\- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of UBTA-UBET Communications, Inc.'s (DBA Strata Networks) Application for Increase in Utah Universal Service Fund Support	)))))))	DOCKET NO. 15-053-01 DPU Exhibit 4.0 Direct Testimony of Casey J. Coleman

DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE

September 25, 2015

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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, EMPLOYER, AND BUSINESS ADDRESS.

A. My name is Casey J. Coleman. I am employed by the Division of Public Utilities ("Division") for the State of Utah. My business address is 160 East 300 South Salt Lake City, UT 84114.

Q. BRIEFLY OUTLINE YOUR EMPLOYMENT BACKGROUND.

A. Before working for the Division, I was employed by a telecommunications consulting firm as a Financial Analyst. Then for approximately three years I worked for the Division as a Utility Analyst and now work as a Technical Consultant for the Division.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I received a Bachelor of Science degree from Weber State University in 1996 and a Masters of Business Administration from Utah State University in 2001.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE UTAH PUBLIC SERVICE COMMISSION?

A. Yes. I testified before the Commission as an expert witness in Docket Nos. 02-049-82, 03-049-49, 03-049-50, 05-053-01, 05-2302-01, 07-2476-01, 08-2469-01, 10-049-16, 10-2521-01, 10-2526-01, 08-046-01, 15-2302-01 and 15-042.01.

II. SUMMARY

Q. PLEASE SUMMARIZE AND DESCRIBE THE PURPOSE OF YOUR TESTIMONY.

A. An application filed by UBTA-UBET Communications, Inc.'s DBA Strata Networks ("UBTA") on April 6, 2015 requests that the Public Service Commission of Utah ("Commission") grant an increase in support from the Utah Universal Public Telecommunications Service Support Fund ("UUSF"). My testimony will focus on three specific areas of the application submitted by UBTA. First, my testimony discusses the appropriate capital structure for UBTA to be used in this application. Second, my testimony will outline Utah Admin. Code § R746-360-8 Calculation of Fund Distributions in Rate-of-Return Incumbent Telephone Corporation Territories and its applicability to this application. Finally, my testimony discusses the cost of capital used to develop the revenue requirement for UBTA.

III. CAPITAL STRUCTURE FOR UBTA

Q. WHAT CAPITAL STRUCTURE IS THE DIVISION RECOMMENDING FOR UBTA?

A. The Division recommends using the actual capital structure as discussed in Mr. Searle's direct testimony.

IV. INTERSTATE / INTRASTATE SEPARATION

Q. IS UTAH ADMIN. CODE § R746-360-8 APPLICABLE IN UBTA'S REQUEST FOR A RATE INCREASE?

A. Yes. In December 2009, the Utah Rural Telecom Association ("URTA") petitioned the Commission to amend Utah Admin. Code § R746-360-2 B and R746-360-8 to enable companies to have the interstate rate of return applied to interstate assets and the intrastate rate of return applicable to assets used within the state. After some modification the current rule was adopted by the Commission.

Q. WHAT INFORMATION IS NEEDED TO CALCULATE THE INTERSTATE / INTRASTATE RETURN CALCULATION?

A. From my interpretation of the rule, there are two different pieces of information required to make this calculation. First, the interstate rate of return calculated by National Exchange Carriers Association, Inc. ("NECA") as reported on the FCC form 492A. Second, the appropriate allocation of rate base for UBTA between interstate and intrastate as required by the FCC in Title 47 part 36.

Q. DOES THE DIVISION AGREE WITH THE SEPARATION FACTOR USED BY MR. SEARLE IN EXHIBIT 3 OF HIS TESTIMONY?

A. Yes.

Q. WHAT IS THE INTERSTATE RATE OF RETURN REPORTED TO NECA ON THE FCC FORM 492A FOR UBTA?

A. The interstate rate-of-return as reported on form 492A is 9.40 percent.

Q. WHY DID THE DIVISION USE THE 9.40 PERCENT INTERSTATE RATE FROM THE NECA FORM 492A?

A. As Exhibit DPU 4.4D shows, in the cover letter from NECA to the FCC explaining the computation of the intrastate rate Ms. Chirico states:

> NECA has provided two Form 492 reports. The first applies to companies that participate in NECA's Common Line pool. The second applies to the smaller subset of companies that participate in both NECA's Common Line and Traffic Sensitive pools. Because all Common Line pool participants receive a uniform return on investment, the Common Line rate of return reported on both forms is identical.

