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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 UNVERSAL SERVICE FUND SUPPORT	UTAH RURAL TELECOM ASSOCIATION'S POST-HEARING REPLY BRIEF DOCKET NO. 15-2302-01

The Utah Rural Telecom Association ("URTA") hereby files this Reply Brief as permitted by the Utah Public Service Commission.

I. DEPRECIATION METHOD

URTA is very concerned about the any change of a company's carefully selected depreciation method when evaluating Utah USF disbursements or rate case proceedings. (T. 302, Lns 18-22). The Division states that normalization of depreciation expense is a bit of an unusual concept. This is true because depreciation by its very nature is the distribution of the cost of a capital asset over its useful life. Therefore, so long as the useful life is accurate, depreciation does not need to be "normalized." As a company adds capital assets depreciation expense goes up. As a company retires assets, depreciation expense goes down. The Division argues that to set a high UUSF now would effectively fund accelerated depreciation of the new capital assets that Carbon is currently installing. This statement is not true and is, in fact, improperly conflating a "high UUSF" with a "high depreciation expense" number. As URTA and Carbon argued in their original Post-Hearing Briefs, the Commission's job in this case (and all UUSF and rate cases) is to determine a test period that the Commission finds best reflects the conditions that a public utility will encounter during the period when the rates (or in this case UUSF distribution) will be in effect.

The Division believes that Carbon's group method of depreciation impermissibly accelerates depreciation and does not accurately reflect the Commission approved useful lives of many of the "assets". The Division, as a result, has reviewed Carbon's depreciation expense under an entirely different depreciation method than that employed by the company for the last 15 years. In effect, the Division is asking the Commission to apply a different set of rules to Carbon retroactively. While URTA can appreciate the concerns that the Division may have about rapidly accelerated depreciation, URTA believes that URTA members should be permitted to use their chosen group asset depreciation method, as prescribed by Part 32 of the code of federal regulations, and if the Commission determines that any modifications are needed to address concerns related to accelerated depreciation expense, the Commission should use adjustments to the average service life as described by Utah Code Annotated Section 54-7-12.1.

The testimony in this case is undisputed that the group depreciation method allows for modifications in the asset life of the group to better match the asset's book value with its actual useful remaining life. Specifically, the FCC method as identified in the Direct Testimony of Hellewell (Hellewell Direct Testimony, Line 223-234) permits component assets to be placed into groups and provides for the adjustment of the remaining lives in group asset accounts to properly reflect changes in the economic life of plant and equipment used to provide telecommunications services as required by Utah Code Section 54-7-12.1.(T. 228, Line 24).

There simply is no reasonable justification for requiring Carbon to employ a different depreciation method in this case.

As previously stated by URTA, URTA is very concerned with the processes employed by the Commission. If the Commission ultimately decides to require URTA members to employ a certain prescribed method of depreciation, the Commission should engage in rulemaking proceeding to provide a uniform policy, and to permit input into the process and the proposed rule from all interested parties.

II. RATE OF RETURN

URTA submits that the use of a hypothetical capital structure for companies who have high levels of debt or high levels of equity is a sound policy. Imputing debt on a company that has none takes into consideration the premise that equity is more costly than debt so that companies should consider cheaper debt financing. The Commission has approved the use of hypothetical capital structure in previous rate cases and the policy is a sound public policy that should continue. If the Commission is opposed to use of the previously used hypothetical capital structure sliding scale, the Commission, can, of course, use a company's actual capital structure in the calculation. In this particular case, Carbon has no debt so the state rate of return would go up significantly. On the other hand, as previously discussed, if the Commission is considering adoption of an optimal capital structure, it is required to do so in a formal rulemaking proceeding under the Utah Administrative Rules Act.

The next issue related to the rate of return in this case is the interstate rate of return that is to be used pursuant to R746-360-8. The Division and Carbon agree that the correct interstate rate of return to use from Form 492 is 11.45% (T. 174, Ln 9). NECA provides two Form 492 reports: one applies to companies in NECA's Common Line pool; and another that applies to companies that participate in traffic sensitive pools (Meredith Surreb., Lns 18-21). Carbon only participates in the NECA common line pool (T. 186, Ln 21-24). Therefore, pursuant to R746-360-8 and NECA, 11.45% is the appropriate interstate rate to use for Carbon. It is not appropriate to use the Form 492 that is not applicable to the applicant.

The last element of the rate of return calculation is return on equity. Carbon proposed a 12.13% return on equity because it was the return on equity approved by the Commission in August of 2014. The Division and the Office base their return on equity rate on CAPM calculations using betas from other companies. CAPM calculations use betas from selected companies, and such betas capture everything the market knows about such company. Thus, the betas are market efficient as to such company. However, when applying a beta from a much larger company to Carbon, adjustments must be made to account for real differences between the companies. Carbon is a much smaller, rural company than the companies used in the Division's CAPM model (Meredith Rev. Reb, Lns 297-300). As a result, the Commission should adjust the CAPM calculation, using, for example, a small company premium to derive a reasonable return on equity for Carbon.

The Division and the Office also argue that telecom companies that participate in a state USF program do not have a risk profile that supports a small company premium or other adjustments. This is not supported by the evidence. The volumes of testimony filed in this matter demonstrate there is no regulatory certainty with regard to UUSF distribution in the State of Utah. Many of the factors used in determining UUSF eligibility are at issue in this case evidencing the uncertainty and costs companies face when requesting UUSF in Utah. Furthermore, as Meredith points out, Drs. Billingsley and Heaton both specifically looked at telephone companies that receive USF funds, and still determined that a small company premium is the minimum adjustment that should be made for such companies. (T. 113, Lns 5-11, T. 139, Lns 4-11). These findings of Dr. Billingsley and Heaton are unrebutted. The fact is, financial publications develop small company premia and other adjustments that financial analysts routinely use for small companies when trying to find an appropriate return on equity from the experience of larger companies.

Finally, the Commission should note that Carbon has taken a very moderate position on return on equity. While it would be completely consistent with financial practice to apply a 5-7% adjustment to the Division and/or Office calculations (See Meredith Rev. Reb., Lns 122-155), Carbon has only suggested a return on equity of 12.13% as recently determined to be just, reasonable by the Commission in Hanksville's 2014 Application. Additionally, NECA's method, unrebutted in this case, of using free cash flow that parallels the DCF method supports Carbon's conservative ROE of 12.13%.

III. CONCLUSION

URTA urges the Commission to carefully weigh the policy and process considerations in this case. Any rule or policy changes should be handled in a statutory rulemaking proceeding under applicable Utah law. The evidence provided by Carbon and URTA demonstrates that the rate of return proposed by Carbon is conservative, just, and reasonable.

Dated this 9th day of March, 2016.

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CERTIFICATE OF MAILING

I hereby certify that a true and correct copy of the Utah Rural Telecom Association's Post-Hearing Reply Brief, Docket No. 15-2302-01 was sent to the following individuals by email and/or mailing a copy thereof via first-class mail, postage prepaid (as indicated), this 9th day of March, 2016:

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