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Before the Public Service Commission of Utah

In the Matter of Carbon/Emery Telcom, Inc.'s Application for an Increase in Utah Universal Service Fund Support	Docket No. 15-2302-01 Office of Consumer Services Post Hearing Brief

Pursuant to the Administrative Law Judge's January 27, 2016 oral Order and the February 10, 2016 Scheduling Order, the Office of Consumer Services ("Office") hereby submits this Post Hearing Brief.

INTRODUCTION

The instant case presents numerous issues and sub-issues. The general issues are: (1) the rate of return ("ROR") to be used, (2) the shifting of cost from Carbon/Emery Telecom's ("Carbon") non-regulated operations to its regulated operations through Carbon's flawed Cost Allocation Manual ("CAM"), (3) the calculation of depreciation expenses (4) the composition of Carbon's rate base, (5) the projected revenue reduction for access line loss, and (6) the use of interest synchronization to determine Carbon's income tax expense. The Office, Division of Public Utilities ("Division") and Carbon take various positions on these issues. This Brief will identify and analyze the parties' positions and demonstrate that Carbon should not receive any of its request for an increase of $816,909 in additional UUSF disbursements and its existing UUSF disbursements of $1,038,714 should be reduced by $428,807 leaving a total UUSF disbursement of $609,907.[1]

ARUGUMENT

A review of the record reveals that Carbon has taken positions that are obviously calculated to improperly increase UUSF distributions in a manner that are not supported by the record, contrary to controlling law and, in some cases, ridiculous. In doing so, Carbon has violated Utah Code Ann. § 54-8b-6 by seeking to subsidize its nonregulated operations through disbursements from the UUSF, Utah Code Ann. § 54-8b-15(6)(a) by seeking to recover unequitable and excessive cost recovery for basic telephone service, and Utah Code Ann. § 54-8b-15(5) by seeking to obtain a competitive advantage over other telecommunication providers. This is thoroughly demonstrated by a review of the evidence offered in support of the parties' positions.

A. RATE OF RETURN

The Office asserts that the proper overall ROR is 8.45% arrived at through the following formula, which basic structure is undisputed although three of its inputs, presented in bold, are contested.

State Return on Equity		**10.00%**	x	**Capital Structure 50%**	=	5.00%
State Cost of Debt		5.63%	x	**50%**	=	2.82%
				State ROR		7.82%
Intrastate	Separation Factor	59.89%	x	ROR 7.82%	=	4.68%
Interstate		40.11%	x	ROR **9.40%**	=	3.77%
				Over All ROR		8.45%

[1] Ostrander Revised ConfidentialSurrebuttal pg. 2, ln. 30-36

The three issues under dispute are the appropriate interstate ROR, the capital structure and the state return on equity ("ROE"). The Office asserts that the correct interstate ROR is 9.40%, pursuant to the proper interpretation of Utah Admin. Code r746-360-8.[2] The Division and Carbon argue that, under their interpretation of Rule 746-360-8, that the appropriate interstate ROR is 11.45%.[3] Second, the Office asserts that the appropriate hypothetical capital structure is a 50% 50% split between the cost of equity and debt, based on a comparison of similar companies in the relevant time period.[4] The Division and Carbon argue that a hypothetical capital structure of 65% equity and 35% debt should be used based on 2008 blanket policy determination made by the Division.[5]

Finally, the Office contends that the correct state ROE is 10.00% based on a review of similar rural local exchange companies in another jurisdiction using both the Discount Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") methods for determining ROE, and comparison to recent returns granted by this commission to other jurisdictional utilities.[6] The Division argues that the appropriate state ROE is 10.75% based on CAPM analysis of similar companies.[7] Carbon contends that a state ROE to be used is 12.13% based solely on the contention that this rate is used in another "recent UUSF case."[8] As demonstrate below, the Office's arguments compel the conclusion that the appropriate over all ROR is 8.45%.

[2] Brevitz Revised Confidential Direct pg. 11, ln. 197-207.
[3] Coleman Surrebuttal pg. 2, ln. 26-31; Meredith Revised Rebuttal pg. 16, ln. 423-425.
[4] Brevitz Revised Confidential Direct pg. 9, ln 159-170.
[5] Coleman Direct pg. 3-4, ln 45-68; Meredith Revised Rebuttal pg. 15-16, ln. 399-420.
[6] Brevitz Revised Confidential Direct at pg.14 - 16, ln. 249-290; Brevitz Surrebuttal pg. 16, ln. 281-288.
[7] Coleman Direct pg.7-8, ln. 137-153.
[8] Woolsey Direct pg. 7, ln. 7 & fn. 2.

