

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of Emery Telephone's)	
Application for an Increase in)	Docket No. 15-042-01
Utah Universal Service Fund Support)	
)	Rebuttal Testimony
)	of David Brevitz, C.F.A.
)	For the Office of
)	Consumer Services
)	

NON-CONFIDENTIAL - REDACTED VERSION

August 28, 2015

1 Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

2 A. My name is David Brevitz. My business address is Brevitz Consulting Services,
3 3623 SW Woodvalley Terrace, Topeka, KS, 66614.

4 Q. HAVE YOU PREVIOUSLY FILED DIRECT TESTIMONY IN THIS MATTER
5 ON BEHALF OF THE OFFICE OF CONSUMER SERVICES ("OCS")?

6 A. Yes.

7 Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

8 A. The purpose of this rebuttal is to respond to positions taken in the testimony of
9 Casey Coleman on behalf of the Division of Public Utilities ("DPU") and make
10 clear that my direct testimony on those issues should be adopted by the
11 Commission. Specifically I am referring to Mr. Coleman's stated basis for
12 adopting a different hypothetical capital structure (65% equity, 35% debt) than I
13 recommend (50% equity, 50% long term debt), his stated basis for accepting
14 Emery's proposed 11.45% rate of return for interstate services, and his selection
15 of "comparable companies" for purposes of determining return on equity.

16 **RATE OF RETURN FOR INTERSTATE SERVICES**

17 Q. PLEASE ADDRESS MR. COLEMAN'S ACCEPTANCE OF EMERY'S
18 PROPOSED 11.45% RATE OF RETURN FOR INTERSTATE SERVICES.

19 A. Mr. Coleman correctly notes that there are different rates of return reflected on
20 the FCC Form 492 and then selects the wrong rate of return for use in this case
21 based on an apparently incomplete discussion with NECA management and
22 incorrect application of the Commission's rule regarding computation of
23 interstate rate of return. In doing so, Mr. Coleman incorrectly agrees with
24 Emery's proposal to use the highest rate of return displayed on the Form 492,
25 which is for a subset of interstate jurisdictional services - not for all interstate
26 services.

27 **Q. WHAT IS THE STATED BASIS FOR MR. COLEMAN'S AGREEMENT WITH**
28 **EMERY'S PROPOSED 11.45% RATE OF RETURN?**

29 A. Mr. Coleman's testimony states beginning at line 110 that "the question of which
30 rate to use [11.45% or 9.40%] is really a matter of whether Emery participates in
31 the Common Line Pool, or the smaller subset of companies that participate in
32 both NECA's Common Line and Traffic Sensitive pools." I strongly disagree -
33 this is not the matter that determines which rate of return to use. Ultimately, the
34 Commission's rules determine which rate of return to use, and determine the
35 question.

36 **Q. MR. COLEMAN STATES HE HAD A PHONE CONVERSATION WITH A**
37 **NECA REPRESENTATIVE TO OBTAIN THIS INFORMATION, AT LINE**
38 **113. IS NECA INDEPENDENT OF EMERY TELEPHONE?**

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39 A. No, quite the opposite. "NECA" stands for "National Exchange Carriers
40 Association". NECA is "a membership association of U.S. local
41 telecommunications companies".¹ NECA represents the interests of its member
42 local exchange companies like Emery, and is far from independent of its member
43 companies. NECA's board members are selected from its member incumbent
44 local exchange companies (10 directors), with additional "outside" directors (5
45 directors) who worked for companies or entities that worked for or on behalf of
46 various NECA members.² NECA has an advocacy function on behalf of its
47 members,³ which includes rate of return issues. The person Mr. Coleman spoke
48 with is the Western Region Manager, and a person at that management level
49 would no doubt be well acquainted with current advocacy issues and positions,
50 and the information provided to DPU would no doubt be consistent with those
51 advocacy positions. It is not known what questions were asked or discussed on
52 the call, but in any regard the conclusion that Mr. Coleman came away with for
53 use in this case is clearly contrary to the Commission's rules.

