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**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

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| In the Matter of the Consideration of the Role of Patronage when Determining Rate of Return, Affordable Base Rate, and Support from the Utah Universal Public Telecommunications Service Support Fund for Certain Telephone Corporations | ) | **Docket No. 11-2528-01**<br><br>Position Statement of Emery Telephone |

Emery Telephone (the "Company"), hereby files the following Position Statement as directed by the Public Service Commission of Utah (the "Commission") in response to the issues the Commission has set forth in its Notice of Agency Action in the above-reference docket:

## RESPONSES TO ISSUES RAISED BY THE COMMISSION

1. **Definition of Patronage**. The Company is organized under Utah law as a non-profit corporation operating as a cooperative. The members of a cooperative are its owners and members are not required to be current customers of services provided by the cooperative. Under Utah law, member of a cooperative, even though the cooperative is a not-for-profit entity, are entitled to the margins or profits generated by the operation of the business of the cooperative. As such, those owners are entitled to share in the earnings of the cooperative in any given year based on each member's respective amounts of revenue paid to the cooperative for services during that year, including but not limited to local exchange service. To the extent that a member's share of the profits is not currently paid but the payment thereof is deferred to be used by the Company as an investment in the Company, the member is credited with "capital credits" in the amount of the deferred payments. Those capital credits are retired (or paid) at such time as the Board of Directors determines that there are sufficient funds available to do so. Capital credits may accrue in a members' capital account over an extended period of time. For example, the Company has un-retired capital credits that have accrued for all years back to approximately 1986. The retirement or payment of those capital credits is known as

"patronage." Payment of patronage is the repayment of amounts invested by the Company's members in the Company's business operations. Members receive patronage payments as ordinary income, subject to state and federal tax laws. The Company does not issue the patronage payments as rebates on past telephone services or as credits against future service charges. The member may use the patronage payment how he or she so chooses.

2. **Should a telephone corporation's support from State USF fund be reduced proportionate to the amount of patronage paid?** No, for the following reasons:

a. **The owners of a cooperative should not be treated differently from the owners of a for-profit corporation**. Section 54-8b-15(5), Utah Code Anno., provides that "[o]peration of the fund shall be nondiscriminatory and competitively and technologically neutral in the collection aid distribution of funds . . . ." The reduction of the USF eligibility of a cooperative based on patronage payments made in retirement of capital credits would violate Utah law and R746-360-4 of the Commission's Rules and Regulation.

Shareholders in a for-profit corporation receive dividends based on the earnings of the company. The amount of earnings, if any, which is distributed in any year to the shareholders of a for-profit corporation is at the discretion of the company's board of directors and is based on the investment made by each of the shareholders. Likewise, the patronage allocated to the members of a cooperative is retired at the discretion of the cooperative's board of directors and is based on the investment by the members of the cooperative reflected as capital credits. Unlike a for-profit corporation in which dividends are paid in the year in which they are declared, a cooperative's members may not receive patronage distributions for an extended period of time. Those earnings not distributed are invested in capital projects or held in cash by the cooperative. Using earnings reduces the company's dependence on borrowed funds to make such investments. The owners of a public utility, whether a cooperative or investor-owned, are entitled to a return of, and a return on, invested capital. In the case of both a cooperative and an investor-owned utility, earnings which are used for capital investment by the company are earnings to which the owners are entitled but which they have deferred distribution in order to benefit the company.

b. **Patronage distributions do not constitute a reduction of the amount which current subscribers of the cooperatives local services pay for telecommunications services**. There seems to be a mis-perception that patronage distributions result in an across-the-board reduction in the amounts which current subscribers pay for services provided by a cooperative.

First, the members receiving patronage distributions in payment of capital credits consist of both former subscribers and current subscribers of telephone service. Depending on the formula or methodology used by a cooperative in determining the basis upon which capital credits are retired, i. e., FIFO, percentage of outstanding accrued capital credits, etc., a substantial portion of patronage in any given year may be paid to members or former members who are not current subscribers of telephone service. The argument that the cost of telephone service is globally reduced by payment of patronage does not follow based on the simple fact that many members entitled to patronage payments are not current subscribers of telephone service, and may not have been for several years. In some instances, the percentage patronage paid to current subscribers may be as low as 25 percent of the total patronage paid. There is no uniform or constant ratio between patronage receiving members and current subscribers of the company's telephone service.

