19-28 (Duval)). This was not Mr. Duval's testimony. In the portion of the hearing transcript upon which Cal Advocates relies, Mr. Duval was explaining that the portion of the loop costs that are "100 assigned" to "interstate" consist "primarily" of "electronics." RT at 978:19-28 (Duval). His statements did not involve a comparison between "electronics" and overall loop costs, as Cal Advocates incorrectly suggests.

should be adjusted, the proper course would be to raise these concerns directly with the FCC, not seek to manipulate these rules by counting interstate revenue twice.

2. Kalish's "Proxy" Concept Is No Different From "Imputation."

Mr. Kalish attempts to salvage "wholesale imputation" by calling it a "proxy adjustment," but his description of the proposal is identical to Cal Advocates' recommendation.[133] This semantic artifice does not ameliorate the fatal legal and conceptual flaws in counting interstate revenue as intrastate. If intrastate revenue is assumed to exist but is not actually received, the revenue in the rate design falls short of the revenue requirement, which state law and constitutional authorities forbid.[134] Indeed, Mr. Kalish admits that "[u]ntil such time as state law is amended, . . . the "Commission's options may be limited."[135] This observation is equally true of Mr. Kalish's attempted "rebranding" and lays bare the unspoken agenda behind wholesale imputation – it is an attempt to avoid the restrictions of state law by devising a proposal with the veneer of compliance, but the same forbidden result.[136]

V. ROLE OF FEDERAL FUNDING IN RATEMAKING [SCOPING MEMO (6)].

The Independent Small LECs' opening brief surveyed the types of federal high-cost support and identified the components that impact intrastate ratemaking. No party offered a contrary view, nor did any party propose to alter the current treatment of federal funding.

While parties' overall conclusions on this subject do not appear to be in conflict, certain comments suggest a misunderstanding of the ratemaking process. Mr. Kalish remarks that "the Commission should be flexible in separating income into constituent parts, and assigning funds . . . between accounts."[137] Separation of federal funding happens today, but it is not a matter of "flexibility;" it involves the application of the FCC's Part 36 jurisdictional separations rules.[138] Parts 32 and 36 of the FCC's rules already classify costs and revenues according to a uniform

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[133] *Kalish OB* at 11-12. Mr. Kalish characterizes his "proxy" concept as a "variation on Cal Advocates' broadband imputation proposal," but he then describes the proposal as "[e]stablishing a GRC policy of adjusting the Small LECs' statements of income and expenses to include as income an amount equal to the wholesale broadband access fee." *Id.* at 12. This is the exact same proposal that Cal Advocates is advancing. RT at 1183:23-28 (Ahlstedt) ("money doesn't actually change hands.").

[134] Mr. Kalish also misuses this term "proxy." *Kalish OB* at 20. As Mr. Kalish acknowledges, for one figure to be a "proxy" for another, it must legitimately "represent the value" of the figure for which it stands. *Id.* In Mr. Kalish's proposal, the interstate wholesale figure would simply be imported into the rate design; it does not "represent the value" of any legitimate intrastate expense.

[135] *Kalish OB* at 12-13.

[136] Mr. Kalish reasons that by cloaking the proposal in the nomenclature of a "proxy," it is "more likely to pass legal scrutiny than a literal reassignment of wholesale broadband revenue . . . ." *Id.* at 10.

[137] *Kalish OB* at 13.

[138] 47 C.F.R. § 36.1, *et seq.*; *see also* SB 379 (Fuller 2012) § 1(a) (expressing Legislative intent to retain the FCC's "cost allocation and cost separation rules").

system of accounts.[139] No legitimate ratemaking purpose would be served by a further breakdown into "constituent parts" that attempts to trace a "source" to its "use."[140]

Cal Advocates notes that federal funding dollars are "commingled with other sources of revenues," but nothing is unusual about "commingling."[141] Once a dollar of revenue is received, it belongs to the company,[142] and it is fungible with all other dollars in company accounts.[143] Any of these dollars could then be used to fulfill operational requirements, such as paying operating expenses, making investments, or satisfying tax liabilities.[144] It does not matter which dollar is used to pay which cost or whether any specific dollar came from federal support.[145]

VI. RATEMAKING TREATMENT OF EXPENSES.

A. Corporate Expense Cap. [SCOPING MEMO (2)(B)(I)-(II), (2)(B)(IV)].

The corporate expense cap has proven to be an arbitrary method of measuring corporate expenses, and it is likely to be an even less reliable metric in the dynamic and uncertain environment in which companies must now operate. Nevertheless, Cal Advocates urges for its retention, and asks the Commission to further institutionalize a rigid approach to ratemaking by removing the rebuttable presumption. Rather than subjecting California companies to reductive national metrics that overlook California's distinct cost drivers, the Commission should gauge expenses incurred to operate in California. Likewise, the Commission should embrace the uniqueness of these rural telephone companies and evaluate them according to their specific prudent and necessary expenses, as it does for other utilities.

1. Removal of the Rebuttable Presumption Would Make the Use of the Corporate Cap Categorically Unlawful.

Even though the record contains no evidence that the corporate expense cap is a legitimate measurement of the reasonable corporate expense that any Independent Small LEC needs to fulfill its operational requirements,[146] Cal Advocates asks the Commission to marry its expense calculations to a faceless national metric and remove the "rebuttable presumption." Eliminating this critical flexibility would render the Commission powerless to account for

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[139] 47 C.F.R. § 32.1, *et seq.*
[140] *See* LEC-1 (Duval Opening) at 62:23-63:2 (explaining why tracing of "sources" and "uses" is irrelevant in intrastate ratemaking).
[141] *Cal Adv OB* at 25.
[142] *See Ponderosa v. Pub. Util. Comm'n*, 197 Cal.App.4th 48, 57 (2011) ("The revenue paid by the customers belongs to the company") (citing *Board of Commrs. v. N.Y. Tel. Co.*, 271 U.S. 23, 32 (1926)).
[143] LEC-1 (Duval Opening) at 62:6-7.
[144] RT at 931:8-12 (Duval) ("They can spend it however they see fit. Accordingly, they have to invest in facilities, they have to pay expenses, they have to pay taxes, and the like.").
[145] RT at 931:12-14 (Duval) ("you don't trace a source of revenue through to how it is utilized . . . .").
[146] *See, e.g.*, LEC-1 (Duval Opening) at 39:17-40:2, 45:8-21; LEC-2 (Duval Reply) at 34:1-10.

