Kira M. Slawson (7081)
BLACKBURN & STOLL, L.C.
Attorneys for Utah Rural Telecom Association
257 East 200 South, Suite 800
Salt Lake City, Utah 84111
Telephone: (801) 521-7900

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 PETITION FOR REVIEW, REHEARING OR RECONSIDERATION OF THE COMMISSION'S MARCH 31, 2016 ORDER DOCKET NO. 15-2302-01

Pursuant to §§ 54-7-14.5, 54-7-15, and 63G-4-301 of the Utah Code, and R746-100-11(F) of the Utah Administrative Code, Utah Rural Telecom Association, Inc. ("URTA") respectfully petition's the Utah Public Service Commission's (the "Commission") to review, rehear, or reconsider the issues enumerated below from its March 31, 2016 Report and Order (the "Order").

I. INTRODUCTION

On January 26 and 27, 2016, the Commission held a hearing (the "Hearing") on Carbon's Application for an Increase in Utah Universal Service Fund ("UUSF") Support. Carbon, the Division of Public Utilities (the "Division"), the Office of Consumer Services (the "Office"), and the Utah Rural Telecom Association ("URTA") pre-filed written testimony and presented

evidence on numerous disputed issues at the Hearing. At the conclusion of the Hearing the parties submitted Closing Arguments in writing.

On March 31, 2016, the Commission issued the Order. After reciting the Procedural History, the Commission adopted certain "Undisputed Facts and Issues as Commission Findings." (Order P. 6). URTA takes exception to certain of the "Undisputed Facts and Issues" because the evidence in the record demonstrates certain of these "undisputed facts" are disputed. These will be discussed below in Section II(A).

Turning to what the Commission terms the "Disputed Issues" in the Order, the Commission ruled on: (1) the cost of debt; (2) the cost of equity; (3) a capital structure to be imputed to Carbon; (4) the appropriate interstate rate of return; (5) Carbon/Emery's overall rate of return; (6) test year investments, including telephone plant under construction ("TPUC"), materials and supplies are reasonably allowed in rate base; (7) Carbon's depreciation expense for the test year; (8) Carbon's test year rate base; (9) Carbon's corporate overhead allocation methods; (10) Carbon's test year revenue; (11) adjustments to revenue; (12) the Commission adopted an interest synchronization amount to impute hypothetical interest expense deductions; (13) the Commission calculates Carbon's net income after taxes for the test period; (14) the Commission calculates that Carbon/Emery is entitled to $886,068.30 in UUSF support through December 31, 2019 (reduction of $152,645.70[1]); and $700,522.26 beginning January 1, 2020.

URTA requests that the Commission review, rehear, or reconsider its decisions on: (1) certain "Undisputed Facts;" (2) the cost of equity; (3) the hypothetical capital structure to be imputed to Carbon; (4) the method of calculating the depreciation expense adjustment; (5)

---

1 While the Commission did not provide worksheets showing the actual calculations, it would appear that the Commission's calculation may include a $3,144 error in revenue.

consideration of the interstate revenue impact of the depreciation expense adjustment approved by the Commission; and (6) the imputation of interest expense based on the hypothetical capital structure imputed to a company with no debt, including the effect of interstate separations on such imputed expense. Additionally, URTA maintains that the Commission's Order constitutes a rule under the Administrative Rulemaking Act without compliance with Utah Code Section 63G-3-101. Support for this Petition for Review, Rehearing, and Reconsideration of the Commission's decisions on these issues is as follows:

II. REQUEST FOR REVIEW, REHEARING, OR RECONSIDERATION

A. Certain of the Commission's "Undisputed Facts and Issues" Are Disputed.

The Commission has identified and enumerated 15 separate "facts" or "issues" in the Order which it claims are not disputed. The testimony in the record shows that certain of these facts are either disputed or inaccurate. For ease of reference URTA identifies the facts in italics by their number in the Order. Citations to the record containing contrary are provided after each such fact.