Second, there is no direct relationship between patronage distributions and the amounts which members pay for services during any given year. The members of a cooperative delay receipt of the portion of the cooperative's earning which have been allocated based on the operating margins of the cooperative for more than twenty or more years in order for the cooperative to have the ability to make capital investments in the company from internally-generated funds. In some years patronage is paid, and other years it is not, depending on the capital needs of the company from year-to-year and the availability of funds with which to retire capital credits, at the discretion of the board of directors. Given the substantial delays in the retirement of capital credits, the amount which the members ultimately receive doesn't have any bearing on the amounts members may have paid for telephone service in years past.

c. **Reducing a cooperative's USF eligibility based on patronage distributions will constitute confiscatory rate-making in violation of due process clauses under both the United States and State of Utah Constitutions.** Under the public policy commonly known as the "regulatory compact," which governs public utilities such as the cooperatives, privately-owned property is dedicated to public use and subject to federal and/or state regulation in exchange for just and reasonable rates which "provide sufficient revenue to enable the utility to recover its costs of service and a reasonable rate of return on the value of property devoted to public use." *Utah Department of Business Regulation v. Public Service Commission,* 614 P.2d 1242 (Utah 1980).

The amount of revenue necessary to enable a utility to recover its costs of service and a reasonable rate of return constitutes a utility's revenue requirement. The revenue requirement is made up of several components including subscriber charges, intercarrier compensation (access), settlements, and federal and state USF. If any one of the sources of revenue are reduced or eliminated without a corresponding increase from another source, the result is a shortfall in revenue resulting in the inability of the utility to recover its costs and earn a reasonable rate of return.

Reducing state USF by the amount of patronage paid to members, who may or may not be subscribers, in any given year will result in the cooperative's inability to recover its costs of service and earn a reasonable rate of return. As such, the reduced rates established by the Commission would be confiscatory and constitute a "taking" without just compensation in violation of the Fifth Amendment to the United States Constitution and Article I, Sections 7 and 22 of the Constitution of Utah.

d. **Reducing a cooperative's USF eligibility based on patronage distributions will violate Utah law requiring the Commission to establish just and reasonable rates.** Under Utah law, Section 54-7-12(2)(d), the Commission has the legal obligation to establish just and reasonable rates which provide sufficient revenue to enable the utility to recover its costs of service and a reasonable rate of return on the value of property devoted to public use. Reducing state USF by any amounts attributable to patronage paid will result in the cooperatives being denied the ability to recover its costs of service and earn a reasonable rate of return.

If the Commission determines that state USF will be reduced by the amount of patronage paid, then the only revenue source by which the cooperative can make itself whole and generate sufficient revenues to recover its costs of services and earn a reasonable rate of return is to increase current subscriber rates pursuant to authority granted to the cooperative under Section 54-7-12(7), Utah Code Ann. Those rates would necessarily be in excess of the Affordable Base Rate established by the Commission to ensure universal service as required under Section 54-8b-15(6)(a), Utah Code Ann. As a result, current subscribers of cooperatives would be forced to pay higher rates than those paid by similarly-situated subscribers of investor-owned telephone corporations by virtue of patronage payments for which they have not received a concomitant benefit.

The resulting disparate treatment by the Commission of current subscribers of cooperatives vis-à-vis their counterparts, who are customers of investor-owned telephone corporations, would not be in the public interest and would constitute impermissible discrimination by the State of Utah in violation the Fourteen Amendment to the United States Constitution.

e. **Reducing or eliminating state USF based on patronage paid will adversely impact the on-going operations of the cooperatives and the quality and availability of services to its subscribers.**

- Reducing a cooperative's rate-of-return will result in a reduction of the retained earnings in which the cooperatives may invest in broadband and other emerging technologies. The cooperatives have traditionally utilized a substantial portion of their earnings to reinvest in the development and deployment of plant and facilities with a focus on broadband and other emerging technologies. As noted above, a cooperative does not distribute all of its earnings from year-to-year but retains those earnings for possible future capital investment. As a result, patronage is distributed on a delayed basis; in some cases, up to twenty years. Reducing the rate-of-return for cooperatives will result in lower levels of retained earnings for such capital investment and effectively deny the cooperatives' subscribers the benefits of the deployment of broadband and other emerging technologies in their service territories.

- Reducing a cooperative's rate-of-return will result in a loss of borrowing power. In addition to a decrease in available, internally-generated capital with which to invest in plant, facilities and emerging technologies, a reduction in the cooperatives' rate-of-return will also make it much more difficult, if not impossible, for cooperative to borrow funds with which to implement expansion of plant, facilities and services. Cooperatives have traditionally relied upon a combination of earnings and borrowed funds in order to fund capital investment. Without the availability of borrowed funds, any development and deployment of plant and facilities, particularly those associated with broadband and emerging technologies, will be dramatically curtailed, if not eliminated.