critical expenses that the corporate cap overlooks. Even the staunchest believer in the corporate cap would have to admit that its simplistic methodology would produce unrealistic results for at least some companies. In these instances, blind application of the cap would be fatal to the Commission's ratemaking determinations, placing them in clear violation of Public Utilities Code Section 275.6(b)(5), which requires support for "reasonable expenses."[147] The rebuttable presumption must be retained as a matter of law to avoid this outcome.[148]

2. Cal Advocates Presents Incorrect and Misleading Information About Rebuttals of the Corporate Expense Cap in The Last Rate Case Cycle.

Cal Advocates' opening brief is riddled with misinformation about the companies' submissions to rebut the corporate cap in the recent rate cases. The centerpiece of this false narrative is the notion that each of the companies' rebuttals to the corporate cap in the recent rate cases were disguised attacks on the cap itself.[149] To the contrary, the rebuttals consisted of expert testimony showing that, as applied, the corporate cap did not reach reasonable levels of corporate expense necessary to support company operations.[150] Cal Advocates also alleges that all 10 companies sought to rebut the cap,[151] that the Commission rejected the rebuttals in each case,[152] and that the "Commission did not allow" Kerman to rebut the presumption.[153] All of these assertions are false. Further, Cal Advocates grossly overstates the resources devoted to address the corporate cap.[154] Cal Advocates presents the unsupported opinion that the rebuttable

[147] Pub. Util. Code § 275.6(b)(5); *see also* RT at 2165:3-7 (Montero) (admitting that "if an expense is reasonable, it must be included in revenue requirement.").
[148] TURN recognizes the need for flexibility in the Commission's ratemaking. *TURN OB* at 36-37.
[149] *Cal Adv OB* at 27-28.
[150] *See, e.g.,* A.16-10-001, *Ruling Denying Ponderosa Motion for Clarification* at 4 (Jan. 20, 2017) (Ponderosa "shall have the opportunity to rebut the presumed level of expenses imposed under the cap by demonstrating that a different level of corporate expenses is reasonable.").
[151] LEC-2 (Duval Reply) at 36:20-37:1, 37:5-14 (Pinnacles and Calaveras did not seek to rebut the cap).
[152] Five of the eight cases that involved proposed rebuttals of the cap were resolved by settlement, so no conclusion on the corporate cap was reached. *See* LEC-2 (Duval Reply) at 38:16-39:2.
[153] CalAdv-10 (Tully Exhibits), Exh. D-1 (Kerman RT) at 138:26-139:19 (ALJ Halligan) (over Cal Advocates' objection, refusing to strike portions that relate to "Kerman's attempt at rebutting the FCC caps and their appropriateness for application to Kerman.").
[154] Cal Advocates' account of the Ducor case is disingenuous. *Cal Adv OB* at 26, n. 108, 28-29. It is misleading for Cal Advocates to suggest that three expert witnesses were focused on rebutting the cap, when in reality, only one expert witness—Dr. Lehman—presented testimony seeking to rebut the cap and other witnesses merely referenced Dr. Lehman's testimony in addressing other subjects, such as rate case expense or results of operations. Likewise, Cal Advocates is well aware that the Ducor rate case was not staffed with five attorneys. The transcript in that case shows that only two attorneys handled the hearings, although other attorneys had limited involvement in the underlying case due to attorney turnover and scheduling conflicts. So much of Cal Advocates' discussion of this topic depends on extra-record materials and impressions about other proceedings. The Commission should ignore these inferences, but if they are considered, the Commission should take official notice of the full records of the rate cases, which undermine Cal Advocates' arguments.

presumption has resulted in increased litigation expense,[155] backed only by the testimony of Tony Tully, who only worked on two of the ten rate cases and whose presentation includes numerous errors and hearsay statements.[156] Mr. Duval provides a more accurate picture of the role that the corporate cap played in the rate cases, based on his participation in five of them.[157] The Commission should disregard Cal Advocates' false characterization of the corporate cap as a central, resource-intensive issue in the recent rate cases.

3. Res Judicata Has No Bearing On the Commission's Consideration of Whether to Eliminate or Modify the Corporate Cap.

In discussing the corporate expense cap, Cal Advocates mentions the "principle of res judicata" and the restriction on collateral attacks in Public Utilities Code Section 1709.[158] These citations have no relevance to the Commission's examination of the corporate expense cap in Phase 2. Res judicata does not apply to an administrative agency's exercise of quasi-legislative authority,[159] and the Commission remains free to revisit policies, which, like the corporate cap, have been shown to contradict the public interest. The question of whether to eliminate the corporate expense cap is squarely within the scope of this proceeding and is not restricted in any way by the Phase 1 Decision.[160] No collateral attack is involved in the Commission reevaluating its policy based on the record and experience over the past six years.

B. Rate Case Expense.

Cal Advocates takes the extraordinary position that small telephone companies should be barred from recovering the costs of participating in mandatory, formal rate cases if their other corporate expenses exceed the FCC's arbitrary corporate expense cap.[161] The fundamental inequity in this proposal cannot be overlooked; it would strip companies of the ability to defend themselves in ratemaking proceedings that are core to their existence and turn the rate case process into an unfunded mandate.[162]

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[155] *Cal Adv OB* at 28-29. The true facts are that Cal Advocates' aggressive litigation tactics in the rate cases are the principal cause of litigation expense. LEC-2 (Duval Reply) at 35:15-26:12.
[156] Cal Adv-10 (Tully Opening), Attachment A at A-1; RT at 2298:25-27 (Tully); *see* n. 154, *supra.*
[157] LEC-1 (Duval Opening) at 4:5-7; LEC-2 (Duval Reply) at 35:15-26:12.
[158] *Cal Adv OB* at 26.
[159] *Hollywood Circle, Inc. v. Dept. of Alcoholic Beverage Control*, 55 Cal.2d 728, 732 (1961).
[160] The question of whether to apply the cap in the next round of rate cases is distinct from the question posed in 2014, which was whether to apply the cap to the 2016-2019 cases. Res judicata only applies if the same claim is involved. *Busick v. Workmen's Comp. Appeals Bd.,* 7 Cal.3d 967, 976 (1972).
[161] *Cal Adv OB* at 29-30.
[162] *See Ind. Small LECs OB* at 54.

