BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Emery Telephone's Application for an Increase in Utah Universal Service Fund Support	:	**Docket No. 15-2302-01** **DPU Exhibit 1.0 R**

REBUTTAL TESTIMONY

OF

William Duncan
STATE OF UTAH
DIVISION OF PUBLIC UTILITIES

September 4, 2015

I. INTRODUCTION

Q: **Please state your name for the record**.

A: My name is William Duncan.

Q: **Are you the same William Duncan that filed direct testimony in this docket?**

A: Yes.

II. PURPOSE AND SCOPE OF TESTIMONY

Q: **What is the purpose of your rebuttal testimony in this proceeding?**

A: My testimony will respond to certain issues raised by Mr. Ostrander and Mr. Brevitz in their direct testimony filed on behalf of the Office of Consumer Services (OCS).

Q: **Please summarize the issues that the Division wishes to address.**

A: The DPU has two issues it would like to address. First, the use of a hypothetical capital structure of 65% equity and 35% debt, and second, the use of the NECA DSL tariff as an adequate revenue reimbursement from the unregulated company to the regulated company for the use of regulated infrastructure.

Q. **Please address the use of a hypothetical capital structure and why the DPU is comfortable with this method**.

A. Mr. Brevitz addresses this issue on lines 148-155 of his direct testimony. I do not disagree with his statement that the Utah PSC rejected this proposed rule. However, I believe that some context is needed to help the Commission understand why the DPU utilizes this proposed rule as policy. From my perspective, in 2008 when the Utah Rural Telephone Association (URTA) approached the Commission seeking a rulemaking in this matter, it really wanted one thing – regulatory consistency. Prior to 2008, the DPU had used various policies about capital structure. These policies may have started from PSC rule R746-344-5A which calls for the use of "an average rate base and capital structure." While this rule is not a part of R746-360, which defines how USF support is determined, average (50/50) capital structures were apparently used for several years by the DPU. Rural ILEC's came to rely on the 50/50 hypothetical capital structure in making investment decisions. As time passed, different management in the DPU utilized different hypothetical and/or a mixture of hypothetical and actual capital structures to determine USF support. Rural ILEC's faced a confusing situation, never knowing what the "rules" would be from case to case.

The DPU saw this a reasonable request – to establish a rule that would provide certainty and consistency from case to case in the regulatory process. The task force that was formed to study this question consisted of a broad cross-section of interested parties, including OCS. That task force met several times during 2008 to develop a rule that all parties could support.

Although the Commission rejected the proposed rule, in its reply to the DPU the Commission stated "The general parameter of the rule accompanied by the variability attempted to be included in the rule proposed may be applied by the Division itself in its interaction with companies”.[1] Consequently, the DPU adopted the proposed rule as policy, and has been consistent in the application of that proposed rule since that time.

While the DPU understands the OCS concerns with the 65/35 hypothetical capital structure, the DPU believes that this proceeding is not the place to make major policy changes. Adoption of Mr. Brevitz’s 50/50 hypothetical would once again introduce the regulatory uncertainty the task force was trying to eliminate with the proposed rule. For example, would the 50/50 hypothetical apply in all cases? This inconsistency in regulatory practice makes investment decisions difficult in capital intensive industries.

The DPU would support a much broader proceeding to examine this question that could ultimately result in consistent practices that could be applied globally. Adoption and application of a rule for capital structure would give predictability while also allowing deviation if sufficient evidence shows the rule’s general provision is not in the public interest in a specific case.

Q. Please respond to Mr. Ostrander’s comments concerning Emery’s revenue reimbursement rate for DSL/Broadband.

A. On lines 610 – 632 of his direct testimony, Mr. Ostrander questions the use of Emery’s reimbursement rate for DSL/Broadband. On line 631, Mr. Ostrander states that “it is clearly inappropriate for Emery to rely on this prior method in these proceedings after it has exited the NECA pool.” This is used as support for BCO-1, which allocates 50% of

1 See letter to Phil Powlick, PSC Docket No. 07-999-09

costs to the unregulated affiliate.

