- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Application of Carbon/Emery Telcom, Inc. for an Increase in Utah Universal Service Fund Support	DOCKET NO. 15-2302-01 REPORT AND ORDER

ISSUED: March 31, 2016

SYNOPSIS

The Public Service Commission of Utah (Commission) decreases Carbon/Emery Telcom, Inc.'s (Carbon/Emery) ongoing annual subsidy from the Utah Universal Service Fund (UUSF) by $152,645.70 to a total of $886,068.30 per year through December 31, 2019. Beginning January 1, 2020, the Commission decreases Carbon/Emery's annual subsidy by an additional $185,546.64 to a total of $700,522.26, in the absence of a prior demonstration that the decrease is no longer warranted.

I. Utility History.

Carbon/Emery's last UUSF review was in 2009 (Docket No. 09-2302-01).[1] The case was resolved by stipulation on the basis of a 2008 historical test year. In that test year, Carbon/Emery had an actual capital structure of [redacted]% debt and [redacted]% equity. This actual capital structure was used to calculate the final subsidy.[2]

---

[1] The Commission takes notice of Docket No. 09-2302-01 pursuant to Utah Code § 63G-4-206(1)(b)(iv).

[2] Application for Increase in USF Eligibility, filed September 22, 2009 in Docket No. 09-2302-01, at page 3 ¶ 6. *See also* Report and Order, issued June 24, 2010 in Docket No. 09-2302-01 at page 3: "The revenue requirement and state USF distribution are based on … [Carbon/Emery's] actual capital structure."

Prior to the 2009 stipulation, Carbon/Emery had been receiving $250,714 per year in UUSF subsidy.[3] Pursuant to the stipulation, Carbon/Emery's annual subsidy increased by $788,000 to a total of $1,038,714.[4]

II. Procedural History.

1. On March 27, 2015, Carbon/Emery Telecom (Carbon/Emery) filed this application, requesting an additional $563,262 in annual UUSF subsidy. The application included direct testimony from Brock Johansen, Chief Executive Officer of Carbon/Emery, and from Darren Woolsey, Chief Financial Officer of Carbon/Emery.
2. On April 2, 2015, Carbon/Emery amended its application, increasing the amount of requested additional subsidy from $563,262 to $816,909. The amended application included amended testimony from Mr. Johansen and Mr. Woolsey.
3. On April 24, 2015, Mr. Woolsey filed supplemental direct testimony in support of the amended application.
4. On July 27, 2015, AT&T petitioned to intervene in this docket. On August 12, 2015, both Carbon/Emery and the Division of Public Utilities (Division) filed objections to AT&T's petition. The parties fully briefed the issue and, on September 8, 2015, the Commission issued an order denying AT&T's petition.
5. On August 21, 2015, the Division and the Utah Office of Consumer Services (Office) filed direct testimony. William Duncan, Telecommunications Manager; Casey J.

---

[3] Stipulation of the parties, filed May 20, 2010 in Docket No. 09-2302-01, at page 2 ¶ 6.

[4] *Id*.

Coleman, Financial Analyst; and Joseph Hellewell, Utility Analyst, testified for the Division. Bion C. Ostrander and David Brevitz testified as expert witnesses for the Office.

6. On August 28, 2015, the Utah Rural Telecom Association, Inc. (URTA) petitioned to intervene in this docket. No party opposed the petition, which the Commission granted on September 18, 2015.
7. On September 4, 2015, all parties filed rebuttal testimony. Mr. Woolsey and Douglas Meredith filed testimony for Carbon/Emery. Mr. Duncan and Mr. Hellewell filed testimony for the Division. Mr. Brevitz filed testimony for the Office. On September 15, 2015, Mr. Woosley filed erratum rebuttal testimony.
8. On September 11, 2015, Carbon/Emery filed a motion for partial summary judgment concerning the proper allocation of fiber- and internet-related common costs between Carbon/Emery and its non-regulated affiliates. This motion was not briefed by the parties or adjudicated by the Commission. Rather, on September 18, 2015, the parties agreed to withdraw the issue and to revise their testimony of record accordingly. The Commission approved the parties' agreement in a September 21, 2015 order, which the Commission amended for clarification on October 26, 2015.
9. On September 18, 2015, Mr. Meredith filed direct testimony for URTA, and all other parties filed surrebuttal testimony. Mr. Woolsey and Mr. Meredith filed testimony for Carbon/Emery. Mr. Duncan, Mr. Coleman, and Mr. Hellewell filed testimony for the Division. Mr. Ostrander and Mr. Brevitz filed testimony for the Office.