1. Cal Advocates Mischaracterizes Federal and State Authorities as Obstacles to Recovery of Rate Case Expense.

Cal Advocates mischaracterizes the Phase 1 Decision to argue that the Commission intended to foreclose rate case expense when it adopted the corporate cap. Cal Advocates portrays this as a settled proposition, even though the Phase 1 Decision does not directly address rate case expense and despite the decades of Commission precedent confirming that the cost of navigating a mandatory regulatory process is a legitimate operating expense.[163] The passage of time has opened the door to this revisionist interpretation, but Cal Advocates' own comments in 2014 prove that parties did not understand the corporate cap to foreclose rate case expense. In comments on the proposed decision that led to the Phase 1 Decision, Cal Advocates' predecessor organization admitted that, even with the corporate cap in place, "the cost of preparing the GRC filing itself . . . would be recovered from the A-Fund."[164]

Cal Advocates also suggests that the FCC intended to restrict the recovery of rate case expense when it adopted the cap, but Cal Advocates' proffered authorities do not support its claim.[165] It cites to a 1997 FCC order discussing a previous formulation of the corporate cap, but that order says nothing about rate case expense.[166] Cal Advocates also argues that the "cost study" underlying the 2011 corporate cap formula "included rate case expense," but the record shows otherwise.[167] It points to the language of 47 C.F.R. Section 6720, but that citation only proves that *actual* rate case expense is recorded to a corporate expense account once it is incurred. That provision has no impact on the longstanding California intrastate ratemaking

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[163] *See Ind. Small LECs OB* at 53, n. 334 (summarizing authority allowing recovery of rate case expense). The Phase 1 Decision refers to the corporate cap as tool to "reduce rate case litigation costs," but it never suggests that the cap encompasses the expense itself. *See* D.14-12-084 at 29. Read in context, this statement reflects the Commission's belief that the imposition of a presumptive cap would reduce disputes, and thus, "litigation costs." If the Commission had intended this statement to repudiate decades of precedent separately calculating and authorizing rate case expense, it would have said so directly.

[164] *Office of Ratepayer Advocates ("ORA") Opening Comments on 2014 Proposed Decision* (Dec. 8, 2014) at 4. ORA argued against flexibility in the corporate cap mechanism, similar to Cal Advocates' position today. It opposed the inclusion of a "safety valve" on the grounds that disputes over deviations from the cap would generate rate case expense that would impact ratepayers. If ORA believed that the corporate cap included rate case expense, there would have been no reason for this concern. The truth is that no party understood the corporate cap to bar rate case expense in 2014.

[165] *Cal Adv OB* at 30-31.

[166] *See In the Matter of Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, *Report and Order*, FCC 97-157 (rel. May 8, 1997) at ¶ 947 (articulating the basis for an older version of the corporate expense cap, without any mention of rate case expense).

[167] The "cost study" that Cal Advocates references involved single year of data, and since "rate cases are not common for most companies across the country," the corporate cap methodology could not have accounted for this expense. *See* LEC-2 (Duval Reply) at 40-10-11; *see USF/ICC Transformation Order*, App. C, ¶ 2, n. 1 (cap methodology used 2010 NECA data submission, reflecting 2009 expense data).

practice of recovering *projected* rate case expense based on the anticipated cost of the process. As Mr. Duval explained, rate case expense is not part of the historical base of expenses that is used to project expenses in a future test year.[168] It is a separate, transactional expense that has been separately recovered by amortizing it over an appropriate period of time. None of Cal Advocates' federal authorities suggests that the FCC intended to upset this practice, nor could these authorities overcome the unrebutted statutory and United States Supreme Court authority confirming that rate case expense must be recovered.[169]

2. Widely Accepted Ratemaking Practice Supports Including the Unamortized Portion of Rate Case Expense in Rate Base.

Cal Advocates vociferously opposes the inclusion of the unamortized portion of rate case expense in rate base, claiming that it would cause rate case expense to "be considered twice, first through the corporate operations cap formula and again as part of rate base."[170] This portrayal is incorrect, as the corporate cap does not include rate case expense, and the inclusion of unamortized expense amounts in rate base merely reflects the fact that cost recovery is occurring over a longer timeframe. Contrary to Cal Advocates' claim, this is not a manipulation of the ratemaking process, nor does it create "perverse incentives."[171] While the Commission has not consistently employed this approach, it is common in many other states,[172] and the Commission used it in Pinnacles' most recent rate case.[173] The Commission also used a similar methodology in addressing a parallel issue, the deferred tax impacts of the 2017 *Tax Cuts and Jobs Act.*[174]

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[168] RT at 2338:26-2339:2 (Duval) (historical expense data used to project overall expenses in a rate case "does not include rate case expense" because "[r]ate case expense is estimated separately, identified separately, amortized, and then added to the test year expenses.").

[169] Cal Advocates cites Public Utilities Code Section 275.6(c)(7) as support for its view, but that provision does not address expenses, let alone rate case expense. The pertinent statutory authority is Section 275.6(b)(5), which confirms that "reasonable expenses" must be included in "revenue requirement." These expenses necessarily include reasonable rate case expense. Cal Advocates also has no defense to *Driscoll*, which holds that a utility is entitled to "fair and proper expenses for presenting its side to the Commission" in a rate case. *Driscoll v. Edison Light & Power Co*., 307 U.S. 104, 120-121 (1939).

[170] *Cal Adv OB* at 31.

[171] Companies would have no incentive to increase rate case litigation expenses during the process because rate case expense is projected at the beginning of a rate case and not adjusted for actual results.