1. Interstate ROR

All parties agree that the interstate ROR is determined by the correct interpretation of Utah Admin. Code r746-360-8,[9] which provides:

> "Total embedded costs" shall include a weighted average rate of return on capital of the intrastate and interstate jurisdictions. . . .
> (a) In order to determine the interstate return on capital to calculate the weighted average rate of return on capital for Incumbent telephone corporations, the Commission shall:
> (i) use the prior year return reported by the National Exchange Carries Association (NECA) on **FCC Form 492** for Incumbent corporations that do separations between intrastate and interstate jurisdictions under 47 CFR Part 36.

(bold added.) It is clear that the appropriate interstate return on capital, i.e., interstate ROR, is determined by the ROR reported on FCC Form 492. However, Form 492 contains several different RORs for three different cost pools, the common line cost pool of 11.45%, switched traffic sensitive pool of 10.12%, and the special access pool 6.05% and one ROR averaging the return from all the pools of 9.40%.[10] Carbon's interstate operations are composed of common line service, switched traffic sensitive services and special access service.[11] In fact, a significant majority of Carbon's interstate business consists of its switched traffic and special access services.[12] However, Carbon only participates in the NECA's common line cost pool and receives an actual ROR from that cost pool,[13] leaving "the bulk of the interstate earned rate [of return] [] unknown".[14]

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[9] Coleman Hearing pg. 185-186, ln. 24-2; Meredith Revised Rebuttal pg. 16, ln. 424-425.
[10] Brevitz Revised Confidential Direct pg. 10-11, ln. 181-207,
[11] Brevitz Confidential Rebuttal pg. 5-6, ln. 63-83.
[12] *Id*.; Coleman Surrebuttal pg. 7 ln. 146-147.
[13] Coleman Surrebuttal pg. 6, ln. 115-117.
[14] *Id*. pg. 7 ln. 146-147.

Based on these facts, the Office asserts that appropriate interstate ROR is 9.40%, which represents a ROR on all of Carbon interstate business.[15] The Division and Carbon argue that the appropriate interstate ROR is 11.45%, the ROR for the common line pool because this is the only cost pool in which Carbon participates. The Division and Carbon make this argument despite the fact that the term "cost pool" does not appear in Rule 746-360-8 and that this rate only reflects a minority of Carbon's interstate business.[16] However, when Rule 746-360-8 is read in light of the settled rules of construction, it is clear that the only reasonable interpretation is that the appropriate ROR is 9.40%, the return representing the entirety of Carbon's interstate business.

Administrative rules are interpreted "in the same manner as statutes, focusing first on the plain language of the rule." *Utah Chapter of Sierra Club v. Air Quality Bd.*, 2209 UT 76, ¶13, 226 P.3d 719. "The plain language of a [rule] is to be read as a whole and its provisions interpreted in harmony with other provisions in the same [rule.]" *Lyon v. Burton,* 2000 UT 55, ¶ 17, 5 P.3d 616. If the language of the rule lends itself to two alternative readings, the interpretation should be adopted that avoids absurd results or "lends to the more practical outcome." *Utley v. Mill Man Steel, Inc.,* 2015 UT 75, ¶ 48 & n. 24, 357 P.3d 992. Moreover, if a term is missing from the provision of a rule under consideration but used in other portions of the rule or similar rules, it is presumed that the term was intentionally excluded. *State Farm Mut. Ins. v. Clyde*, 920 P.2d 1183, 1187 (Utah 1996.)

Applying these rules of construction to Rule 746-360-8 compels the conclusion that the appropriate interstate ROR is the 9.40%. First, as a matter of semantics and arithmetic it is impossible to harmonize the Division's and Carbon's argument that the appropriate interstate

[15] Brevitz Revised Confidential Direct, pg. 10-11, ln. 181-207; Brevitz Confidential Rebuttal pg. 2-5, ln. 17-71.
[16] Coleman Surrebuttal pg. 5 ln. 101-105; Meredith Revised Rebuttal pg. 16, ln. 422-434.

ROR under Rule 746-360-8 is the ROR for a minority of Carbon's interstate business with the remaining language of Rule. Rule 746-360-8(A)(1) provides that "`Total embedded costs' shall include a weighted average rate of return on capital of the intrastate and interstate jurisdictions." It is axiomatic the plain meaning of this term "rate of return on capital of the . . . interstate jurisdiction[]" refers to just that, the return of the entire interstate operations. The term "interstate jurisdiction" cannot logically refer only to a minority of the interstate jurisdictional operations, just as the term United States of America cannot logically refer only to the state of Utah, which represents a minority of the fifty states.