54 **Q. HOW IS THE USE OF THE RATE OF RETURN FOR ONLY THE**
55 **INTERSTATE NECA COMMON LINE POOL CONTRARY TO THE**
56 **COMMISSION'S RULES?**

¹ <https://www.neca.org/Home.aspx>

² https://www.neca.org/NECA_Board.aspx

³ https://www.neca.org/About_Us.aspx

57 A. The Commission's rules at Utah Admin. Code § R746-360-8 (A) (1) clearly require
58 calculation of "a weighted average rate of return on capital of the intrastate
59 and interstate jurisdiction" (emphasis added). The 11.45% rate of return for the
60 Common Line pool proposed by Emery and agreed to by Mr. Coleman
61 comprises only a portion of the interstate jurisdictional services. The position
62 expressed by Mr. Coleman in his testimony on this issue suggests to me that the
63 conversation with the NECA representative did not make this point clear, so
64 from that standpoint it is understandable how the DPU testimony failed to
65 account for the other interstate jurisdictional services in the interstate rate of
66 return recommendation – which include the categories of switched and special
67 access.

68 **Q. DOES EMERY IN FACT HAVE INTERSTATE SWITCHED AND SPECIAL**
69 **ACCESS SERVICES, AND CAPITAL DEVOTED TO THOSE SERVICES?**

70 A. Yes, Emery like all incumbent local exchange companies provides these services.
71 In fact these other services (unrecognized in the common line rate of return) are
72 the preponderant part of Emery's interstate jurisdictional rate base according to
73 Emery's cost separations study, as shown by the following calculation drawn
74 from Emery's Part 69 distribution of its interstate rate base in its most recent cost
75 2014 study (provided in response to OCS 2.16), which is attached as OCS Exhibit
76 2R-1 (Confidential).

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77 [BEGIN CONFIDENTIAL]

	<u>Source</u>
[REDACTED]	[REDACTED]

78

79 [END CONFIDENTIAL]

80 Emery’s proposed 11.45% drawn from the rate of return for only the common
81 line pool is applicable to only [BEGIN CONFIDENTIAL] [REDACTED] [END
82 CONFIDENTIAL] of Emery’s interstate jurisdictional rate base, and thus does
83 not meet the Commission’s rule, which requires “weighted average rate of return
84 on capital of the intrastate and interstate jurisdiction”. Fully [BEGIN
85 CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] of capital (or rate base) for
86 interstate jurisdictional services is unaccounted for by use of the 11.45% rate of
87 return for only the common line portion of the interstate business. It is for this
88 reason, to be consistent with the Commission’s rules, that I recommended use of
89 the full interstate jurisdictional rate of return as shown on the Form 492 – 9.40%.

90 Q. IS THE USE OF THE COMMON LINE ONLY RATE OF RETURN
91 INCONSISTENT WITH THE COMPANY’S PROPOSED

92 STATE/INTERSTATE SEPARATION FACTOR CONTAINED IN MR.
93 WOOLSEY'S EXHIBIT 3?

94 A. Yes. As noted by Mr. Coleman at line 86, the separation factor divides "rate base
95 for Emery between interstate and intrastate" under FCC separations rules. The
96 company's proposed state/interstate separations factors total to 100% as they
97 should, yet the 11.45% common line rate of return is applicable to only a
98 relatively small fraction of that interstate rate base as shown above, leaving the
99 difference identified above unaccounted for under the Commission's rules.

100 Q. ONE COULD NOTE ON OCS EXHIBIT 3R-1 (CONFIDENTIAL) THAT THE
101 "RATE OF RETURN" LINE SHOWS AN INPUT OF 11.25%. SHOULD THIS
102 RATE OF RETURN BE USED?

103 A. No. This return is an assumption used for cost study purposes, based on an FCC
104 rate of return from 1984. It is also contrary to the Commission's rules to use this
105 return, since the Commission's rules explicitly call for earned rate of return as
106 reported on the FCC's Form 492. The earned rate of return for the interstate
107 jurisdiction on that report is the 9.40% which I recommend that the Commission
108 use in this case.