[172] *See, e.g.*, *Public Service Co. of New Mexico*, 2007 WL 2409514, ¶ 101 (New Mexico "has a long-standing policy" of including unamortized rate case litigation expenses in rate base); *Washington UTC v. Alderton-McMillan Water System*, 1992 WL 474764 at 7 (Washington Commission concludes that including unamortized portion of rate case expense included in rate base "is reasonable and appropriate"); *see also Public Service Co. of Colorado*, 2006 WL 1994845, ¶ 38 (Colorado); *Texas Utilities Elec. Co.*, 1994 WL 833163, FOF 105 (Texas); *SourceGas Distribution, LLC*, 2008 WL 9895025, FOF 4, O.P. 1 (Wyoming); *Wilder Resorts, Inc.*, 2004 WL 3262004, ¶ 47 (Montana).

[173] D.19-12-011, App. A (adopting Pinnacles' proposed operating rate base); RT at 2035:3-11 (Duval).

[174] *See* Res. T-17617 at 8 (O.P. 4-5); Res. T-17619 at 8 (O.P. 4-5); Res. T-17626 at 8 (O.P. 4-5).

C. Operating Expenses.

1. Imposing a Backward-Looking Expense Cap With an Outdated Inflation Factor Would Be Contrary to Prospective Ratemaking and Statutory Requirements.

Cal Advocates' brief suggests that NECA cost study figures should be used to project test year operating expenses.[175] Based on inconsistent testimony from Cal Advocates' witnesses during the hearings,[176] the Independent Small LECs did not understand the "cost study" proposal to extend to expenses, except for companies impacted by the operating expense cap. To the extent that Cal Advocates' proposed use of the cost study extends to expenses, this multiplies the unreasonableness of using outdated cost projections. Using a two-year-old cost study to forecast expenses for a future test year could create large shortfalls in expense forecasts, especially if Cal Advocates compounds the problem by using a two-year-old composite inflation factor.[177] All of the problems with Mr. Hoglund's rate base proposal apply to this proposed expansion, but the detrimental effects would be far larger.[178] Especially given current events, the past cannot be assumed to be the future. There is no reason to depart from the established practice of measuring costs as of the same date that rates take effect, which is January 1st of the future test year.

2. Rigid Caps on All Operating Expenses are Incompatible With Today's Dynamic and Uncertain Environment.

Cal Advocates claims that the use of the operating expense limitation will streamline the rate case process,[179] but this alleged efficiency is just a shortcut to the wrong answer. Even in normal times, relying on a rote, national formula to produce viable predictions of future expenses for California companies can lead to shortfalls in cost recovery and leave companies without sufficient funding to support their operations, thereby compromising safe, reliable, and responsive service. In this time of crisis, the imposition of formulaic, inflexible ratemaking practices could hamstring these small companies just when they are needed most.[180] The Commission recently acknowledged the extraordinary circumstances caused by the COVID-19 pandemic and required all utilities to provide certain emergency customer protections to ensure

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[175] *Cal Adv OB* at 32.
[176] Mr. Hoglund testified that he is not suggesting the use of the expenses in the cost study and that the use of the cost study would "just be the rate base number." RT at 2259:7-12 (Hoglund). Ms. Montero's testimony focused on the operating expense limitation, and at times appeared to conflict with Mr. Hoglund's statement. *See* RT at 2192:15-2193:12 (Montero).
[177] *Ind. Small LECs OB* at 57; *see also* LEC-1 (Duval Opening) at 46:9-26 (explaining two-year time lag and need for inflation calculations to be grown beyond NECA figures); RT at 2193:20-2194:2, 2194:10-18, 2195:13-2196:22 (Montero) (admitting that cost study data used for test year 2019 is two years old).
[178] *See* Section VII, *infra*.
[179] *Cal Adv OB* at 32.
[180] *See Ind. Small LECs OB* at 55-56.

the continuity of essential services.[181] These are socially beneficial measures that promote the public interest, and the Commission should not hamstring companies in pursuing them by imposing a rigid cap that does not account for the corresponding expense.

If the operating expense cap is imported into intrastate ratemaking, it must at least be presented as a rebuttable presumption to avoid conflicts with statutory authority.[182] TURN recognizes this need for flexibility, which is especially critical today.[183]

VII. RATEMAKING TREATMENT OF INVESTMENTS. [SCOPING MEMO (2)(B)(I), (2)(B)(II), (2)(B)(IV)].

Parties provided limited commentary on the proper treatment of investments,[184] and the only tangible recommendations are Cal Advocates' proposal to use backward-looking NECA cost studies to calculate rate base and its proposed disallowance of all new investments until companies' ISP affiliates reach an 87% adoption level. The legal and policy problems with these concepts are detailed in the companies' opening brief.[185] Both suggestions deviate from statutory ratemaking requirements and do a disservice to rural communities that depend on continued deployment of broadband-capable facilities to meet their evolving needs.[186]

Cal Advocates' opening brief offers nothing to cure the legal infirmities in its proposals or show how they would benefit consumers. Cal Advocates attempts to bolster its cost study proposal by suggesting that the use of historical information would avoid "double recovery."[187] This argument is perplexing because Mr. Hoglund admitted on the stand that he is not aware of any "double recovery" in recent rate cases.[188] He further confirmed that the operation of the FCC's Part 64 and Part 36 rules already foreclose "double recovery," as long as they are correctly applied in rate cases.[189] Therefore, based on Cal Advocates own testimony, existing