10. Also on September 18, 2015, Carbon/Emery filed a motion for partial summary judgment concerning its depreciation methodology and the Division's proposed adjustment to its depreciation calculation. The parties fully briefed the motion, and the Commission issued an order on October 15, 2015.
11. On October 28, 2015, Carbon/Emery filed a petition for review and clarification of the Commission's October 15, 2015 order regarding depreciation. The Commission granted the petition and issued an amended order on November 24, 2015.
12. On December 17, 2015, the parties filed revised versions of previously-filed testimony, as contemplated in the Commission's October 26, 2015 order, through which the parties were granted leave to withdraw information and argument of record relative to how Carbon/Emery's common costs should be allocated between regulated and non-regulated operations. Mr. Ostrander and Mr. Brevitz revised their direct testimony. Mr. Woolsey, Mr. Meredith, Mr. Duncan, and Mr. Ostrander all revised their rebuttal testimony. Mr. Ostrander also revised his surrebuttal testimony.
13. On December 18, 2015, Mr. Woolsey filed sur-surrebuttal testimony for Carbon/Emery.
14. On January 15, 2016, Mr. Hellewell filed sur-surrebuttal testimony for the Division.
15. In the process of filing pre-hearing testimony, Carbon/Emery revised its position, ultimately requesting that its annual UUSF subsidy be increased by $570,643.
16. On January 19, 2016, all parties filed final witness and exhibit lists for hearing.

17. On January 21, 2016, the Commission notified the parties that they would be required to address at hearing whether a continued or increased subsidy to Carbon/Emery would comply with the following statutory language:
    a. Utah Code § 54-8b-6, which prohibits Carbon/Emery from using UUSF funds to subsidize its non-regulated activities;
    b. Utah Code § 54-8b-15(6)(a), which restricts the Commission from disbursing UUSF funds for any purpose other than cost recovery of basic telephone service; and
    c. Utah Code § 54-8b-15(5), which prohibits any UUSF subsidy that would provide Carbon/Emery with a competitive advantage over any other telecommunications provider in Utah.
18. The hearing in this docket was conducted on January 26-27, 2016. Carbon/Emery was represented by Kira Slawson, accompanied by Mr. Johansen, Mr. Woolsey, and Mr. Meredith as witnesses. The Division was represented by Justin Jetter, accompanied by Mr. Duncan, Mr. Coleman, and Mr. Hellewell as witnesses. The Office was represented by Robert Moore, accompanied by Mr. Ostrander and Mr. Brevitz as witnesses. URTA was represented by Kira Slawson, accompanied by Mr. Meredith as witness.
19. No public witnesses appeared at the public hearing portion of the proceeding to offer comments or testimony.

20. At hearing, the parties agreed to provide closing argument by post-hearing brief. On March 2, 2016, the parties filed their closing argument briefs. On March 9, 2016, each party filed a final reply brief.
21. In its closing argument brief, the Office made several errors in its numerical calculations. Therefore, on March 7, 2016, it submitted an errata sheet to provide corrected numbers. At least two of the corrected numbers do not appear elsewhere in testimony.
22. On March 9, 2016, Carbon/Emery and URTA jointly filed an objection to the Office's errata sheet, moving to strike any numbers not supported by testimony.
23. On March 14, 2016, the Office responded to the objection. In brief, the Office agreed that any numbers not supported by testimony are subject to being stricken.

III. Motion to Strike the Office's Errata Sheet.

This docket presents several issues as to which each party has taken a different position. Where the contested issues are interrelated, an adjustment to one affects other equations in the overall UUSF calculation. We do not adopt any party's position in full. Therefore, it is necessary for us to make the calculations independently. The Office's errors are irrelevant.

We grant the joint motion of Carbon/Emery and URTA to strike any numbers in the Office's March 7, 2016 errata sheet that are not supported by testimony of record.

IV. We Adopt the Following Undisputed Facts and Issues as Commission Findings.

1. Carbon/Emery's UUSF subsidy will be calculated based on a 2014 historical test year.

2. Carbon/Emery provides both intrastate and interstate services; [redacted]% of Carbon/Emery's operations are intrastate, and [redacted]% are interstate.
3. Carbon/Emery has no debt. The last time Carbon/Emery had debt, its weighted average cost of debt was 5.636%.
4. Carbon/Emery is a wholly-owned subsidiary of a cooperative (Emery Telephone Cooperative). Carbon/Emery is not publicly traded. Carbon/Emery has never made a public offer of stock or shares.
5. Carbon/Emery participates in only one of the National Exchange Carriers Association (NECA) common line services cost pools. The September 30, 2014 NECA Form 492 (NECA 492) reports this cost pool's earned rate of return at 11.45%. Carbon/Emery provides special and switched access services, and has chosen not to participate in the associated NECA cost pools. The NECA 492 reports the blended rate of return, which applies to telecommunications companies that participate in all three pools, at 9.4%.
6. Historically, Carbon/Emery's telecommunications network has been comprised of aerial and buried copper cable, which at all relevant times has been adequate to provide basic telephone service. Carbon/Emery's copper network is not fully depreciated.
7. Carbon/Emery faces intermodal competition for basic telephone service from wireless and voice over internet protocol (VoIP) providers. In recent years, Carbon/Emery has seen a decline in customer demand for local exchange basic telephone service.