The September 30, 2014 form 492 filed by NECA to the FCC shows a Common Line pool rate of return of 11.45 percent, while the interstate rate of return for the smaller subset of companies is 9.40 percent.

The question of which rate to use is really a matter of whether UBTA participates in the Common Line Pool, or the smaller subset of companies that participate in both NECA's Common Line and Traffic Sensitive pools. As the NECA Tariff F.C.C. No. 5 shows, which I have included as Exhibit DPU 4.1 DIR, UBTA-UBET is in the Common Line pools as well as the other traffic sensitive pools. Because of this fact, the appropriate Form 492A to use is the form that shows the blending of the interstate rates, the 9.40 percent.

V. COST OF CAPITAL (DPU 4.2)

Q. WHAT IS THE ALLOWED RATE OF RETURN THAT THE DIVISION IS RECOMMENDING FOR UBTA?

A. As exhibit 4.2 illustrates, the Division recommends using an allowed rate-of-return of 7.72 percent.

Q. EXPLAIN THE DIFFERENCES BETWEEN UBTA'S REQUESTED ALLOWED RATE-OF-RETURN AND THE RATE RECOMMENDED BY THE DIVISION?

A. The two differences between UBTA and the Division on this point are the appropriate intrastate cost of equity and the appropriate Interstate rate from NECA form 492A. The Division recommends a rate of 10.75 percent instead of the 14.01 percent recommended by Mr. Searle.

Q. HOW DID THE DIVISION DETERMINE A COST OF EQUITY OF 10.75 PERCENT?

A. The Division used a Capital Asset Pricing Model ("CAPM"), which is a model based on the proposition that any stock's required rate of return is equal to the risk-free-rate of return plus a risk premium reflecting only the risk remaining after diversification. Generally, if parties know the risk premium, the risk-free-rate and beta, a rate of return can be calculated. In CAPM terminology, beta is a measure of the extent to which the returns on a given stock move with the stock market.

The ideal scenario is to calculate a beta specific to an individual stock or company based on a variety of different financial information. With small rural telephone companies, the information needed is not publicly available, making a specific beta calculation for UBTA or any rural phone company challenging. To determine an approximate beta that could apply to UBTA, the Division looked at publicly traded telecommunications companies with similar profiles to determine a beta that would be representative. With this calculated beta and following the general guidelines of CAPM the Division was able to calculate, as reflected in Exhibit 4.3 UBTA Telephone Return on Equity – Intrastate, the cost of equity for UBTA at 10.75 percent.

Q. IS THE DIVISION COMFORTABLE WITH THE RESULTS?

A. Comfortable yes, ecstatic no. The Division recognizes that there are some inherent difficulties in using a CAPM model and the Commission's apparent discomfort using a CAPM model. The Division used a CAPM model because this seemed like the most viable model with publicly available information for small rural phone companies in Utah. A Bond-Yield-Plus-Risk-Premium approach is not precise enough to yield a cost of equity that should be used in a rate case. In a Discounted Cash Flow (“DCF”) model dividends are necessary to make the model work. It is impossible with small privately held telecommunications companies to determine a dividend yield. Without a dividend yield it is impracticable to calculate a cost of equity using a DCF model.

Because CAPM was the only financial model available to the Division that could produce results that allowed a certain level of comfort the Division used the CAPM model.

VI. CONCLUSION

Q. WHAT IS THE DIVISION’S RECOMMENDATION FOR THIS PETITION?

A. The Division recommends that the Commission use the actual capital structure of UBTA and an allowed rate-of-return of 7.72 percent.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.