- Reducing a cooperative's rate-of-return may result in increased costs of borrowing funds. A reduction in the cooperative's authorized rate-of-return may result in the cooperative's lender increasing the risk rating of the cooperative and, as a result, increasing the interest rate and other borrowing costs on the cooperative's loans.

- Reducing a cooperative's rate-of-return will result in the violation of existing loan covenants. A reduction in a cooperative's rate-of-return, and the concomitant reduction in revenues resulting therefrom, will result in the violation of existing loan covenants with the cooperative's lenders. The structure of the loans from the cooperatives' lenders have been based on traditional rate-of-return regulation in which there is no differentiation between the levels of return for a cooperative and those for an investor-owned utility. Further, a reduction in revenues may result in the cooperatives' inability to service debt which has been borrowed for the purpose of acquiring, expanding, and modernizing plant and facilities and developing and deploying broadband and other emerging technologies.

- Reducing a cooperative's rate-of-return may adversely impact the quality of services as well as the range of services available. As noted above, any reduction in the rate-of-return for cooperatives which would necessarily reduce the revenue requirement for the companies would result in a decrease in internally-generated funds available for capital investment as well as adversely impact the ability of the cooperatives to borrow funds with which to invest in acquiring, expanding, developing, replacing and maintaining the plant and facilities of the cooperatives. As such, the subscribers of the cooperatives may be denied the new services and technologies which the subscribers of investor-owned utilities will enjoy. Also, without sufficient capital, cooperatives will not be able to replace and modernize older facilities thereby ultimately affecting not only the types of services available but also the quality of those services. Further, decreases in revenues resulting from a reduction in the rate-of-return may force the cooperatives to utilize funds which would have otherwise been earmarked for maintenance, repair and replacement to be used to service the debt which the companies had incurred in reliance on the traditional rate-of-return structure which the Commission has employed since the beginning of the cooperative efforts.

f. **Reducing or eliminating state USF based on patronage paid by the cooperatives violates basic precepts of fundamental fairness.** In addition to the reasons cited above, any proposal to reduce or eliminate a cooperative's state USF, and the concomitant adverse impact of its current subscribers, is fundamentally unfair and not in the public interest. Given current developments in federal explicit support mechanisms, any reduction in state USF could have disastrous consequences for both the cooperatives and their subscribers. Whether the reduction or elimination of state USF cause a decrease in the level of services provided to the cooperative's subscribers or an increase in costs to the cooperative's subscribers for basic telephone service, the result is that of disparate treatment when compared to that provided to investor-owned utilities is unfair and is not in the public interest.

3. **Should a telephone corporation's support from the State USF be eliminated if patronage exceeds support from the State USF fund**? No, for the reasons discussed above.

4. **The role of patronage when determining rates of return**. As noted above, determination of rates of return are required to be established to provide the utility a reasonable return (earnings) on the value of property devoted to public use. That determination is separate and distinct from the issue of patronage. Reducing a cooperative's rate of return below a level which is reasonable return on similar investments by investor-owned utilities would be a confiscatory rate-making and in violation of basic protections afforded by the United States Constitution and the Constitution of Utah as well are contrary to Utah law.

5. **The role of patronage when determining affordable base rates**. The determination of the Affordable Base Rates in the context of the State USF is, pursuant to Section 54-8b-15, Utah Code Anno., and R-746-360 of the Commission's Rules and Regulation, to be predicated on the rates that are just and reasonable and affordable for a designated support area. With patronage being paid to members who may or may not be a current subscribers, based on capital credits having accrued in prior years (sometimes in excess of 20 years), there is no reasonable basis upon which the Commission can conclude that the Affordable Base Rate should be increased for a cooperative's subscribers as compared with those of investor-owned utilities, when there is no evidence of a concomitant and uniformly applicable benefit conferred upon the cooperative's subscribers resulting from patronage payments.

## CONCLUSION

For the reasons cited above, the Company submits that patronage paid, or accrued, should have no impact on, nor be considered in connection with, the determination of state USF eligibility of the Company.

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/s/ Brett N. Anderson
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Brett N. Anderson

## CERTIFICATE OF SERVICE

I hereby certify that on July 22, 2011, I caused to be served a copy of the **Position Statement of Emery Telephone** on the following persons in the manner indicated below at the following addresses:

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☑ by **Electronic Mail**
☐ by **Facsimile Transmission**
☐ by **First Class Mail**
☐ by **Hand Delivery**
☐ by **Overnight Delivery**

Dated this 22nd Day of July, 2011

BLACKBURN & STOLL, LC

/S/ Brett N. Anderson
Brett N. Anderson