8. To continue selling local exchange service in the face of competition from wireless and VoIP providers, Carbon/Emery offers bundled services. When customers purchase bundles, they receive local exchange service along with internet service and/or cable television.
9. Internet service and cable television services are not regulated by the Commission, nor are they eligible for subsidy from the UUSF.
10. To deliver internet and cable television services, Carbon/Emery has undertaken a fiber-to-the-home (FTTH) network upgrade. Carbon/Emery estimates that, within the next three to five years, it will have placed FTTH to approximately [redacted]% of its customers.
11. Carbon/Emery's test year costs for plant under construction, materials, and supplies are unusually high due to the FTTH buildout.
12. Carbon/Emery will continue to provide basic telephone service over its FTTH network.
13. The $[redacted] test year rate base, as set forth by Carbon/Emery in its amended application, is subject to a $[redacted] decrease when long-term liabilities are removed from the calculation.
14. Carbon/Emery's $[redacted] total test year operating revenue calculation, as set forth in its amended application, is subject to the following adjustments:

a. An increase of $[redacted], representing new cable television customers. This number is subject to further adjustment on the Commission's determination of Carbon/Emery's allowed rate of return.

b. An increase of $[redacted], arrived at through true-up of Carbon/Emery's DSL revenue.

15. Carbon/Emery calculates its total test year operating expenses at $[redacted].

V. Disputed Issues.

In crafting this order, we generally cite to numbers set forth by the parties in their pre-hearing testimony. We note, however, that many disputed issues are interrelated. As we adjust one calculation, the result changes other calculations in the overall revenue requirement and expense equations. Therefore, we take from the parties' testimony various methodologies for making adjustments, but we independently calculate the final effects of those adjustments.

1. Return on Rate Base.

A. Intrastate Rate of Return.

In fixing Carbon/Emery's intrastate rate of return, the Commission must evaluate the utility's cost of debt, its cost of equity, and its capital structure.

i. Cost of Debt.

We accept and approve the parties' agreement that, in imputing debt to Carbon/Emery, we should use 5.636% as the cost of debt.

ii. Cost of Equity.

Carbon/Emery argues in its amended application that its cost of equity should be set at 12.13%, which is a stipulated value in a case involving a different utility. Carbon/Emery has offered no cost of equity data pertaining to its operations or other empirical support for 12.13% as a reasonable cost of equity.

Each rural telecommunications company in Utah has unique capital circumstances and risks, which vary over time. The cost of equity approved for one utility does not constitute precedent in a subsequent docket involving a different company.[5] Rather, the cost of equity must be evaluated in each case, with due consideration given to the business, financial, and regulatory risks the utility under consideration faces and to current financial market conditions. Carbon/Emery has not adequately demonstrated relevant empirical support for its request for a 12.13% cost of equity.

The Division has calculated the cost of equity through an unadjusted Capital Asset Pricing Model (CAPM) calculation, using test-year data from publicly-traded telecommunications companies with profiles at least somewhat similar to Carbon/Emery's. Under the Division's methodology, Carbon/Emery's cost of equity is 10.75%. The Office calculates a 10% cost of equity using similar market data, but rejecting some of the companies evaluated by the Division as being unreasonably dissimilar to Carbon/Emery.

In resisting the CAPM calculation, Carbon/Emery cites to scholars who have analyzed the CAPM as it relates to small companies. Emphasizing that small companies tend to have less

---

[5] *See* Utah Administrative Code R746-100-10(F)(5)(a): "Cases may be resolved by a settlement of the parties if approved by the Commission. Issues so resolved are not binding precedent in future cases involving similar issues."

liquidity, reduced access to equity markets, and a more difficult time attracting equity investors, these scholars advocate for various premiums to be applied in the CAPM calculation.

While the theory and analysis proffered by Carbon/Emery may apply to some small companies, we find them inapplicable to Carbon/Emery, which benefits from the UUSF. The fact that Carbon/Emery has retired all of its debt in the last six years and funded an aggressive FTTH program provides compelling evidence that it has ample access to capital. Moreover, UUSF capital is essentially cost-free to Carbon/Emery. Thus, the premium Carbon/Emery seeks to apply to the CAPM result is unjustified. Given the foregoing, and noting that we have approved the use of an unadjusted CAPM calculation in previous dockets, we find the methodology and analysis set forth by the Division and the Office to be just and reasonable, and we adopt that methodology and analysis.

We understand the Office's concerns regarding some of the companies whose market data have been used to complete the Division's CAPM calculation. However, we note that no single publicly-traded company will be a particularly good match to Carbon/Emery. The Division has chosen an acceptable pool of comparable companies—some of which drive the calculation downward and some of which push it upward. Where no pool of publicly-traded companies will perfectly reflect the circumstances of a utility with UUSF access, we see little value in attempting to weight the dissimilarities that appear within the pool. Therefore, we adopt the Division's 10.75% cost of equity calculation.

iii. Capital Structure.