> *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 90% of its customers.*

The Commission concludes that the purpose for Carbon/Emery's FTTH network upgrade is so that Carbon/Emery can deliver internet and cable television services. Careful review of the record indicates that, at a minimum, this is a disputed fact. The witnesses for the Office make conclusory statements in their pre-filed testimony that the purpose for Carbon/Emery's FTTH is to permit Carbon/Emery to provide deregulated service. However, this testimony is conclusory

and lacks evidentiary foundation. For example, Mr. Brevitz in his Revised Direct Testimony on lines 57-60, in explaining the scope of his testimony, states:

> In particular I focused on the areas of Carbon/Emery's proposed rate of return and appropriate cost allocations associated with Carbon/Emery's deployment of Fiber to the Home (FTTH) for deregulated services.

This statement seems to imply without any foundational support, that Carbon/Emery is deploying FTTH for deregulated services only. As demonstrated below, this is disputed. Additionally, in support of Mr. Brevitz' argument on return on equity, Mr. Brevitz states:

> 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 programming, and are deploying Fiber to the Home to support this array of services.

In this example, the statement regarding FTTH is made in an off-hand way, but implies, again, that the primary purpose for Carbon/Emery's deployment of FTTH is to provide non-regulated services. Again, this is not accurate, as shown below.

Additionally, Mr. Ostrander on lines 795-800 of his Revised Direct Testimony states:

> The Company is purchasing and placing significant fiber plant in the exchanges of its RLECs for the related benefit of its nonregulated affiliates in providing growth-oriented and higher profit nonregulated services such as internet and IPTV (compared to the stagnant and even declining revenues for local service).

While Mr. Ostrander states this as fact, careful review of his testimony demonstrates there is no foundation for this conclusion in the record, and Mr. Ostrander offers no foundation for his conclusion in his testimony. For example, by Mr. Ostrander's own admission, Carbon/Emery's legacy copper aerial cable "is essentially obsolete" (Ostrander Surrebuttal

Testimony, Lns. 638-640) and acknowledges that the fiber being installed "will also provide basic local service," (Id. at L. 666), he concludes in summary fashion that such fiber "will not provide any substantive 'new' basic local service to customers – so clearly the focus is on expanding and providing new broadband service." (Id. at Lns. 666-668).

In fact, both Mr. Woolsey and Mr. Johansen testify on behalf of Carbon/Emery that the fiber upgrades are necessary for many reasons. First, much of the legacy copper plant is at or beyond its useful life[2] and starting to have errors, thus the upgrade is need to maintain regulated telephone service. Mr. Woolsey specifically stated that the network upgrades are needed to continue to provide packet based telephone service. (Transcript, P. 37, lines 1-16). Additionally, as previously identified above Mr. Johansen testified at the Hearing that "it's hard to provide telecommunications services when [the customers'] lines aren't of good quality." (Transcript, P. 56, Lns 12-13). In follow up, Mr. Jetter asked Mr. Johansen:

> "Q. When you say telecommunications services you mean internet and telephone?
>
> A. No, I'm referring to basic telephone service. Even basic telephone service to serve these you've got to think the net plant. Of course you can put internet across it also, but for this rate increase purpose we're talking basic telephone services." (Transcript, P. 56, Lns 17-21).

Second, Carbon/Emery testified that the fiber upgrade is needed because the subscriber equipment on the copper system is at end of life and is no longer supported by the vendor. (Transcript, P. 35, Lns. 2-10). Rather than invest in updated subscriber equipment for the obsolete copper system, Carbon/Emery has made the prudent business decision to upgrade to a FTTH network. (Transcript, P. 37, Lns. 21-23). Fiber is cheaper to install, and the FCC recommends replacing legacy copper networks with fiber. (Transcript, P. 57, Lns. 13-17).

2 Transcript, P. 35, Lns. 19-21.

In fact, companies like Carbon/Emery who replace their legacy copper with fiber do so to allow them to continue to provide basic telephone service to their residential customers. Additionally, as Mr. Johansen testified, these networks are also used to provide regulated special access circuits. (Transcript, P. 63, Lns. 14-16; P. 64, Lns. 1-4). As Mr. Woolsey further explains:

> "[The network] is not just internet and phone. It's not that simple. The network carries a lot of data. And basic local service isn't our larges revenue source on the regulated side. We have special access. We have data circuits. They are not internet circuits, they are large circuits for Utah [Education] Network or for cell phone providers. We have special access and switch access. . . So the regulated plant provides service in a lot of different capacities." (Transcript P. 73, Lns. 19-25; P. 74, Lns. 1-5).