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[181] Res. M-4842 at 3-4; *see also* D.19-08-025 at 66-67 (O.P. 3) (requiring communications providers to implement emergency customer protection measures to assist Californians in response to wildfires).
[182] *See* Section IV(A)(1), *supra*; Pub. Util. Code § 275.6(b)(5) (reasonable expenses must be recovered).
[183] *TURN OB* at 36-37.
[184] Parties' discussion of investments overlaps to some extent with comments on federal funding, but the focus here is on proposals that would change the way in which investments are addressed in ratemaking.
[185] *Ind. Small LECs OB* at 58-61.
[186] Rate base calculations must be based on what is "reasonably necessary" to support "telephone corporation" investments based on a future test year. Pub. Util. Code § 275.6(b)(3). *See also* LEC-1 (Duval Opening) at 11:20-23 (further investment is needed to "meet the FCC's continually growing broadband requirements and satisfy customer demand, which also continues to expand."); *Ind. Small LECs OB* at 14-15.
[187] *Cal Adv OB* at 34.
[188] RT at 2272:4-5 (Hoglund) ("No. That is not what I'm contending in my testimony.").
[189] RT at 2275:11-19 (Hoglund) (acknowledging federal rules that separate non-regulated and regulated service lines); RT at 2275:20-25 (Hoglund) (recognizing the function of Part 36 in avoiding double-recovery between federal and state jurisdictions); RT at 2276:1-4 (Hoglund) ("as I stated before, if

regulations are sufficient to address the hypothetical concern about "double recovery."[190]

Cal Advocates offers no legal argument that could salvage its adoption-based investment disallowance proposal, which is barred by statute.[191] It cites only to the introductory section of the governing statute, Section 275.6(a), ignoring the remaining sub-sections of the statute that repudiate its argument.[192] Broadband adoption is important, but the CHCF-A is not an adoption program. As Section 275.6 makes clear, the CHCF-A is a vehicle for supporting "telephone corporation" operations and encouraging broadband deployment, not a tool for threatening investment reductions to leverage ISP subscribership.[193] Ongoing broadband investment remains critical to rural communities, despite Cal Advocates' premature declaration of "mission accomplished."[194] The Commission should continue to explore solutions for broadband adoption in appropriate proceedings, such as the open LifeLine docket; it should not pollute the operation of the CHCF-A with a radical deviation from its intended purpose in the name of adoption.

Mr. Kalish's brief also proposes an unlawful reduction in rate base that would undermine the proper operation of the CHCF-A. Mr. Kalish suggests that "federal funds received by the Small LECs that can be attributed to plant investment should not be allowed . . . in accounts that earn . . . a rate of return from the A-Fund."[195] This argument relies on the false premise that there is a link between federal funding and specific investments; there is not.[196] In recognition of this fact, Cal Advocates disavowed its former proposal to pursue such reductions,[197] and the record shows that it would result in extreme revenue shortfalls and distortions of cost recovery

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applied correctly, then the expectation is you wouldn't have double recovery").

[190] There is also no analytical nexus between the use of cost studies and the specter of "double recovery." Whether rate base is historical or projected for a future test year, it is split between interstate and intrastate components according to Part 36, so "double recovery" is not possible. *See In the Matter of Sandwich Isles,* WC Docket No. 10-90, *Order on Reconsideration*, FCC 18-172 (rel. Jan. 3, 2019) at ¶ 16 (separations rules facilitate cost recovery from interstate and intrastate jurisdictions, "while preventing double-recovery"). If Cal Advocates is theorizing about "double recovery" because HCLS uses historical inputs, this is also a phantom concern. Regardless of how HCLS is calculated, it is included as an intrastate revenue source in the intrastate rate design, so it has the effect of lowering CHCF-A. It has no impact on the rate base that the Commission finds reasonable for the future test year.

[191] *Cal Adv OB* at 17.

[192] *See id.; see also* Pub. Util. Code § 275.6(a) (the purpose of the CHCF-A is to "support . . . small independent telephone corporations").

[193] Section 275.6 includes numerous references to "telephone corporations," but includes no link to ISP operations, which receive no funding from the CHCF-A. *See Ind. Small LECs OB* at 29, n. 175.

[194] Cal Advocates focuses on companies' achievements in delivering 10/1 Mbps service, overlooking the unfulfilled and ongoing need for 25/3 Mbps capabilities and beyond. *Cal Adv OB* at 17.

[195] *Kalish OB* at 13.

[196] LEC-1 (Duval Opening) at 65:25-26; *see also Ind. Small LECs OB* at 49-50.

[197] RT at 2269:11-16 (Hoglund) (explaining that rate base reductions by HCLS are no longer Cal Advocates' proposal); *see also* Cal Adv-9 (Hoglund Reply) at 1-2:12-14 (acknowledging that HCLS is commingled with other revenues, so the usage of the funds cannot be traced back to their original source).

mechanisms.[198] No basis exists to arbitrarily reduce rate base by federal funding amounts.[199]

VIII. MODIFICATIONS TO THE RATE CASE PROCESS [SCOPING MEMO (2)(B)(I), (2)(B)(IV), (8)].

No party has contested the fact that the current process is overly burdensome, expensive and inefficient,[200] but only the Independent Small LECs proposed constructive reforms to enhance the efficiency, transparency and fairness of formal rate cases. Neither TURN nor Mr. Kalish opposes the companies' proposed adjustments. These targeted revisions are reasonable and should be adopted, despite Cal Advocates' unfounded opposition.

A. Cal Advocates Does Not Identify Legitimate Legal or Factual Barriers to the Independent Small LECs' Proposed Reforms.

Rather than embrace efforts to streamline the rate case process, Cal Advocates seeks to retain the status quo. The current procedures confer institutional advantages on Cal Advocates, who can run up the cost of these cases through excessive discovery and litigious tactics, while taking the position that the rate case expense is unrecoverable beyond the corporate expense cap. The Commission should resist further institutionalizing this inequity, and reject Cal Advocates' arguments, none of which identify legitimate legal or policy barriers to the proposed reforms.

First, Cal Advocates claims that Public Participation Hearings ("PPHs") should be held before its testimony deadline so that it "can incorporate information it receives at the PPH in its testimony and the administrative law judge can request additional utility testimony and/ or exhibits in evidentiary hearings."[201] However, Cal Advocates cannot cite a single example in any of the last 10 rate cases where it actually incorporated information from PPHs into its rate proposals. Cal Advocates also suggests that the Commission has a settled policy of holding PPHs prior to intervenor testimony, which is incorrect.[202]

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[198] LEC-11 (Duval Opening) at 62:13-19 ("If the Commission were to treat federal funding like a grant program and reduce recoverable investments by these amounts, the embedded costs of building telecommunications networks would never be recovered, resulting in tens if not hundreds of millions of dollars of unrecovered costs that have already been incurred . . . . Such treatment would result in devastating losses . . ., likely resulting in the bankruptcy of each [company] and the default on all outstanding debt, not to mention the elimination of access to future capital to cover costs not covered by universal service and end use[r] funds."); *see also* LEC-4 (Boos Opening) at 31:9-20; LEC-7 (Votaw Opening) at 18:5-13.