Since receiving its 2009 increase in UUSF subsidy, Carbon/Emery has funded all of its capital requirements through retained earnings. Additionally, it has generated sufficient earnings to retire all of its pre-existing debt without raising new capital. Whereas its capital structure in 2008 consisted of [redacted]% debt and [redacted]% equity, its current capital structure is 100% equity. Therefore, consistent with past positions, both Carbon/Emery and the Division recommend that the UUSF subsidy in this case be calculated according to a hypothetical capital structure of 65% equity and 35% debt. The Division emphasizes that this recommendation is consistent with a recommendation generated by a 2008 task force that studied the capital requirements of rural telecommunications companies in Utah.

The Office recommends a hypothetical capital structure of 50% equity and 50% debt. In making this recommendation, the Office emphasizes that the Commission declined to adopt the 2008 task force's recommendation into rule, stating that such a rule would run contrary to Title 54, which requires the Commission "to make its [capital structure] determination based upon the evidence presented in adjudicative proceedings, based on the circumstances facing each company and relevant to the time in which rates will be effective."[6] In addition, the Office has presented evidence indicating that it is generally easier and more affordable for a utility such as Carbon/Emery to find a lender, as opposed to finding public investors. According to the Office's data, companies that are at least somewhat similar to Carbon/Emery typically had debt ratios of at least 43.79% during the test year, and at least one similar company had a debt ratio of 97.25%.

[6] October 27, 2008 letter from Julie Orchard, Commission Secretary, to Phil Powlick, Director of the Division of Public Utilities, on file in this docket as Office Exhibit 2R-2.

We have declined to adopt a rule that would establish a hypothetical capital structure for rural telecommunications companies with high levels of equity. In this case, it is notable that Carbon/Emery has made substantial progress in realizing its FTTH objective without taking on debt or issuing stock. If the utility were required to take such steps, it would have an incentive to keep capital costs within a prudent range. In contrast, one impact of Carbon/Emery funding its entire network upgrade through retained earnings—a strategy which is at least partially enabled by its UUSF subsidy—is that its capital structure does not reflect an appropriate mix of capital sources. A public utility is obligated to provide service efficiently, including using a prudent level of debt as a lower cost source of capital than equity. Carbon/Emery's 100% equity capital structure causes its weighted cost of capital to be too high.

Given the foregoing, we impute debt to Carbon/Emery through the use of a hypothetical debt/equity structure. However, we find the capital structure advocated by the Division and Carbon/Emery to lack evidentiary support. The Office's data show that reasonably comparable non-subsidized telecom companies had debt positions of at least 43.79% during the test year. Carbon/Emery had a very similar debt position of [redacted]% in its 2009 docket. Accordingly, we find a hypothetical capital structure of 43.79% debt and 56.21% equity to be just and reasonable.

iv. Composite Intrastate Rate of Return.

We calculate Carbon/Emery's composite intrastate rate of return at 8.511% as follows:

	Rate of Return	Hypothetical Capital Structure	Adjusted Weighted Rate of Return
Equity	10.75%	56.21%	6.043%
Debt	5.636%	43.79%	2.468%
Composite Intrastate Rate of Return			**8.511%**

B. Interstate Rate of Return.

Utah Admin. Code R746-360-8(A)(1)(a)(i) states, in relevant part:

> 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 … use the prior year return reported by the National Exchange Carriers Association (NECA) to the Federal Communications Commission (FCC) on FCC Form 492 for Incumbent telephone corporations that do separations between intrastate and interstate jurisdictions under 47 CFR Part 36.

The NECA 492 under consideration in this docket reports two different rates of return—11.45% as the stand-alone rate for common line services, and 9.4% as the blended rate for common line, special, and switched access services. The question before the Commission is which of those two rates of return applies to Carbon/Emery.

Carbon/Emery and the Division agree that the Commission should apply the 11.45% return because Carbon/Emery does not participate in NECA's special and switched access cost pools. In contrast, the Office argues that Carbon/Emery has voluntarily and unilaterally withdrawn from the special and switched access cost pools, even though it provides those services. The Office argues that Carbon/Emery's participation in a given cost pool is irrelevant under the language of the rule. If, in fact, Carbon/Emery provides all three services, then the NECA blended rate must be used.

Our administrative rule does not contemplate that the NECA 492 will report more than one rate. While the Office's interpretation of the rule is understandable, we conclude that the interpretation of Carbon/Emery and the Division is reasonable. Given these circumstances, we find

Carbon/Emery's 11.45% interstate rate of return in this instance to be just and reasonable. We apply this rate of return to the [redacted]% of Carbon/Emery's operations that are interstate.