There is ample testimony in the record to dispute the Commission's conclusion that Carbon/Emery has undertaken the FTT network upgrade so it can deliver internet and cable television services. URTA requests that the Commission review and reconsider this conclusion.

B. The Commission Should Provide Clarity and Consistency in Its Cost of Equity Determinations.

With regard to the cost of equity, the Commission found that:

> 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 for one utility does not constitute precedent in a subsequent docket involving a different company. 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. (Order, P.10).

The record shows that Carbon/Emery did, in fact, offer empirical support for its 12.13% requested cost of equity which the Commission has seemingly overlooked in its Order. The

evidence on the record shows that 12.13% is the cost of equity that the Division calculated and the Commission approved in the Hanksville UUSF Application in August of 2014. While URTA acknowledges that the cost of equity must be evaluated in each case with due consideration given to the business, financial and regulatory risks of the particular utility, the Commission can, and should provide rate of return regulated companies with some guidelines and direction on these issues. In this case, the evidence in the record demonstrates that Carbon/Emery utilized the 12.13% cost of equity because that is the figure that the Commission had recently approved for Hanksville Telcom, Inc. which is a Carbon/Emery affiliate, and in other recent UUSF proceedings. (Woolsey Direct Testimony, FN 2). In fact, because the Division had recently proposed 12.13% as a return on equity in the Division's Petition for Increase in UUSF filed for Hanksville Telcom, Inc. Carbon/Emery believed it was eliminating a potential disputed by filing its Application utilizing the same return on equity.

When the Division filed direct testimony suggesting a lower cost of equity for Carbon/Emery based on a CAPM, Carbon/Emery's expert consultant, Douglas Meredith, filed Rebuttal Testimony in support of Carbon/Emery's proposed 12.13% cost of equity, and in opposition to the Division's CAPM calculation. Mr. Meredith identified several issues with Mr. Coleman's CAPM.

First, Mr. Meredith testified that if the Commission were to adopt a CAPM, a small company premium is the minimum adjustment that should be added to the results of a traditional text book CAPM. (Meredith Rebuttal Testimony, Lns. 120-160). Mr. Meredith's testimony further identifies an appropriate small company premium range of between 5.32% and 7.11%. (Meredith Rebuttal Testimony, Lns. 123, 134-135). URTA supports the application of a small

company premium to any CAPM calculation to account for the very real differences between the companies selected for the model and the rural Utah companies.

Second, the record demonstrates that Mr. Coleman determined return on equity using identified 13 “comparable companies” in his CAPM peer group: (1) Alaska Communications; (2)Atlantic Tele-Network, Inc.; (3) Consolidated Communications; (4) Frontier Communications; (5) IDT Corp; (6) Hickory Tech Corp; (7) Cincinnati Bell Inc.; (8) Otelco; (9) Shenandoah Telecom; (10) Windstream Corp; (11) Alteva, Inc; (12) Earthlink Holdings Corp.; (13) Fairpoint Communications, Inc.. Both Mr. Meredith and the Office’s witness, Mr. Brevitz provided testimony that the comparable companies selected by Mr. Coleman in his CAPM model were problematic as they were not similarly situated to Carbon/Emery in size, or service offerings, and financial operations. (Meredith Rebuttal Testimony, Lns. 236-245; Brevitz Rebuttal Testimony, Lns. 157-229). Specifically, Mr. Brevitz suggests that eight of Mr. Coleman’s “comparable companies” selected for the CAPM are inappropriate: (1) Hickory Tech Corporation (no longer in existence); (2) Atlantic Tele-Network (ATNI) (provides primarily wireless service in the US); (3) Cincinnati Bell (CBB) (serves a single large and compact metropolitan area with significant IT services); (4) IDT Corporation (provides mobile services outside of the US); (5) Alteva Inc. (company’s operations and management are problematic and not comparable); (6) EarthLink Holdings (does not provide local exchange service); (7) FairPoint Communications (recent bankruptcy and owned by a variety of entities—not comparable). Id.