[199] As Mr. Duval explained, IRS guidelines confirm that "universal service funding" is "revenue, and not a contribution to capital." LEC-1 (Duval Opening) at 69:6-7.

[200] *See, e.g.*, LEC-4 (Boos Opening) at 34:2-3, 15-23; LEC-1 (Duval Opening) at 55:25-56:8, 56:24-57:1; LEC-7 (Votaw Opening) at 21:16-17. In fact, Mr. Kalish describes the current rate case process as "unnecessarily contentious" and recommends that the Commission expedite it. *Kalish OB* at 13.

[201] *Cal Adv OB* at 34-35. In reality, this allows Cal Advocates to hide its rate proposals from consumers.

[202] Cal Advocates cites to the recent Ducor rate case, suggesting that the ALJ "agreed" with Cal Advocates' position on the timing of PPHs. *Id.* at 35. Neither the Scoping Memo nor Cal Advocates' extra-record transcript citation support such "agreement." A.17-10-004, *Scoping Memo* at 9 (scheduling

Second, Cal Advocates opposes the proposal to meet and confer prior to filing motions, even though this practice was utilized successfully in the Ducor rate case and it is consistent with California State Bar Civility and Professionalism Standards.[203] Cal Advocates suggests that "meet and confer" efforts are overly burdensome, but cites no corroborating evidence and fails to rebut the companies' showing that this rule would avoid unnecessary disputes and conserve ALJ resources. Cal Advocates' only legal citations are a generic reference to the Commission's existing rule governing motions to compel and an irrelevant Supreme Court case addressing statutory construction of the federal RICO statute.[204] Neither of these authorities bars the Commission from taking appropriate action, as ALJ Miles did in the Ducor case, to encourage parties to informally resolve or limit disputes before seeking intervention.

Third, Cal Advocates opposes the Independent Small LECs' proposed limitation on data requests, which would restrict parties to 300 questions absent a showing of good cause to exceed the limit. Cal Advocates attempts to preserve its aggressive discovery strategy even though the record shows that it has unnecessarily increased the burden and expense of these cases.[205] Cal Advocates suggests that a reasonable limitation on discovery would violate its statutory rights, but the Commission previously rejected this contention, recognizing that in formal proceedings, the Commission "has a responsibility to ensure that its data requests seek information that will be helpful to the record" and that the data requests are not "overly broad or vague or unduly burdensome."[206] Cal Advocates' constitutional arguments are equally misplaced, as there is not

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PPH without noting any reasons for doing so). While it is true that the Ducor PPH took place prior to Cal Advocates' testimony, four other recent cases adopted the opposite sequencing, to the benefit of consumers. A.17-10-004 (Foresthill), *Scoping Memo* at 6-7; A.16-10-004 (Cal-Ore), *Scoping Memo* at 5-6; A.16-10-002 (Calaveras), *Scoping Memo* at 5-6; A.16-10-001 (Ponderosa), *Scoping Memo* at 4-5.

[203] LEC-7 (Votaw Opening) at 22:13-17, 25:19-23; *see also Attorney Guidelines of Civility and Professionalism,* Intro, §10.

[204] The reference to Rule 11.3 appears to be an implicit argument that meet and confer requirements can only be imposed if they appear in the Commission's existing rules. This is untrue, as the Commission has authority to adopt reasonable procedures that are tailored to specific contexts. Indeed, the Commission's rules governing applications do not include a requirement to share a "notice of intent" prior to filing," yet the Commission imposed such a requirement in the rate case plan. *See CPUC Rules of Practice and Procedure*, Article 2; *compare* D.15-06-048, Appendix A at 2; *see also Russello v. United States*, 464 U.S. 16, 22-23 (1983) (addressing construction of "interest" was necessarily undermined by other forfeiture provisions in the statute).

[205] *See Ind. Small LECs OB* at 65, n. 397.

[206] D.09-04-035 at 28-29 (noting that some of Cal Advocates' data requests "were redundant and others sought information completely unrelated to this proceeding."). Indeed, the Commission has imposed discovery limits or cutoffs in formal proceedings, including rate cases. *See, e.g.*, *Ind. Small LECs OB* at 65, n. 398; A.00-11-018, *Scoping Memo and Ruling* at 2 (Feb. 16, 2001), 2001 WL 35829664 at *2 ("I acknowledge that under Public Utilities Code Section 309.5(e), ORA does have ongoing authority to compel the production or disclosure of any information it deems necessary to perform its duties from

a constitutional right to unlimited discovery,[207] and the Commission has found that restrictions on discovery do not impair intervenors' due process rights.[208] Cal Advocates also contends that data request limits would somehow create a "perverse incentive" for the Independent Small LECs not to be forthcoming in responding to data requests.[209] This contention lacks merit, as the companies' proposal does not foreclose efforts to follow-up on existing data requests, including bringing motions to compel; it only limits new data requests.

Fourth, Cal Advocates' position on mandatory mediation misconstrues the companies' proposal and ignores the parties' experiences in the recent round of rate cases. The Independent Small LECs are not suggesting that parties should be "forced to agree" on the outcome of a case; the companies are merely suggesting that the parties should be compelled to attend mediation to see if a skilled mediator can minimize or resolve their differences. This is not a revolutionary proposal, and it is consistent with the resolution cited in Cal Advocates' brief, which acknowledges the possibility that parties could be required to participate in alternative dispute resolution.[210] The undisputed facts show that Cal Advocates has recently refused to participate in mediation in rate cases, which has resulted in unnecessarily protracted litigation.[211] The Commission should respond with an appropriate change in procedure to encourage settlement.