Moreover, it is undisputed that, the "interstate" ROR used in Rule 746-360-8 constitutes Carbon's entire interstate operations. [17] Nothing in the language of Rule 746-360-8 suggests a different method of construction for the term "interstate" from the term "intrastate." Moreover, as a matter of arithmetic it is impossible to obtain "**a weighted average** rate of return . . . of the intrastate and interstate jurisdiction" if only a minority of the intrastate operations is used in the calculations.

In addition, Rule 746-360-8(A)(1)(a) provides that the Commission shall "use **the** prior year return reported" on FCC form 492, not **a** return reported on FCC form 492. This connotes that a single ROR be used for all companies. However, under the Division's interpretation various ROR will be used depending on the company's participation in various cost pools. More to the point, whether a ROR will bear any reasonable relationship to actual rate of return for the interstate operations will also depend on participation in various cost pools. Here, because Carbon only participates in the common line pool representing a minority of its interstate operations, the proposed ROR will bear no relationship to Carbon's actual interstate ROR.

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[17] *See* Woolsey Direct pg. 7, ln. 7 & fn. 2.

Under the Office's interpretation all companies use the same ROR, which bears a reasonable relationship to the actual interstate ROR because it incorporates all of interstate operations. Therefore, the Office's interpretation leads to the more practical outcome over the absurd outcome of the Division's and Carbon's interpretation, which leads to inconsistent results and allows, such as in this case, for the use of a ROR that bears no reasonable relationship to a company's actual interstate operations. *Utley*, 2015 UT at ¶ 48 & n. 24.

Finally, it must be noted that the term "cost pool" does not appear in Rule 746-360-8. Therefore, the Division and Carbon's notion that the correct ROR in Form 492 is the one that relates to the cost pool in which Carbon participated must be read into the Rule, in contravention of the plain meaning doctrine. Moreover, as noted above, if a term is missing from the provision of a rule under consideration but used in other rules, it is presumed that the term was intentionally excluded. *State Farm*, 920 P.2d at 1187. In *State Farm*, the Supreme Court refused to read in the term "in loco parentis" into the wrongful death statute, in part, because the "legislature has used the term 'in loco parentis' in several unrelated statutes. . . . In light of these statutes, [the court] concluded that the legislature knew how to use the term 'in loco parentis' but chose not to do so" in the wrongful death statute. *Id.*

Here, paragraph 746-380-8(A)(1)(iii) provides that for companies regulated on a different basis then the instant case "the Commission shall: . . . (iii) use the actual interstate return of an Incumbent telephone corporation's relevant tariff group reported to the FCC in its most recent Form 492A." This is the precise type of language that the Division and Carbon seek to read into paragraph 746-380-8(A)(1)(i), i.e., "actual interstate return" and "corporation's relevant" cost pool. Therefore, under *State Farm*, it must be assumed that the Commission knew how to use such language but chose not to do so. In fact, the instant case presents a stronger argument for the application of *State Farm* because the language sought to be inferred appears in the same rule, just two paragraphs away from the paragraph under consideration.

Thus, all relevant rules of construction compel the conclusion that the appropriate ROR is 9.40%, the rate that relates to the entirety to the Carbon's interstate business.

2. Capital Structure

All parties agree that because Carbon does not carry any long-term debt a hypothetical capital structure should be used in determining the appropriate ROR.[18] The Office asserts that the appropriate capital structure to be used is a 50% debt 50% equity structure.[19] This structure is based on a comparison of publicly available data for comparable companies during the relevant time period, 2013 and 2014.[20] The Division and Carbon argue that the appropriate hypothetical capital structure to be used is 35% debt 65% equity.[21] However, this proposed capital structure is not based on any recent analysis of either Carbon or the telecom industry but rather on a nearly decade old blanket policy determination made by the Division pursuant to a 2008 Capital Structure Task Force finding.[22]

The 2008 Task Force submitted a rule to the Commission based on its findings but the Commission, in an October 27, 2008 letter, rejected the proposed rule. While the letter did state that the Division could apply the general parameters of the prosed rule in its dealings with telecom companies, the letter concluded:

> 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

[18] Coleman Direct pg. 3-4, ln. 45-68; Woolsey Direct at pg. 7, ln. 7; Brevitz Revised Confidential Direct at pg. 7-9, ln. 119-170.
[19] Brevitz Revised Confidential Direct at pg. 9 ln. 167-170.
[20] *Id.* pg. 9, ln.159-164.
[21] Coleman Direct pg. 3-4, ln. 45-68; Meredith Revised Rebuttal pg. 15-16, ln. 396-420.
[22] Coleman Direct pg. 3-4, ln. 45-68; Meredith Revised Rebuttal pg. 15-16. ln. 396-420

> circumstances facing each company and the relevant time in which rates will be effective.[23]

Since the rejection of the proposed rule in 2008, the Division has nevertheless continued to employ the proposed rule as Division's policy, primarily to promote regulatory consistency.[24]

The difficulty with the Division and Carbon's position is that the notion of regulatory consistency is diametrically opposed to the factors the Commission relied on to reject the proposed rule, i.e., deciding each docket on the evidence concerning the circumstance of the individual case and the relevant time period. Indeed, the relevant time period is particularly important because the Division admits that there has been significant change in the telecommunications industry since 2008 and the industry is continually evolving.[25] Given this fact, it is impossible to retain blanket regulatory consistency over several years as the Division has sought to do and at the same time decide each case based evidence regarding the relevant time period.