Similarly, Mr. Meredith agreed that Hickory Tech, Alteva, ATNI, EarthLink, and IDT are not comparable companies, and should not be included in Mr. Coleman’s peer group. (Meredith Rebuttal Testimony, Lns. 234-245). Additionally, Mr. Meredith testified that the companies

identified by Mr. Coleman that are distressed (Frontier, Windstream, Alaska, and Otelco) should also be eliminated from Mr. Coleman's identified peer group. (Meredith Testimony, Lns. 258-261). In fact, the record reflects that there are only two of Mr. Coleman's original 13 "comparable companies" that Mr. Brevitz and Mr. Meredith agree are useful and comparable: Shenandoah and Consolidated.

Despite this voluminous and consistent testimony from the Office and company experts regarding the inappropriate selection of the peer group for the basis of the Division's CAPM, the Commission concluded that "the Division has chosen an acceptable pool of comparable companies . . . we see little value in attempting to weight the dissimilarities that appear within the pool." The selection of the peer group is the single biggest factor in determining a CAPM return on equity rate. So the Commission's conclusion that there is little value in attempting to weight the dissimilarities is not supported by the evidence, and should be reviewed and reconsidered.

Further, as noted in the testimony and identified above, there are only two companies that all parties agree are comparable companies: Shenandoah and Consolidated. Shenandoah, as the Commission is aware, has a debt structure of 43.79% in 2014, and is the company from which the Commission adopted the capital structure imputed against Carbon/Emery in this case (Brevitz Rebuttal Testimony, L. 163; Order, P. 13). Pursuant to the CAPM data compiled by Mr. Coleman, Shenandoah has an unadjusted return on equity of 13.35% (Coleman Direct Testimony, Exhibit DPU 3.1). This is higher than the return on equity proposed by Carbon/Emery. Looking at the testimony in the record and examining the company that is most

comparable to Carbon/Emery, the 12.13% return on equity suggested by Carbon/Emery is supported by the evidence and is just and reasonable.

While URTA acknowledges that it is problematic to consider one company in a peer group, Mr. Meredith also provided testimony on NECA's peer group analysis used in NTCA's Free Cash Flow Method. Mr. Meredith offers unrebutted testimony that NTCA has proposed a free cash flow rate to calculate return on equity which calculates the median value for rate of return for rural carriers of at least 11.75% based on NECA's peer group data (Meredith Rebuttal Testimony, Lns. 380-394). This well-established peer group seems to have been ignored by the Commission.

Finally, the record reflects that Mr. Meredith provided testimony that the companies selected by Mr. Coleman in his CAPM model were problematic as they were not similarly situated to Carbon/Emery in size or service offerings. (Meredith Rebuttal Testimony, Lns. 236-245). Mr. Meredith also had concerns about Mr. Coleman's use of spot rates for the inputs in his CAPM. As Mr. Meredith testified, "a generally accepted practice is to trend these over a period of time to smooth out normal and expected fluctuations in the market. Data from the U.S. Department of Treasury reports that the trend for the three-month T-Bill from 1990 – today is 3.04%, and the trend for the 20 year T-Bond is 5.009%." (Meredith Rebuttal Testimony, Lns. 271-278). Mr. Meredith recommends use of Department of Treasury 20 year T-Bond rate of 5.009%. (Id.). When adjusting the CAPM to address these concerns, the evidence provided by Mr. Meredith indicates an adjusted CAPM of 16.83% cost of equity. (Meredith Rebuttal Testimony, L. 325).

URTA suggests that Carbon/Emery did provide testimony in support of its 12.13% return on equity, despite the Commission's conclusion to the contrary. It would appear that the Commission has overlooked this testimony offered by Mr. Meredith. URTA requests that the Commission review its determination on this issue in light of Mr. Meredith's testimony contained in the record.