C. Overall Rate of Return.

We calculate Carbon/Emery's overall rate of return to be 9.697% as follows:[7]

	Separation Factor	Rate of Return	Weighted Average Rate of Return
Intrastate	[redacted]%	8.511%	[redacted]%
Interstate	[redacted]%	11.45%	[redacted]%
Total	**100%**		**9.697%**

2. Rate Base.

A. Plant under Construction, Materials, and Supplies.

Carbon/Emery's test year costs for construction, including materials and supplies, are unusually high due to the FTTH buildout. It is a standard ratemaking principle to normalize high levels of spending, if such levels are known to be temporary.[8] Otherwise, a utility will begin over-earning upon completing an upgrade or other significant construction project. For this reason, the Office recommends removing 50% of plant under construction and 50% of materials

[7] Prior to hearing, Carbon/Emery filed rebuttal argument about a free cash flow methodology that has been developed by NTCA—The Rural Broadband Association. In rebuttal, Carbon/Emery claims that NECA has used the NTCA methodology to calculate an 11.75% median overall rate of return for rural carriers. As rebuttal rather than direct testimony, we find the information regarding the NTCA methodology relevant for the limited purpose of demonstrating that methods other than the CAPM might be used to calculate an overall rate of return. It does not necessarily follow that a different method should be used. Where we have previously approved use of the unadjusted CAPM methodology for calculating cost of equity; where Carbon/Emery did not advocate for any methodology in its direct testimony; and where we have not seen a thorough vetting of the NTCA methodology, we decline to adopt it or to view it as discrediting the Division's CAPM result.

[8] *See* Utah Administrative Code R746-700-40(A)(2): "An applicant submitting a general rate case application shall provide …[a]djusted results of operations for [an historical 12-month period.] These adjustments shall include, but are not limited to, normalization adjustments[.]"

and supplies from Carbon/Emery's rate base. The Office bases this recommendation on financial records showing that Carbon/Emery's annual investment costs prior to the FTTH buildout were about 50% lower than during the test year. [9]

Carbon/Emery recognizes that its test year investments are unusually and temporarily high, but emphasizes that the expenditures also are necessary to complete the upgraded FTTH network. In addition, Carbon/Emery argues that similar expenditures will be needed through approximately 2019 to complete the majority of the network upgrade.

Both arguments have merit. We therefore find it reasonable to allow the full amount of Carbon/Emery's test year investment for plant under construction, materials, and supplies for the time Carbon/Emery estimates it will take to complete [redacted]% of its FTTH buildout.[10] However, on January 1, 2020, if Carbon/Emery's UUSF subsidy has not again come before us for review, the UUSF subsidy shall be automatically reduced to reflect a 50% lower level of test year plant under construction, materials, and supplies. Accordingly, on January 1, 2020, $[redacted] will be deducted from Carbon/Emery's plant under construction account, and $[redacted] will be deducted from its materials and supplies account. If, in 2018, Carbon/Emery believes these reductions should not be made, it may file a petition with supporting testimony demonstrating why, in its view, the 2014 cost levels should be retained.

---

[9] The Division has taken no position on this issue.

[10] While we understand that Carbon/Emery desires to place FTTH to every customer, we do not have before us evidence sufficient to demonstrate that the high per-customer costs of placing fiber to the most remote locations in Carbon/Emery's service area are justified, prudent, and in the public interest, particularly where reliable basic telephone service is in place. Therefore, on the record before us, we cannot recognize the anticipated expenditures beyond 2019. *See* Utah Administrative Code R746-360-9.

B. Adjustments to Rate Base Deriving from Adjustments to Depreciation Expense.

The Division argues that, for every decrease to depreciation expense, there must be a corresponding increase to rate base. While acknowledging this principle, the Office argues that any increase to rate base should be 50% of the depreciation adjustment to normalize Carbon/Emery's rate base, which the Office sees as containing unnecessary assets.

While we understand the Office's concern, we find the record does not support the 50% adjustment. Because the adjustment percentage appears to be arbitrary, we reject it and apply the Division's methodology for correlating rate base and depreciation expense. As explained below, we accept the Division's vintage depreciation adjustment and make a corresponding increase of $[redacted] in rate base.

C. Total Rate Base.

We calculate Carbon/Emery's total test year rate base to be $[redacted]. Beginning January 1, 2020, we calculate a total rate base of $[redacted], due to the reduced levels of plant under construction, materials, and supplies noted in Section (V)(2)(A) above.

3. Expenses.

A. Depreciation.

This issue has been briefed by the parties at length due to Carbon/Emery's September 18, 2015 motion for partial summary judgment. The Commission has previously issued an order rejecting Carbon/Emery's argument that its depreciation calculation may not be adjusted through application of a single-asset straight-line methodology. We will not repeat here the analysis and explanations set forth in that order.[11]

Carbon/Emery has many assets that are fully depreciated, yet remain in service. For purposes of calculating depreciation expense, Carbon/Emery does not remove fully-depreciated units from its asset groups until they are taken out of service. Therefore, when a new unit is added to a group containing fully-depreciated units, the total amount of depreciation expense increases beyond what is needed to pay for the new unit over its Commission-ordered depreciable life, raising the possibility of over-recovery in the long run.

Carbon/Emery does not dispute that its chosen method of implementing group depreciation accelerates recovery of its investment at rates that exceed those set by this Commission and that its current depreciation method will fully depreciate all of its existing assets in approximately five years. Moreover, Carbon/Emery acknowledges that its group depreciation method will result in expense over-recovery unless the Division closely monitors Carbon/Emery's earnings and asks the Commission to reset the depreciation expense before such over-recovery occurs. Carbon/Emery nevertheless defends its group depreciation method on four bases.