Accordingly, in order to adopt the Division and Carbon's argument this Commission must reverse the position outlined in the October 27, 2008 letter and adopt the Division's policy argument. This is because neither the Division nor Carbon has done any analysis into the appropriate capital structure and has based their argument entirely on the policy of regulatory consistency underlying the rejected rule.[26] The only evidence addressing the hypothetical capital structure in the relevant time period is offered by the Office and this tribunal's findings of fact must be based on substantial record evidence. *See* Utah Code Ann. § 63G-4-403(4)(g)(an

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[23] Duncan Hearing pg. 165, ln. 4-10.
[24] Duncan Hearing pg. 163-164, ln. 25-3.
[25] Duncan Hearing pg. 166, ln. 11-14.
[26] Coleman Direct pg. 3-4, ln. 45-68; Meredith Revised Rebuttal pg. 15-16. ln. 396-420

agency's finding of fact must be based on "substantial evidence when view in light of the whole record.")

Thus, this tribunal is faced with deciding between two hypothetical capital structures. One, proposed by the Division and Carbon, based on a near decade old policy determination meant to insure regulatory consistency. The other, proposed by Office, based on record evidence concerning the capital structure in the telecom industry in 2014, which is consistent with the Commission's 2008 determination that hypothetical capital structures must depend on evidence of the individual case and the relevant time period. Given the dynamic nature of the telecom industry, this Commission should not reverse the position it employed in rejecting the Division's proposed rule and adopt the Office's 50/50 capital structure.

3. State Return of Equity

The parties propose three different measures of intrastate return on equity ("ROE"), the Office proposes 10.00%, the Division proposes10.75% and Carbon a significantly higher 12.13%.[27] The Office bases its proposal on a comparison of the rate of return on equity (ROE) of Kansas rural telephone companies with remarkably similar profiles to Carbon computed in the course of regular cost of service audits, which began 20 years ago.[28] The ROE was computed by applying both the discount cash flow ("DCF") and Capital Asset Pricing Model ("CAPM") methods, which are regularly used in regulatory cases in state commissions.[29]

The Division based its proposal of 10.75% on its own CAPM analysis of comparable companies.[30] This approach is similar to the Offices and the 0.75% difference is primarily due to

[27] Brevitz Revised Confidential Direct pg. 15, ln. 267-269; Coleman Direct pg. 7, ln. 133-134; Woolsey Direct pg. 7, ln. 7
[28] Brevitz Revised Confidential Direct pg. 14-17, ln. 248-280.
[29] Brevitz Revised Confidential Direct pg. 15, ln. 264-265; Brevitz Confidential Surrebuttal, pg. 18-19, ln. 330-335.
[30] Coleman Direct pg. 7-8, ln. 137-153.

the inclusion of companies in the comparison with lesser comparability, such as companies that have significantly different business lines, problematic management, have never earned a profit, or no longer exists.[31] When these companies are excluded from the CAPM analysis, the result would bring the ROE much closer to the Office's proposed 10.00%. Another difference between the Office and Division's methods is that the Office uses both the DCF and the CAPM, which provide internal checks and a more holistic approach.[32]

Carbon's argument in support of its proposed ROE is full of bluster but contains very little substance. Carbon did not engage in any form of analysis to arrive at its proposed ROE of 12.13%, but rather asserts that because the Division allowed that rate to be used in the Hanksville case it is appropriate to be used in the instant case.[33] Carbon does not assert, and there is no record evidence concerning, when this case occurred or whether there were any similarities between Hanksville and Carbon.[34] While the case resulted in a stipulation there is no evidence concerning whether the ROE was actually contested or whether the case resulted in a "black box" settlement.[35] In any event, Carbon bases its entire argument on the Division's acquiescence in the 12.13% ROE in the Hanksville case and the Division has rejected this approach in the instant case.

Carbon's overall ROR of 10.50% is arrived at through its use of a state ROE of 12.13%, picked almost at random, a contested capital structure of 35% debt, 65% equity and the disputed interstate ROR of 11.45%.[36] Then Carbon argues that this tribunal should accept this 10.50%

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[31] Brevitz Confidential Rebuttal pg. 10-13, ln. 157-231.
[32] Brevitz Confidential Surrebuttal pg. 16, ln. 283-288.
[33] Meredith Hearing pg. 128-129, ln. 6-8.
[34] *Id.*
[35] *Id*,
[36] Woolsey Direct pg. 7, ln. 7.