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109

HYPOTHETICAL CAPITAL STRUCTURE

110 Q. TURNING TO HYPOTHETICAL CAPITAL STRUCTURE, MR. COLEMAN
111 PROPOSES THE USE OF A HYPOTHETICAL CAPITAL STRUCTURE OF
112 65% EQUITY AND 35% DEBT, BASED ON A 2008 TASK FORCE REPORT
113 FILED WITH THE COMMISSION IN 2008. SHOULD THE COMMISSION
114 ACCEPT THIS RECOMMENDATION?

115 A. No. DPU recommends the 65/35 hypothetical capital structure, indicating at line
116 62 of the Coleman testimony that “the Commission never formally adopted the
117 rule as proposed by the Task Force”. This statement completely glosses over the
118 fact that the Commission explicitly rejected that proposed rule on capital
119 structure in favor of individual company determinations, and appropriate fact-
120 based ratemaking determinations. “The Commission questions the need for the
121 proposed rule, and its potential impact in ratemaking settings.” “The
122 Commission is also concerned of the impact of the rule in setting just and
123 reasonable rates under Title 54 where the Commission is required to make its
124 determination based upon the evidence presented in adjudicative proceedings,
125 based on the circumstances facing each company and relevant to the time in
126 which rates will be effective.” The complete PSC letter is attached as OCS 2R-2.
127 The Commission should accept the recommendation of a 50/50 hypothetical

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128 capital structure as contained in my direct testimony, based on analysis of
129 comparable companies.

130 **COMPARABLE COMPANIES IN RATE OF RETURN ANALYSIS**

131 **Q. MR. COLEMAN’S TESTIMONY IS BASED ON “COMPARABLE**
132 **COMPANIES” AS IS YOUR ANALYSIS OF LEVERAGE RATIOS IN YOUR**
133 **DIRECT TESTIMONY. DO YOU USE THE SAME “COMPARABLE**
134 **COMPANIES” AS MR. COLEMAN?**

135 **A.** There is significant overlap in the companies we each consider comparable, but
136 there are some differences as well. I include CenturyLink (CTL) where Mr.
137 Coleman does not. Mr. Coleman includes additional comparable companies of
138 Atlantic Tele-Network (ATNI); IDT Corporation (IDT); Hickory Tech
139 Corporation (HTCO); Cincinnati Bell (CBB); Otelco (OTEL); Alteva Inc. (ALTV);
140 Earthlink Holdings (ELNK); and FairPoint Communications (FRP).

141 **Q. DO YOU HAVE ANY CONCERNS WITH CONSIDERING THESE**
142 **ADDITIONAL COMPANIES TO BE “COMPARABLE” FOR PURPOSES OF**
143 **RATE OF RETURN ANALYSES?**

144 **A.** Yes. While I am not opposed to inclusion of additional “comparable companies”
145 on a well-founded basis, most of these companies clearly should not be
146 considered “comparable” or included as follows:

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- 147 1. Hickory Tech Corporation (HTCO) should not be included in any analysis
148 because it no longer exists, and obviously therefore there would not be any
149 public data associated with its operations. Searching for this ticker symbol
150 will yield a screen, but with no financial or operating data, but evidently
151 including an historic “beta” factor which Mr. Coleman included in his
152 analysis. The reason there is no current financial data for “HTCO” is because
153 first Hickory Tech changed its name to Enventis, and then Enventis later
154 merged with Consolidated Communications (CNLS).⁴ Both Mr. Coleman
155 and I include Consolidated Communications as a “comparable company”.
156 Since Hickory Tech no longer exists, and its operations are included within
157 Consolidated Communications operations, its data should be stricken from
158 Mr. Coleman’s analysis.
- 159 2. Atlantic Tele-Network (ATNI) should not be included in any analysis due to
160 lack of comparability to the U.S. wireline telephony business. According to
161 Atlantic’s most recent SEC Form 10-K filing⁵, its business segments are
162 wireless services in US markets under the tradenames Commnet and Choice;
163 Island Wireless services in the Caribbean under various tradenames;
164 International telephony in Guyana; Competitive Local Exchange Carrier

⁴ <http://ir.consolidated.com/releasedetail.cfm?ReleaseID=918875> and
<http://www.dividendchannel.com/symbol/htco/>