B. Kalish's Proposal to Penalize Rate Case Applicants Is Baseless and Unconstructive.

Mr. Kalish levels false accusations against Foresthill to argue that the Commission should impose "routine penalties" in rate cases.[212] His facts are incorrect and his proposal is unconstructive. Without any support, Mr. Kalish suggests that Foresthill was "caught" engaging in criminal activity akin to tax evasion in its last rate case.[213] No such event occurred, and

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entities regulated by the Commission. However, *for purposes of presenting a case in this proceeding*, we need a date certain for parties to submit data requests and to receive responses. For that reason, I have adopted due dates for discovery requests and responses . . . .") (emphasis added).

[207] Cal Advocates cites to two generic procedural due process cases, neither of which establish a right to "life, liberty, or property" in the use of discovery tools. *See Cal Adv OB* at 36, ns. 156-157.

[208] In D.06-12-042, the Commission denied an application for rehearing from Cal Advocates (then "DRA") and other intervenors objecting to discovery restrictions on due process grounds. D.06-12-042 at 4-7 (finding discovery restrictions were justified to expedite a timely resolution and avoid delay).

[209] *Cal Adv OB* at 36.

[210] Res. ALJ-185 at 5.

[211] *Ind. Small LECs OB* at 64, n. 393.

[212] *Kalish OB* at 16.

[213] This is an outrageous, unfounded accusation grounded in a misunderstanding of the rate case process. During rate cases, parties may disagree as to the reasonableness of costs or the propriety of cost recovery, but if the Commission disallows a cost, it is not evidence of criminal behavior, trickery, or malfeasance.

"penalties" were neither considered nor imposed.[214] Indeed, no Independent Small LEC has been penalized in any rate case over the past 20 years.[215] Mr. Kalish's proposal to increase "penalties" would not make the rate case process more efficient or transparent; it would only inflame tensions in the rate cases and encourage Cal Advocates to bring baseless motions for sanctions in an effort to unfairly advance litigation positions.

IX. BASIC SERVICE RATES AND OTHER END USER RATE PROPOSALS [SCOPING MEMO (4)].

A. TURN Provides a Compelling Opposition to Further Rate Increases.

The Small LECs agree with TURN's well-reasoned analysis and conclusion that the "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."[216] TURN and the Independent Small LECs further agree that "[r]ates should be set in rate cases, governed by rate of return regulation," rather than through the CHCF-A annual advice letter process.[217] As TURN points out, Cal Advocates' rate proposal would unfairly force customers to incur rate increases every year "regardless of whether they are justified by cost increases."[218] The Commission should defer to TURN's judgment regarding "just and reasonable" rates for the Independent Small LECs' customers, consistent with TURN's mission to ensure high-quality and affordable rates and its advocacy for fair rates on behalf of ratepayers in numerous proceedings.[219]

B. Cal Advocates' Proposal for Annual Rate Increases Lacks Record Support and Defies Common Sense.

Unlike TURN's advocacy, Cal Advocates' proposal is not grounded in the interests of the Independent Small LECs' rural ratepayers, and it cannot satisfy statutory standards.[220] Cal Advocates does not even attempt to show that its proposal would result in "just and reasonable rates" for consumers, which is a glaring omission given the current environment, in which many rural customers are struggling financially.[221] Likewise, Cal Advocates asserts that perpetually-

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[214] The dispute in the Foresthill case was over whether Foresthill had to execute written contracts to recover costs for critical services provided by affiliates. Foresthill argued that the costs were reasonable regardless of the existence of a contract, and Cal Advocates disagreed. The Commission adopted a compromise position by disallowing part of the expense. *See* D.19-04-017 at 41-50, 69.
[215] *See Ind. Small LECs OB* at 6, n. 36
[216] *TURN OB* at 40.
[217] *Id.*
[218] *Id.* at 39.
[219] *See, e.g.*, D.16-04-035 at 13-14; D.15-08-016 at 12-13.
[220] *See* Pub. Util. Code § 275.6(c)(3) (rates must be "just and reasonable" and reasonably comparable to urban rates).
[221] *See* TURN-2 (Roycroft Reply) at 68:19-69:8 (explaining that Cal Advocates' proposal for annual

increasing rates would result in rates "reasonably comparable" to rates in urban areas, but it cites no evidence to support this proposition.[222] Indeed, the evidence in the record disproves Cal Advocates' claim, as both the weighted and unweighted average standalone rates of the large ILECs and the lowest bundled voice rates from major CLECs "are far below the rates set for the Independent Small LECs."[223] Cal Advocates' assertion that annual rate increases would avoid "rate shock" is equally barren, and it ignores compelling testimony that the proposal would frustrate consumers and cause them to continually reevaluate their service options.[224]

Cal Advocates also offers the counter-intuitive argument that rate increases are not likely to produce customer losses.[225] Strong company testimony and expert analysis contradicts this premise.[226] Cal Advocates attempts to discount Ducor's line loss figures, arguing that Ducor did not account for "outside factors" that may have led to the declines.[227] However, the only additional variable Cal Advocates identifies is the potential fluctuation in subscribership at "vacation homes." This objection is unavailing, as "seasonality" only affects the smallest of Ducor's three exchanges, and Ducor's rate increases occurred during a time of year when that was unlikely to be a factor.[228] Similarly, Cal Advocates' criticism of Dr. Lehman's analysis rests on a mischaracterization of his findings.[229] None of these attempts to distract from the evidence