ROR, because of the application of a "small company premium," with the addition of similar premiums, (referred to collectively as "small company premium") would justify an overall ROR in excess of 10.50% and therefore a 10.50% ROR must be reasonable. .[37]

Carbon's argument must be rejected. The "small company premium" is a disputed theory in finance,[38]. Perhaps most damaging to its application is that it is entirely one-sided, and does not take into account the benefit of government subsidies and other economic advantages rural incumbent telephones enjoy.[39] First, the concept of a "small company premium" is based on the dubious proposition that capital markets do not act efficiently.[40] However, the existence of efficient markets underlies widely accepted financial and economic principles, such as modern portfolio theory and both the DCF and CAPM methods. Moreover, the apparent "small company premium" can easily be explained by practices such as data mining.[41] Several academic publications have called into question the existence of the "small company premium" in any circumstance,[42] let alone the appropriateness of applying the "small company premium" to rural incumbent phone companies in USF cases.

Additionally, there is no evidence that a "small company premium" has ever been used in a USF case in any jurisdiction.[43] The DCF and CAPM methods, on the other hand, are standard methods of determining ROE in utility rate cases.[44] Moreover, there is substantial friction between the standard DCF and CAPM methods and the concept of a "small company premium."

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[37] Meredith Hearing pg. 127-128, ln. 24-5.
[38] Brevitz Confidential Surrebuttal pg. 22-25, ln. 393-459.
[39] *Id. pg. 20-22, ln. 367-390.*
[40] *Id.* pg. 22, ln. 393-404.
[41] *Id.* pg. 23-24, ln. 416-446.
[42] *Id.* pg. 24-25, ln 447-459.
[43] *Id.* pg. 17-18, ln. 312-316; Meredith Hearing pg. 129-130, ln. 25-21.
[44] Brevitz Confidential Surrebuttal pg. 18-19, ln. 330-335.

As noted above, the DCF and CAPM methods are based on the accepted view that markets operate efficiently while the theory of a "small company premium" is based on the doubtful view that markets are inefficient.[45] Crucially, inherent in the calculations pursuant to the DCF and CAPM methods is a market assessment of risk.[46] Accordingly, adding a premium based on the notion of some alleged additional risk simply results in double counting, and would provide unjust and imbalanced additional return.[47]

Finally, even assuming some validity of the "small company premium" generally, it cannot be applied to rural incumbent phone companies in USF cases. Rural incumbent phone companies enjoy substantial economic benefits that are not incorporated into the "small company premium" model.[48] These benefits include access to state and federal universal service funds, ability to recover increase costs through increase rates as a regulated utility, a defined service area, access to business and profits of related non-regulated entities, and access to low cost subsidized debt financing. [49]

During the hearing, Carbon sought to address this obvious failing by asserting that the existence of government subsidies by does not affect a premium referred to as a "liquidity premium" and that one economist criticized an FCC report that dealt with federal universal service recipients.[50] However, neither of these examples impact the analysis presented in Carbon's prefilled testimony. In fact, Carbon's witness Mr. Meredith stated that he did not "assess a liquidity premium because without further analysis I cannot separate the liquidity

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[45] *Id.* pg. 22, ln. 393-404.
[46] *Id.* pg. 19-20, ln. 335-362.
[47] *Id.* pg. 18-20, ln. 330-362.
[48] *Id.* pg. 20-21, ln. 367-381; Coleman Surrebuttal pg. 18-19, ln. 359-370.
[49] Brevitz Confidential Surrebuttal. pg. 20-21, ln. 367-381; Coleman Surrebuttal pg. 18-19, ln. 359-370.
[50] Meredith Hearing pg. 199 ln. 14-23; pg.138-139 ln. 11-11.

premium from the small company premium."[51] Accordingly, Carbon's attempt to salvage its "small company premium" agreement fails.

Without the "small company premium" argument, Carbon's state ROE analysis dissolves into nothingness because of the absolute lack of any analysis leading to the claimed of a state ROE of 12.13%. Accordingly, the only the Office and the Division's stated ROE analysis are supported by substantial evidence. *See* Utah Code Ann. § 63G-4-403(4)(g). For the reasons outlined above, this tribunal should adopt the Office's state ROE over the Division's and find the appropriate intrastate ROE to be 10.00% leading to an overall ROR of 8.45%.