⁵ <http://biz.yahoo.com/e/150316/atni10-k.html>

- 165 services under Sovernet, ION, and Essexel tradenames; and renewable
166 energy under the trade name Ahana Renewables. These lines of business lack
167 comparability, and Atlantic should not be included as a comparable company
168 in rate of return analysis in this case.
- 169 3. Cincinnati Bell (CBB) should not be included as a comparable company since
170 it serves a single large and compact metropolitan area and also operates very
171 significant IT services, hardware and data center business, including
172 “managed infrastructure services, IT and telephony equipment sales, and
173 provisional IT staffing services.”⁶
- 174 4. IDT Corporation should not be included in any analysis for purposes of
175 determining rate of return in this case due to lack of comparability to the U.S.
176 wireline telephony business. According to its website,
177 through its IDT Telecom division, [IDT] provides retail
178 telecommunications and payment services to help immigrants and the
179 under-banked to conveniently and inexpensively communicate and share
180 resources around the world. IDT Telecom’s wholesale business is a
181 leading global carrier of international long distance voice calls. IDT also
182 holds a majority interest in Zedge (www.zedge.net), a mobile content
183 discovery and acquisition platform that includes one of the most popular
184 Apps for Android and iOS.⁷
- 185 5. Alteva Inc. (ALTV) has a small ILEC operation in New York and New Jersey
186 (the former Warwick Valley Telephone Company area) that is a primarily

⁶ Cincinnati Bell 2014 SEC Form 10-K at page 8.

⁷ <http://ir.idt.net/>

187 rural service area with approximately 50,000 population, and a larger Unified
188 Communications/Hosted VoIP business.⁸ The company's operations and
189 management appear to me to be very problematic⁹, and I would not include
190 this company as a "comparable" company.

191 6. EarthLink Holdings (ELNK) should not be included in any analysis for
192 purposes of determining rate of return in this case due to lack of
193 comparability to the U.S. wireline telephony business. According to its
194 website, EarthLink

195 provides managed network, security and cloud solutions for multi-
196 location businesses. We help thousands of specialty retailers, restaurants,
197 financial institutions, healthcare providers, professional service firms and
198 local governments deliver a reliable and engaging customer experience in
199 their stores and branch offices. We do so by building and managing MPLS
200 WAN networks, by providing virtualized infrastructure, security, hosted
201 voice, secure WiFi and compliance solutions, and by offering exceptional
202 customer care. We operate a nationwide network spanning more than
203 28,000 fiber route miles, with 90 metro fiber rings and secure data centers
204 that provide ubiquitous data and voice IP service coverage. Our EarthLink
205 Carrier™ division sells facilities-based wholesale telecommunications to
206 other providers and our award-winning Internet services connect
207 hundreds of thousands of residential customers across the U.S.¹⁰

208 7. I am very familiar with FairPoint Communications (FRP) from many years of
209 working in other states on various FairPoint cases and dockets, including the
210 acquisition case in which FairPoint acquired Verizon's Northern New

⁸ Alteva Inc. SEC Form 10-K, dated March 17, 2015, at page 3.

⁹ See for example, GMI Ratings Accounting and Governance Risk Overview", attached as OCS 2R-3.

¹⁰ <http://ir.earthlink.net/>

211 England operations, and the subsequent bankruptcy case less than two years
212 later. FairPoint does not pay a dividend and is owned by a variety of entities
213 that acquired ownership as a result of the bankruptcy proceeding, and
214 subsequent "distressed capital" (or "vulture fund") investors. FairPoint has
215 yet to earn a profit, and it is unclear if and when it may do so. For these
216 reasons I would not include FairPoint as a comparable company.

217 I am familiar with Otelco from work in other jurisdictions, and it is not
218 unreasonable to include Otelco as a comparable company.

219 **Q. WHAT IMPACT WOULD CORRECTION OF THE COMPARABLE**
220 **COMPANIES AND INCLUSION OF CENTURYLINK HAVE ON MR.**
221 **COLEMAN'S COMPUTED 10.75% ROE?**

222 A. These corrections would bring the computed ROE much closer to my
223 recommended 10% ROE.

224 **Q. DOES THIS COMPLETE YOUR PREFILED REBUTTAL TESTIMONY?**

225 A. Yes.