---

[11] Carbon/Emery claims Utah Code § 54-7-12.1 as further support for its argument against any use of single-asset straight-line depreciation. Section 54-7-12.1 states; "In determining the depreciation expense … in any proceeding under Section 54-7-12, the commission shall consider all relevant factors, including the alteration of asset lives[.]" Carbon/Emery urges that this statutory language mandates that we calculate any adjustment to depreciation expense by altering asset lives, at the exclusion of any other methodology. First, we note that this is not a proceeding under Section 54-7-12, which deals exclusively with rate increases and decreases. Second, if the statute were applicable, its plain language would mandate that we consider altering asset lives, but would not require us to do so, nor would it bar us from considering all other relevant factors.

First, Carbon/Emery, with support from URTA, argues that its methodology qualifies as group asset depreciation, which is preferred by the Federal Communications Commission (FCC). Therefore, Carbon/Emery and URTA consider that it would be improper for this Commission to impose a different depreciation methodology unless it also enacts rules and allows for a transition period. We have rejected this argument in our order denying Carbon/Emery's motion for partial summary judgment. We emphasize that our adjustment to Carbon/Emery's depreciation expense calculation is limited to this docket and the depreciation expense levels Carbon/Emery seeks to justify.

Second, Carbon/Emery argues that recovering its investment on an accelerated basis also removes assets from its rate base on an accelerated basis, thereby reducing the impact to the UUSF over time. However, according to Carbon/Emery's testimony at hearing, its FTTH buildout will continue for several years, with new assets being acquired more quickly than the rate at which existing assets lose service utility. Therefore, we cannot find it likely that Carbon/Emery's rate base will shrink any time soon. In these circumstances, we decline to depart from the fundamental ratemaking principle that, generally, an asset's depreciable life should match—as closely as practicable—its actual service life.

Third, Carbon/Emery argues that dollars recovered through depreciation are re-invested in the utility, thereby resulting in a benefit, presumably as a no-cost source of capital. The benefit of the FTTH build-out, however, goes to customers whose rates, by statute, may not be subsidized through the UUSF. Therefore, the UUSF may not legally serve as the source of the investment capital that Carbon/Emery seeks to obtain through accelerated depreciation.

Fourth, Carbon/Emery argues that each asset group should be viewed as if it were a single machine. In other words, Carbon/Emery considers that, when a new unit is added to the group, the unit becomes incorporated into the whole, outside of which it has no use. Therefore, Carbon/Emery argues that the new unit must be depreciated along with the whole, even if doing so decreases the total time over which the new unit is depreciated.

Many of Carbon/Emery's asset groups do not function as a "single machine." For example, if an asset group containing poles is supplemented with a new unit, the new pole has no effect on the service life of another pole in the group, which might have been installed 20 years earlier. Similarly, the age of the other poles has no bearing on how quickly the new pole loses utility. We recognize that each asset functions uniquely and that some group assets might be rendered more useful by the addition of a new unit. However, with such a group asset, the capitalization of the new unit should be accompanied by a recalculation of the remaining undepreciated book value of the group, with the total value then being depreciated according to the Commission-approved schedule. Rather than recalculating a group asset's book value when the inclusion of a new unit extends a group asset's life, Carbon/Emery uses the older units to shorten the depreciable lives of new units.

We conclude that Carbon/Emery's depreciation method has the effect of unjustifiably accelerating depreciation of its plant. That acceleration, while helpful in funding the FTTH network upgrade, is not a permissible or appropriate use of UUSF. We therefore turn to the question of how to adjust Carbon/Emery's depreciation calculations so that its depreciation expense reasonably matches the useful lives of its assets, and so that UUSF is not improperly subsidizing investment in assets whose primary purpose is not basic telephone service.

The Division has used a single-asset straight-line depreciation method to calculate a $[redacted] decrease in Carbon/Emery's test year depreciation expense. The Division has also calculated an alternative adjustment by reconfiguring Carbon/Emery's asset groups according to vintage, then applying group asset depreciation, and thereby decreasing test year expenses by $[redacted].

The Office takes a somewhat different approach. It has eliminated, from two of Carbon/Emery's asset groups,[12] all units that are fully depreciated or that will be fully depreciated in two to three years. It then has used group asset depreciation to calculate a $[redacted] decrease in test year expenses.

We find the Office's approach somewhat subjective, both in its identification of asset groups to consider and in its choice of units to exclude. Therefore, we focus on the Division's calculations. We are satisfied that the Division's vintage methodology complies with both the FCC's group asset methodology and the depreciation schedules we have set for Carbon/Emery's assets. In addition, at hearing, Carbon/Emery testified that it does not accelerate depreciation on assets allocated to the non-regulated side of its operations. For those operations, Carbon/Emery uses a group depreciation method similar to the Division's vintage methodology. In other words, the record before us shows the vintage group methodology we adopt for purposes of re-evaluating Carbon/Emery's UUSF subsidy is similar to the methodology Carbon/Emery currently

[12] We note that there are over 20 asset groups on Carbon/Emery's financial records.

uses for its unregulated operations. In making this downward depreciation expense adjustment, we also make a corresponding adjustment to increase rate base.