B. Allocation of Costs

As local incumbent telecoms Carbon and its regulated affiliates must allocate the common costs they share with Carbon's non-regulated affiliates to arrive at percentages of regulated to non-regulated costs, which are then applied to costs associated with the individual companies.[52] Done correctly this will prevent cross subsidization between the regulated and non-regulated companies. Costs allocations are preformed pursuant to the affiliate transaction rules of FCC Part 64 Section 46.903 and a company's Cost Allocation Manual ("CAM") by applying "allocators factors" that presumably have a "cost-causative" or "direct" relationship to various common cost pools.[53] Here, the Office uses the five allocation factors of revenues, expenses (excluding depreciation and income taxes), net plant, payroll and billing records applied to four contested costs pools of costs associated with the Chief Executive Officer ("CEO"), Board of Directors ("BOD"), Public Relations & Marketing ("PR/MK") and Customer

[51] Meredith Revised Confidential Rebuttal pg. 14, ln 368-370.
[52] *See* Ostrander Revised Confidential Direct pg. 16-21, ln. 374-458.
[53] *See Id.*

Service Representatives ("CSR").[54] This process yields percentages of 50% regulated 50% non-regulated for the cost pools of CEO and BOD, 25% regulated 75% non-regulated for PR/MK and 35% regulated 65% non-regulated for CSR.[55] Carbon, on the other hand, uses a single allocation factor of billing records applied to the four cost pools. This yields percentages of 74% regulated and 26% non-regulated for the cost pools of CEO, BOD, PR/MK and 63% regulated and 37% non-regulated for the cost pool of CSR.[56]

Carbon reaches these percentages through the operation of a flawed CAM. For example, the CAM does not contain any explanation of cost apportionment principles, or methods for defining costs pools, underlying studies or calculations so it is not possible determine if Carbon followed the affiliate transaction rules of FCC Part 64 Section 46.903.[57] The laxity of Carbon's analysis is demonstrated by the absence of any explication for an extra 25% weighting factor for a type of billing records referred to as CABS, relating to telephone exchanges between Carbon and other telecoms.[58] Indeed, during cross Mr. Woolsey, while stating that CABS generally take more time to bill, admitted that the 25% figure was based on a random estimation with no accounting analysis.[59] However, the most profound failing with the CAM is that it is based on

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[54] Ostrander Revised Confidential Direct pg.18, ln. 395-414; pg. 34 ln. 731-733.
In the prefilled testimony both the allocation factors and the cost pools were marked confidential. However, prior to the hearing counsel from the Office and Carbon agreed that only actual numbers representing Carbon's finances were to be treated confidential and during cross allocation factors and cost pools were referred to in the open hearing without objection. *See* Woolsey Hearing pg. 75-76, ln. 20-12.

[55] Ostrander Revised Confidential Direct pg. 18, ln. 413-414.

[56] Ostrander Revised Confidential Direct pg. 28 ln. 600-602; pg. 36, ln. 763-764; pg. 38, ln. 816-817.
The Division generally supports Carbon's position although it did not file any written testimony on this issue. Duncan Hearing pg.162, ln. 5-8.

[57] Ostrander Confidential Surrebuttal pg. 7, ln. 152-160.

[58] *Id.* pg. 11, ln 238-241.

[59] Woolsey Hearing pg. 86, ln. 23-25.

the use of a single allocation factor of billing records and the use of outdated data, 2011 data for the CEO, BOD and PR/MK cost pools and 2010 for CRS cost pool.[60]

First, the use of a single allocation factor of billing records applied to the corporate overhead pools of CEO, BOD and PR/MK appears to be unique to Carbon. Carbon cannot cite to any USF case in any jurisdiction that has used this approach and the Office's witness Mr. Ostrander has never encountered this approach in his 35 years of experience of reviewing CAMs.[61] Furthermore, the use of a single allocator of billing records to capture the diverse types of costs associated corporate overhead costs pools, such as: payroll and benefits of the CEO and BOD, and marketing staff, NTCA Coop and URTA membership dues, travel expenses, cell phone costs, etc.[62] Rather, what is needed to capture all these diverse costs is an all encompassing allocator that can only be accomplished by the use of multiple allocation factors as proposed by the Office.[63]

Furthermore, Carbon's criticism of the use of revenues and expenses, viewed individually, simply makes the Office's point. Specifically, Carbon argues that some specific revenues and expenses are not directly related to the time spent on the time spent on these issues by Carbon's management.[64] However, the use of billing records is not directly related to these issues either.[65] There are problems with every single allocator.[66] That is why it is necessary to use multiple allocators to even out individual discrepancies.[67] Moreover, Carbon has used

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[60] Ostrander Confidential Surrebuttal pg. 9, ln. 199-200; pg. 10, ln. 225-226; Ostrander Revised Confidential Direct pg. 38, ln. 827.