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inflationary rate increases would not result in "just and reasonable" outcomes).
[222] *Cal Adv OB* at 37.
[223] LEC-11 (Lehman Opening) at 10:11-13:6; *see also* LEC-12 (Lehman Reply) at 1:22-24 (Cal PA's proposal "will further exacerbate the current disparate treatment of customers of the Independent Small LECs – facing higher rates than urban customers despite having lower income levels.").
[224] *Cal Adv OB* at 38; LEC-4 at 32:11-25 (Boos Opening) (Ponderosa's customers would react poorly to annual rate increases, which would create a misimpression that the company is constantly seeking to raise rates and cause customers to drop service, even if the annual increases are small); LEC-7 (Votaw Opening) at 18:23-19:25 (Ducor's customers would also react negatively to continual rate increases and explore other less reliable service options in Ducor's territory, which would pose a health and safety hazard); LEC-12 (Lehman Reply) at 1:24-27 ("Automatic annual increases in rates will lead to continual reevaluation of subscription behavior by customers, leading some to forego landline service and endangering their health and safety, especially where wireless service does not work at customers' homes."); *id.* at 6:16-7:4 (further explaining harmful customer impacts from annual rate increases).
[225] *Cal Adv OB* at 38.
[226] LEC-7 (Votaw Opening) at 19:5-25, 20:25-21:2; LEC-4 (Boos Opening) at 32:16-25.
[227] *Cal Adv OB* at 38-39.
[228] RT at 1932:14-26 (Votaw). The rate increase was implemented in August, long before customers would be likely to leave vacation homes due to winter weather.
[229] Cal Advocates argues that Dr. Lehman did not consider other potential causes of line losses, but he explained that these variables are "certainly reflected in the data" and captured by his comparative trend methodology. RT at 1988:5-10 (Lehman). Cal Advocates also mis-cites Dr. Lehman for the proposition that "the actual decline in subscribership . . . falls within the confidence interval of the projected line." *Cal Adv OB* at 39, n. 178 (citing RT at 1988-1989:11-2 (Choe, Lehman)). Dr. Lehman testified that he was not sure whether the actual decline fell within the confidence interval "because it wouldn't prove anything." RT at 1989:7-26 (Dr. Lehman). Figure 2 of his reply testimony shows two confidence intervals (50% and 90%) and Cal Advocates does not identify which interval it is referencing. LEC-12

change the unrebutted fact that the Independent Small LECs lost more customers than the "mean forecast" in the months following the rate increases.[230] The quantitative and qualitative data regarding the rate increases shows that they cause customers to drop service in larger numbers. Cal Advocates' opposing view is at odds with the record and contrary to common sense.

C. Kalish Offers an Irrelevant and Misleading Description of Independent Small LECs' Services.

Kalish advances various false and unsupported allegations regarding the Independent Small LECs' rates,[231] but none of his claims address the issues in the Scoping Memo.[232] He cites no record evidence to support his tangential commentary and it should be disregarded.[233]

X. RATEMAKING TREATMENT OF MISCELLANEOUS REVENUES [SCOPING MEMO (5)].

The Independent Small LECs' opening brief addressed the Commission's questions regarding miscellaneous revenues and demonstrated that no substantive or procedural changes are needed in this area. The only other discussion of this topic is from Mr. Kalish, but his remarks misapprehend the issue. Miscellaneous revenues are not "a category that includes access to Small LEC loops by . . . ISPs," as Mr. Kalish suggests.[234] Rather, as detailed in the Independent Small LECs' opening brief, "miscellaneous revenues" are a well-understood category of regulated revenue defined by 47 C.F.R. Section 32.5200.[235] These revenues are already counted in intrastate rate design and have the effect of "reducing A-Fund draws."[236] Mr. Kalish's claims do not relate to any of the scoping questions and should be disregarded.

XI. CHCF-A ANNUAL FILING PROCESS [SCOPING MEMO (7)].

As the Independent Small LECs explained in their opening brief, the CHCF-A annual filing process has been a successful regulatory mechanism that has stabilized rural telephone company revenues between rate cases and promoted resource conservation, fiscal responsibility, and judicial economy.[237] The companies identified two limited adjustments that should be made to the process, one driven by a binding appellate decision and the other by a need to return the

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(Lehman Reply) at 9, Figure 2 Legend. Nevertheless, the actual data do not fall within either.
[230] LEC-12 (Lehman Reply) at 10:2-17.
[231] *Kalish OB* at 17.
[232] Scoping Memo at 7 (Issues 4(a) and 4(b)).
[233] Mr. Kalish's remarks overlook the regulatory requirements underlying the provision of basic telephone services, ignore customers' abilities to choose any long-distance provider without restriction, and wrongfully suggest the companies' services should resemble those of price-deregulated wireless carriers.
[234] *Kalish OB* at 17.
[235] *Ind. Small LECs' OB* at 71.
[236] *Kalish OB* at 17.
[237] *Ind. Small LECs OB* at 7-9.

"waterfall" mechanism to its original function.[238] These revisions would preserve the ministerial nature of the annual process and retain the benefits that it affords.

By contrast, Cal Advocates and TURN propose major changes to the CHCF-A process that would compromise its function and lead to a multiplicity of controversies on an annual basis. Cal Advocates proposes to co-opt the annual filing process into a vehicle for automatic, mandatory customer rate increases, thereby necessitating annual battles over revenue calculations and elasticity percentages, issues that do not arise today.[239] TURN seeks to augment the "means test" by using it as a deterrent to ISP affiliate price increases.[240] This would be a major expansion of the "means test" that would invite extensive disputes over whether a change in affiliates' Internet access service packages constitutes an increase and how the "pro forma" version of the means test should be conducted.[241] These proposals would inject controversy into what should be an administrative process, and both should be rejected.

XII. CONCLUSION.

The Independent Small LECs have been stalwarts of universal service and pioneers of telecommunications infrastructure deployment since the early 20th century, but their continued stewardship depends on reasonable policymaking from this Commission. To equip these small providers for success in the next hundred years, the Commission should reject the extreme proposals from Cal Advocates and TURN and focus on the Independent Small LECs' proposals for targeted reforms to the rate case process and equitable adjustments to ratemaking standards.

Respectfully submitted this May 19th, 2020.

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[238] *Id.* at 74-75.
[239] *Cal Adv OB* at 37-38, 40.
[240] *TURN OB* at 17.
[241] For example, if an ISP were to change an Internet package from 25/3 Mbps to 25/5 and charge $2.00 more for the package, it is unclear whether that would count as a "rate increase." Addressing details of this type is likely to involve an extensive regulatory apparatus and a burdensome annual process.