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Before the Public Service Commission of Utah

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

The Office of Consumer Services ("Office") herby submits this Reply Brief in response to the Briefs of the Division of Public Utilities ("Division"), Carbon/Emery Telecom, Inc. ("Carbon") and Utah Rural Telecom Association ("URTA"). While the Office only addresses a few specific points, points not addressed are not conceded. The Office simply relies on the arguments made in the initial briefing and testimony to support its positions.

Rate of Return

There are three contested issues impacting the Carbon's appropriate rate of return ("ROR"), the interstate ROR, the appropriate hypothetical capital structure and the intrastate return on equity ("ROE").

Interstate Rate of Return

In its initial brief, Carbon argues "the Division and Carbon/Emery have both presented testimony that the correct interstate rate of return should be taken from the

NECA Form 492 that is applicable to the applicant." (Carbon initial brief at pg. 12.) This sentence improperly implies that the Office is citing the wrong form. All parties are citing to Form 492. The issue is which ROR listed on Form 492 is applicable in this case. For the reasons outlined in our initial brief, the correct interstate ROR is 9.40%. (Office's initial brief at pg. 4-8.)

Hypothetical Capital Structure

Carbon argues that the "testimony is undisputed that imputation of a hypothetical capital structure negatively affects Carbon/Emery's rate of return . . . . It is not . . . just and reasonable, to impute a capital structure of 50% debt for a company that has no debt unless the Commission is adopting capital structure to be used for all companies going forward." (Carbon's initial brief at pg. 12.)

However, all parties agree that a hypothetical capital structure is appropriate in this case. As Mr. Coleman of the Divisions testified: "If a small rural phone company decides to use a capital structure that does not maximize the earnings of the company, rate payers may be exposed to higher USF surcharges because of this management decision."[1] Moreover, it is undisputed that "[c]ompetitive firms seek to optimize capital structure to provide the <u>lowest overall</u> weighted cost of capital. Equity is more costly than debt, so cheaper debt financing is used by competitive firms to reduce the overall weighted cost of capital."[2]

Therefore, it is appropriate to use a hypothetical capital structure that reflects the competitive market for comparable companies. This is precisely what the Office has

[1] Coleman Surrebuttal pg. 28, ln. 573-576.
[2] Brevitz Revised Confidential Direct at pg. 7, ln. 123-126 (emphasis in original.)

done. The 50% debt 50% equity split is based on an analysis of comparable competitive companies in the relevant time period and the Office's recommendation is conservative; the analysis can support a capital structure of 70% debt.[3]

Moreover, the contention that 50/50 split would only be appropriate if it "was used for all companies going forward" is contrary to the Utah Public Service Commission's ("Commission") reasoning in rejecting the adoption of a blanket rule used to determine hypothetical capital structure, i.e., determining each case "based upon the circumstances facing each company and the relevant time."[4] For the reasons outlined in the Office's initial brief, a blanket rule of a 50/50 split would be as inappropriate as the rejected hypothetical capital structure Rule proposed by the Division. (Office's initial Brief at pg. 9-10.)

The Division ceases on one sentence in the Commission's October 27, 2008 letter asserting that the Division can apply the variability contained in the proposed rule in its own interactions with the companies, but ignores the real import of the letter, which is that the Commission desires to "make its determination based upon the evidence presented in adjudicative proceedings."   The Office's 50/50 hypothetical capital structure recommendation is based on current industry analysis and direct evidence and should be accepted by the Commission.

State Return on Equity

Carbon makes two arguments regarding the state return on equity that are of note. First, that the Office relies on "stipulated cases out of Kansas on companies that are not

[3] *Id.* pg. 9 ln. 159-170.
[4] Duncan Hearing pg. 165, ln. 4-10.

even closely comparable to Carbon/Emery" and second the Office has not taken in account "regulatory risk" in addressing the application of a small company premium. (Carbon's initial brief at page 15.) Neither contention has merit.

Two of the Kansas cases were litigated and in each case the Commission adopted the staff-recommended return on equity and in the remaining cases "the KCC staff-recommended return on equity, and rate of return was utilized in computing the final authorized KUSF draw."[5] Moreover, the evidence establishes that the Kansas companies are extremely analogous to Carbon.

> Carbon/Emery is similarly situated with the rural local exchange companies in Kansas. Rural local exchange companies generally serve rural areas with low population densities, benefit from low cost borrowing through CoBank and RUS, are organized with multiple deregulated affiliates which also provide broadband internet access and cable TV programing, and are deploying Fiber to the Home to support this array of services.[6]

Clearly, Carbon's contention that these companies are "not even closely comparable to Carbon/Emery" is baseless.

In addition, the Division and Office argue that the supposed small company premium relied on by Carbon to increase their state return on equity does not take into account the numerous economic benefits received by rural incumbent phone companies. Carbon counters this claim by asserting that "regulatory risk" associated with the Division and the Commission's review of UUSF disbursements counteracts any "elusive 'certainty' derived from state UUSF." (Carbon's initial brief at pg. 14.) As an example of this "regulatory risk," Carbon points to the Division's challenge of their depreciation

[5] Brevitz Revised Confidential Direct pg. 14, ln. 254-259.
[6] *Id.* pg 15-16, ln. 269-275.

method. (*Id.*) However, neither the Division or the Office is arguing that local incumbent telecoms should not have access to the UUSF, rather the argument proposed is that Carbon should receive the appropriate amount of UUSF funding. It is as if Carbon is arguing that the risk associated by the possibility that they will not be able to over recover from the fund under their excessive accelerated depreciation method justifies them over recovering under an exaggerated return on equity.

Moreover, state UUSF funding is only one of the numerous benefits available rural incumbent phone companies and this new issue of "regulatory risk" was not raised by Carbon's witness Mr. Meredith in his prefilled testimony, although he listed almost every other conceivable risk that could possibly associated with small companies.[7] Accordingly, this new "risk" is without any economic, financial, regulatory or academic support.

Conclusion

For the forgoing reasons the challenged arguments of the Carbon, URTA and the Division must be rejected.

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[7] Meredith Revised Rebuttal pg. 12-13, ln. 335-345.