[61] Ostrander Confidential Surrebuttal pg. 9, ln. 199-211; pg. 10, ln. 216-219; Woolsey Hearing pg. 79 ln. 18-22, pg 20, 16-18.

[62] Ostrander Confidential Surrebuttal pg. 11-12, ln. 246-267; Ostrander Hearing pg. 271, ln. 15-22.

[63] Ostrander Revised Confidential Direct pg. 33, ln. 715-724.

[64] Woolsey Revised Confidential Rebuttal pg. 16-19, ln. 322-357, ln. 371-388.

[65] Ostrander Confidential Surrebuttal pg. 13-15, ln. 295-302, 328-338.

[66] *Id.* ln. 330-331.

[67] *Id.* ln. 330-333.

revenues as an allocator as recently as May of 2014 and the use of revenues has the added benefit of being difficult to manipulate.[68]

Second, the use of outdated data is fatal to Carbon's analysis. While the Office uses the latest available 2014 financial data,[69] Carbon uses billing records from 2011 in its corporate overhead allocators of COE, BOD and PR/MK.[70] However, since 2011 the number of regulated local service customers, and their associated billing records, has declined and the number of non-regulated customers, and their associated billing records, has increased.[71] Moreover, Carbon's management cannot possibly be spending their time in the same manner in 2011 as they do in the test year of 2014 because since 2011 the fiber construction program that drives significant non-regulated internet revenues has become a higher priority.[72]

Another timing issue plaguing Carbon's analysis, which is actually related to the issue of "cost causative" drivers, is the fact that both the Office and Carbon agree that a significant amount of Carbon's management time is spent on forward looking planning, board decisions and marketing efforts.[73] However, billing records will not reflect the time spent on business operations that have yet come to fruition.[74] Billing records that do not exist cannot be an indicator of future services or customers.[75]

An example of how Carbon's analysis improperly allocates excessive costs to regulated entities can be seen with Carbon's triple play marketing promotion advertising three bundled

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[68] *Id.* pg. 14-15, ln. 300-302, 318-324.
[69] Ostrander Confidential Surrebuttal pg. 11, ln. 237-238.
[70] *Id.* pg. 10, ln. 225-226.
[71] Ostrander Confidential Surrebuttal pg. 10, ln. 226-228.
[72] *Id.* pg. 13, ln. 278-282.
[73] *Id.* ln. 284-290; Woolsey Revised Confidential Rebuttal, pg 19, ln. 284-290.
[74] Ostrander Confidential Surrebuttal pg. 13, ln. 284-290.
[75] *Id.*

services.[76] Of the three services, one ise regulated (basic local telephone service), and two non-regulated (internet and TV.)[77] The non-regulated services generate significantly more profit.[78] Nevertheless, Carbon's analysis results in allocating marketing costs from this promotion 74% to the regulated service and only 26% to the two non-regulated services, instead of a third to each service.[79]

Carbon seeks to justify this odd result by arguing that local phone service is the focus of its marketing efforts.[80] However, this contention is belied by the fact that the marketing material Carbon provided to the Office did not include any stand-alone advertising for basic local service.[81] Moreover, the advertising for the triple play did not provide any specific promotion for local service but simply listed it as one component of the bundle.[82]

C. Depreciation

Depreciation has been in the forefront of this case. However, the main conflict has been between Carbon proposed group method depreciation with a high rate of accelerated depreciation and the Division's proposed single asset depreciation method with a more normalized rate of depreciation.[83] While the Office is supportive of the Division's approach, it offers an alternative approach based on group method depreciation with specific adjustments to groups of assets that are either fully depreciated or will be fully depreciated within three years.[84] At the close of the hearing, the Hearing Officer posed two questions to be addressed in the

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[76] Ostrander Revised Confidential Direct pg. 36-38, ln. 775-809; Ostrander Hearing pg. 273-274, ln 6-1.
[77] Ostrander Hearing pg. 273, ln. 9-13.
[78] Woolsey Hearing pg. 99, ln. 17-20.
[79] Ostrander Revised Confidential Direct pg. 37, ln. 783-790; Ostrander Hearing pg. 273, ln. 6-18.
[80] Woolsey Hearing pg. 102, ln. 12-25; Woolsey Revised Confidential Rebuttal pg. 23, ln. 481-482.
[81] Ostrander Hearing pg. 273-274 ln. 19-1.
[82] *Id.*
[83] *See* Woolsey Revised Confidential Rebuttal pg. 40-41, ln. 787-795, 807-812; pg. 43-44, ln. 857-863.
[84] Ostrander Revised Confidential Direct pg. 48-49, ln. 1053-69; Ostrander Confidential Surrebuttal pg. 24, ln. 535-544.

briefing. However, because the Office employs a group method of depreciation, only one question is relevant to the Offices position.