The DPU has two comments concerning this statement. First, Emery does use the same methodology as NECA to arrive at the reimbursement rate for DSL/broadband services. The Division reviewed Emery's calculation for setting this rate and found it to be a reasonable proxy for the rate Emery Telephone would be reimbursed if it were still in the NECA pool. Emery has exited the NECA pool for reasons that can be better articulated by Emery. Second, does Mr. Ostrander's comment indicate that the reimbursement rate would be appropriate if Emery were still in the NECA pool?

While the DPU recognizes the OCS's concerns in this issue, once again the concept of regulatory consistency arises. Over the last several years, the DPU has consistently used NECA tariff rates as the standard for review in determining UUSF support. Adoption of Mr. Ostrander's 50/50 allocation of interstate costs is a major departure from past practice. Adoption of the 50/50 allocation of costs also seems somewhat arbitrary since in Mr. Brevitz's testimony, he suggests that there are a number of appropriate methods from 5% regulated (lines 414-416), to 33% regulated (line 440), to 50% regulated (line 447-448) If one of these results is adopted, should that same standard be applied in the next case?

The DPU recognizes the evolving nature of the telecommunications industry. Only 10-15 years ago, the Commission regulated telephone companies that also sold internet service. Now it seems we have internet companies that also sell telephone service. The question of proper cost allocation (or proper revenue reimbursement) is another issue that should be examined in a broader forum where all interested parties can participate.

To date, the DPU has not seen fit to evaluate companies' broadband reimbursement rates on an intensive and case by case basis because the NECA tariff reasonably balances the need for appropriate reimbursement with the ease of determination for widely varying companies. Should the Commission find the method inadequate, the Commission should evaluate reimbursement regimes more broadly in a rulemaking proceeding.

Q. **Conclusion**:

A: In recent years the DPU has generally attempted to treat all rural ILEC's in a consistent manner and apply the same standards in all cases. The DPU's recommendation in this case follows those same standards. There are other standards that are not unreasonable. Generally speaking, the methods presented by Mr. Brevitz and Mr. Ostrander are not unreasonable, although it is not clear that the final adjustments chosen are free from arbitrary values. They do represent a significant departure from the consistency the DPU has tried to achieve.

When the FCC issued its USF/ICC transformation order in November, 2011, it was apparent that revenue sources traditionally relied upon by rural ILEC's would be reduced.

Unfortunately, those changes are not finalized[2]. With no subsequent change in Utah State law or PSC rules, it was apparent that requests for UUSF support would increase. Nearly four years later, that scenario is playing out in the form of an increased number of applications for increased UUSF support. The applications for UUSF support will likely only continue. In rejecting the Capital Structure Task force recommendation the Commission noted:

> The Commission is also concerned of the impact of a rule in setting just and reasonable rates under Title 54 where the Commission is required to make its determination based upon the evidence presented in adjudicative proceedings, based upon the circumstances facing each company and relevant to the time in which rates will be effective. [3]

With this explanation, the Commission indicated a desire to evaluate each issue on a case by case basis. This was three years before the FCC transformation order. With the change in FCC policy, and sixteen rural ILECs to regulate, it may be time to examine methods that provide a higher level of regulatory efficiency.

At an appropriate time, it may be beneficial to consider these recurring issues in a rulemaking to provide consistency and predictability. For now, the Commission should reject the OCS's proposed adjustments in favor of the DPU's recommended methods, which arrive at reasonable values in light of the regulatory burden and other considerations that make other methods difficult.

Q. Does this conclude you rebuttal testimony?

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2 The FCC has released seven orders on reconsideration since the original USF/ICC transformation order was released in November, 2011.

3 See PSC letter to Phil Powlick PSC Docket No. 07-999-09

A. Yes.