B. Corporate overhead.

In allocating test year overhead between regulated and non-regulated operations, Carbon/Emery has used its 2011 billing records as the sole factor to allocate accounting and general costs—which include compensation for the chief executive officer, public relations/marketing personnel, and board of directors. Using billing records, Carbon/Emery calculates that [redacted]% of its accounting and general costs are incurred to support regulated operations. Carbon/Emery also calculates that [redacted]% of its customer service costs are incurred to support regulated operations.

The Office does not credit the utility's 2011 billing records as accurately reflecting how the utility's chief executive officer, its board of directors, and its public relations/marketing employees spent their time on a daily basis during the test year. If these personnel did not spend the majority of their time planning, implementing, marketing, and supporting basic telephone service, then the Office considers that a majority of the utility's corporate overhead should be allocated to its non-regulated operations.[13] The Office considered the 2011 billing records and four additional allocation factors: revenues, operating expenses, net plant, and payroll. From this analysis, the Office concludes that $[redacted] of Carbon/Emery's test year corporate overhead should be allocated to non-regulated operations.

---

[13] The Division has taken no position on this issue.

While we recognize there might be value in using multiple factors to develop a methodology for allocating fixed, joint, and common costs such as overhead, we are not persuaded that the Office's specific method is superior to Carbon/Emery's. We also note Carbon/Emery's testimony that at least one of the Office's additional factors has a negligible effect on the overall calculation. Given the foregoing, and noting that the Division does not contest Carbon/Emery's cost allocations, we will not apply the Office's adjustment in this case, but we remain open to receiving additional support for allocation factors in future cases.

4. Expected Revenue

A. Migration of Cable Television Customers.

The parties agree that additional net revenue must be added to Carbon/Emery's revenue forecast to represent new accounts that will transition from Carbon/Emery's cable network to the new FTTH network as the buildout takes place. In testimony, the parties agree on the methodology for making this adjustment. Applying the adopted 9.697% overall rate of return, and using this same methodology, we calculate a total of $[redacted] in new revenue.

B. Projected Decline in Access Lines.

In its amended application, Carbon/Emery states that revenues are expected to decrease through December 31, 2017, as customers choose to forego telecom access lines in favor of cellular or VOIP service. However, in the test year, Carbon/Emery's actual access line losses were less than projected.

Given Carbon/Emery's incorrect forecast of future reductions in access lines, the Office recommends against adjusting Carbon/Emery's test year revenue to account for any anticipated access line declines. The Office considers any such adjustment to be unknown, unmeasurable, and unduly speculative, particularly where it extends three years beyond the test year. The Division considers it appropriate to make the adjustment, and agrees with Carbon/Emery's access line reduction numbers and the concomitant reduction in forecast revenues.

Line counts are decreasing for most telecommunications utilities; the losses are real and should be reflected in this docket. In making the adjustment, we find it appropriate to use the numbers generated from the actual test year rate of loss, forecasted to the rate effective period, as set forth by the Division and Carbon/Emery.

C. Operating Income.

Based on our adjustments to this point and including Carbon/Emery's current UUSF subsidy level, we calculate total expected revenue of $[redacted]. We calculate Carbon/Emery's expenses to be $[redacted]. In sum, we calculate Carbon/Emery's pre-tax operating income to be $[redacted], which amount is subject to state and federal taxation.

5. Interest Synchronization.

Before taxes are calculated, interest expense, if any, should be deducted. The Office has argued for imputed interest expense based on the hypothetical capital structure approved in this docket.

As noted above, utilities have an obligation to provide service at a reasonable cost and with appropriate efficiency. That a utility chooses to meet its capital requirements with 100% equity does not entitle it to pass the associated higher capital costs on to ratepayers or to receive higher than necessary UUSF subsidies. Therefore, we find the Office's adjustment to be appropriate, and we flow through to all relevant calculations the hypothetical capital structure of 43.79% debt and 56.21% equity. We calculate an interest expense of $[redacted], resulting in total taxable income of $[redacted].

6. Taxes.

Carbon/Emery and the Office do not dispute the method for calculating taxes. Income taxes on $[redacted] totals $[redacted] ($[redacted] in state taxes and $[redacted] in federal taxes). Therefore, we calculate Carbon/Emery's net income after tax at $[redacted].

7. Allowed UUSF Subsidy. [14]

Given the foregoing, we conclude that Carbon/Emery's test year income was $[redacted] more than its revenue requirement. In other words, it over-earned by that amount in relation to the cost of capital we adopt in this order. Accounting for the gross-up factor for taxation, Carbon/Emery's over-earning requires a reduction of $152,645.70 in the current annual UUSF subsidy. We further conclude that, beginning in 2020, the reduction in plant under construction, materials, and supplies discussed above will result in Carbon/Emery over-earning by $[redacted] (an incremental change of $[redacted]), requiring a reduction from the current UUSF subsidy of $338,191.74 (an incremental change of $185,546.04).