1. Future UUSF Case

The question presented at the hearing is: whether the better approach is to accept Carbon's accelerated depreciation method with its extremely high current depreciation expense and rely on the Division to initiate a UUSF case in the event that in future years Carbon is over-recovering or to accept the Division's and Office's approach and apply a more normalized deprecation rate and expense and rely on Carbon to bring a future UUSF case in the event that it is under-recovering?[85] The answer to this question is largely one of process.

If Carbon's approach is accepted, the Division would be forced to audit Carbon, and any telecom that uses Carbon's group depreciation method, annually to determine when Carbon reaches a depreciation cliff and begins to over-recover. This places an undue and unwarranted burden on the Division. Moreover, this burden increases the possibility that Carbon over-recovery could go unnoticed. On the other hand, if the Division and Office's approach is accepted, Carbon and similarly situated telecoms will know through the ordinary course of operating its business if it is under-recovering and can bring an UUSF case at that time.

2. The Office's Depreciation Adjustment

The Office's depreciation analysis tracks the above discussion. The Office proposes to stop depreciation on two groups of assets that are fully depreciated and to amortize over a five-year period the depreciation expense of two other groups of assets that will be fully depreciated in three years.[86] These adjustments are designed to prevent Carbon from continuing to recover

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[85] Hearing pg. 314-315, ln. 19-20.
[86] Ostrander Revised Confidential Direct pg. 48-50, ln. 1053-1059, 1078-1086.

large depreciation expenses once these accounts are fully depreciated.[87] Carbon argues that this adjustment is unwarranted because it assumes no continuing investment.[88] However, the Office is not proposing to permanently stop depreciation on these accounts. When and if Carbon adds new assets to these accounts it can record this depreciation expense on its books and recover the expense in a future UUSF case.[89]

The reasons outlined in the previous section support the Office's position. In addition, the Office's approach is consistent with the historical 2014 test period. Carbon's approach is dependent on future reinvestment,[90] despite not having made a "forecasted" filing.[91] Moreover, these future investments are not "known and measurable" or they would be included in the test period telephone plant is service account.[92] Accordingly, the Office's adjustments are appropriate.

D. Telephone Plant Under Construction and Materials and Supplies

The Office proposes 50% reduction from the rate base on the Telephone Plant Under Construction and Materials and Supplies accounts because these accounts are overstated due to Carbon's current fiber construction program.[93] This adjustment is appropriate. If these accounts are not normalized Carbon will over-recover when the fiber construction programs slows or terminates.

E. Projected Decline in Access Lines

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[87] *Id.* pg. 49, ln. 1069-1076.
[88] Woolsey Revised Confidential Rebuttal pg. 37, ln. 729-731.
[89] Ostrander Confidential Surrebuttal pg. 27, ln. 597-601.
[90] *Id.* pg. 26-27, ln. 575-577, 605-609.
[91] *Id.* pg. 27, ln. 605-609.
[92] *Id.*
[93] Ostrander Revised Confidential Direct pg. 44-45, ln. 943-949, 983-986; Ostrander Confidential Surrebuttal pg. 22-23, ln. 492-510.

Carbon's proposed adjustment for a decrease in revenues for projected access line loss must be rejected. The three-year adjustment is too far outside the test year to be "known and measurable" and Carbon makes no attempt to offset these projected revenue losses with factors that tend to decrease line loss.[94] In fact, Carbon has already been forced to reevaluate its projections demonstrating their unreliability.[95]

F. Interest Synchronization

The Office proposes an "interest synchronization" adjustment to deduct from income tax expense the amount of interest expense that is included as a weighted-debt cost component in the ROR that is applied to the rate base.[96] This approach properly "synchronizes," or matches, the interest expense deduction for income tax expense purposes with the interest expense that is included in the ROR component.[97] This is a common adjustment that has been used before by the Utah Public Service Commission in cases applying hypothetical capital structures that include a weighted debt component.[98]

CONCLUSION

As demonstrated above, Carbon should not receive any of its request for an increase of $816,909 in additional UUSF disbursements and its existing UUSF disbursements of $1,038,714 should be reduced by $428,807 leaving a total UUSF disbursement of $609,907.[99]

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[94] Ostrander Revised Confidential Direct pg. 47, ln. 1015-1030.
[95] Ostrander Confidential Surrebuttal at pg. 23, ln. 517-527.
[96] Ostrander Revised Confidential Direct pg. 51, ln. 1112-1115.
[97] *Id.* pg. 51-52, ln. 1115-1118.
[98] Ostrander Confidential Surrebuttal pg. 37, ln. 806-825.
[99] *Id.* pg. 2, ln. 30-36

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