ORDER

Based on the findings and conclusions set forth in this order, and accounting for taxation gross-up effects, we authorize a total annual UUSF disbursement to Carbon/Emery of

---

[14] Carbon/Emery has not yet submitted to the Division its costs for this case. That matter will be adjudicated separately.

$886,068.30, which equates to a monthly disbursement of $73,839.10, beginning immediately and ending December 31, 2019. Beginning January 1, 2020, we reduce the total annual disbursement to $700,522.26, which equates to a monthly disbursement of $58,376.86.

DATED at Salt Lake City, Utah, March 31, 2016.

/s/ Jennie T. Jonsson
Administrative Law Judge

Approved and confirmed March 31, 2016 as the Order of the Public Service Commission of Utah.

/s/ Thad LeVar, Chair

/s/ David R. Clark, Commissioner

/s/ Jordan A. White, Commissioner

Attest:

/s/ Gary L. Widerburg
Commission Secretary
DW#272825

Notice of Opportunity for Agency Review or Rehearing

Pursuant to Utah Code Ann. §§ 63G-4-301 and 54-7-15, a party may seek agency review or rehearing of this order by filing a request for review or rehearing with the Commission within 30 days after the issuance of the order. Responses to a request for agency review or rehearing must be filed within 15 days of the filing of the request for review or rehearing. If the Commission fails to grant a request for review or rehearing within 20 days after the filing of a request for review or rehearing, it is deemed denied. Judicial review of the Commission's final agency action may be obtained by filing a Petition for Review with the Utah Supreme Court within 30 days after final agency action. Any Petition for Review must comply with the requirements of Utah Code Ann. §§ 63G-4-401, 63G-4-403, and the Utah Rules of Appellate Procedure.

CERTIFICATE OF SERVICE

I CERTIFY that on March 31, 2016, a true and correct copy of the foregoing was served upon the following as indicated below:

By E-Mail:

Kira Slawson (kiram@blackburn-stoll.com)
Counsel for Carbon/Emery Telcom, Inc.

Brett N. Anderson (bretta@blackburn-stoll.com)
Blackburn & Stoll, LC

Vicki Baldwin (vbaldwin@parsonsbehle.com)

Sharon Bertelsen (bertelsens@ballardspahr.com)

Larry Bowman (larry.bowman@charter.com)

Brian W. Burnett (brianburnett@cnmlaw.com)

(cflregulatory@chartercom.com)

Eddie L. Cox (ecox@cut.net)

William J. Evans (wevans@parsonsbehle.com)

James Farr (james.farr@centurylink.com)

Amy Gross (agross@tminc.com)

Alan Haslem (ahaslem@mleainc.com)

Ray Hendershot (ray.hendershot@beehive.net)

William Huber (William.huber@questar.com)

Bill Hunt (williamp.hunt@dish.com)

David R. Irvine (Drirvine@aol.com)

Kristin L. Jacobson (Kristin.l.jacobson@sprint.com)

Brock Johansen (bjohansen@emerytelcom.com)

Dawn Kubota (kubotad@ballardspahr.com)

Jasen Lee (jlee@desnews.com)

Kirk Lee (kirk.lee@ftr.com)

Shirley Malouf (srmalouf@stoel.com)

Jennifer H. Martin (jhmartin@stoel.com)

Stephen F. Mecham (sfmecham@gmail.com)

Gregory Monson (gbmonson@stoel.com)

Sharon Mullin (slmullin@att.com)

Thorvald Nelson (tnelson@hollandhart.com)

Janice Ono (Janice.ono@att.com)

Sheila Page (spage@utah.gov)

Mike Peterson (mpeterson@utahcooperatives.org)

Pam Pittenger (pam.pittenger@ftr.com)

Jenny Prescott (jenny.prescott@allwest.com)

Bruce Rigby (bruce@ucmc-usa.com)

Gary Sackett (gsackett@joneswaldo.com)

Alan L. Smith (alanakaed@aol.com)

Ted D. Smith (tsmithlaw@earthlink.net)

Joe Solana (compliancemanager@gsaudits.com)

Kendra Thomas (kthomas@kfrservices.com)

Bruce H. Todd (btodd@stratanetworks.com)

Jake Warner (jakew@beehive.net)

James H. Woody (jwoody@union-tel.com)
John Woody (jowoody@union-tel.com)
Union Telephone Company

Patricia Schmid (pschmid@utah.gov)
Justin Jetter (jjetter@utah.gov)
Rex Olsen (rolsen@utah.gov)
Robert Moore (rmoore@utah.gov)
Utah Assistant Attorneys General

By Hand-Delivery:

Division of Public Utilities
160 East 300 South, 4th Floor
Salt Lake City, Utah 84111

Office of Consumer Services
160 East 300 South, 2nd Floor
Salt Lake City, Utah 84111

____
Administrative Assistant