C. The Capital Structure Determination is a Departure from Commission Practice Which Should be Reconsidered.

It is undisputed that during the test period Carbon/Emery had no debt. However, all parties to the proceeding recommended the imputation of some debt to Carbon. The Office suggested imputation of 50% debt (Brevitz Direct Testimony, Lns. 167-170). The Division and Carbon/Emery proposed application of a hypothetical capital structure against Carbon/Emery utilizing the method developed by a taskforce appointed by the Commission in 2008 (Woolsey Testimony, Lns. 164-167; Transcript, P. 163, Lns. 1-7). In particular, as stated in the Testimony of Casey Coleman, William Duncan, and Douglas Meredith, both the Division and Carbon/Emery recommended imputation of 35% debt to Carbon/Emery to provide regulatory consistency to Carbon. (Coleman Direct Testimony, Lns. 38-70; Transcript, P. 195, Lns. 9-19; Duncan Rebuttal Testimony, Lns. 33-64; Meredith Rebuttal, Lns. 399-420). As presented in the testimony, in 2008 Utah Rural Telecom Association ("URTA") petitioned the Commission for rulemaking on capital structure. Prior to 2008, the Division had used various policies for capital structure including: 1) use of an "average (50/50) capital structure;" 2) use of the company's actual capital structure; 3) or a mixture of hypothetical and actual capital structure. (Duncan Rebuttal Testimony, L. 22-30).

As stated by Mr. Duncan, "rural ILEC's faced a confusing situation, never knowing what the 'rules' would be from case to case." (Duncan Rebuttal Testimony, L. 30-31). In response to URTA's petition for rulemaking in Docket No. 07-999-01, the Commission formed a task force to study the questions related to capital structure and propose a rule to the Commission. As the Commission is aware, the taskforce met for several months and proposed a capital structure rule to the Commission. The Commission did not adopt the rule, but stated in a letter in the docket that "the general parameter of the rule accompanied by the variability attempted to be included in the rule proposed may be applied by the Division itself in its interaction with companies." (Duncan Rebuttal Testimony, L. 39-42, citing Docket No. 07-999-01). From that point forward, the Division has adopted the proposed rule as policy and has applied it consistently in its evaluation of rate cases and UUSF applications since that time (Duncan Rebuttal Testimony, L. 42-43).[3] As indicated by Mr. Duncan, the Division has consistently utilized the Division's "policy" on capital structure and such action was explicitly, in some cases, and implicitly in other cases condoned by the Commission. At no time since the Division began using the capital structure policy in 2008 has the Commission issued any written order, warning or dicta that the application of the Division's policy on capital structure would be questioned or rejected.

3 In the Matter of the Increase in Rates of Manti Telephone Company, Docket No. 08-046-01 (use of hypothetical 65% debt); In the Matter of Carbon/Emery Telcom's Application for Increase of Rates, Docket No. 09-2302-01 (use of actual debt because it was between 35-65% ; In the Matter of the Increase in Rates of All West Communications, Inc., Docket No. 11-2180-01 (use of hypothetical 65% debt) ; In the Matter of Manti Telephone Company's Application for Additional USF, Docket No. 13-046-01(use of hypothetical 65% debt); In the Matter of Gunnison Telephone Company's Application for Rate Increase, Docket No. 14-043-01(use of hypothetical 65% equity); In the Matter of the Division of Public Utilities' Petition for Increased USF Distribution for Hanksville Telcom, Inc., Docket No. 14-2303-01(use of 65% equity); In the Matter of Emery Telephone's Application for UUSF, Docket No. 14-042-01(use of hypothetical 65% equity); In the Matter of Emery Telephone's Application for UUSF, Docket No. 15-042-01(use of hypothetical 65% equity) ; and In the Matter of UBTA-UBET Communications Inc.'s application for Increase in UUSF, Docket No. 15-053-01 (use of actual capital structure).

Utah law permits "relief from agency action that is 'contrary to the agency's prior practice' unless the agency 'gives facts and reasons that demonstrate a fair and rational basis for the inconsistency.'" *Mountain Fuel Supply Co. v. Public Service Commission,* 861 P.2d 414, 421 (Utah 1993). Departure from this policy is contrary to the Commission's prior practice, and the Commission has not justified the inconsistency by giving facts and reasons that demonstrate a fair and rational basis for the inconsistency as required by Utah Code Section 63G-4-403.

On the contrary, the Commission, in its Order, merely stated that "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." (Order, page 13). The Commission then states that "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." (Order, P. 13).

This conclusion ignores the testimony of William Duncan cited above, and the testimony of Douglas Meredith, and errs in adopting a policy that is not consistent with prior practice. In addition to supporting the recommendation of the taskforce and the long standing policy of the Division, Douglas Meredith also testified that imputing 35% debt to Carbon/Emery "represents a reasonable balance of competing interests." (Meredith Rebuttal Testimony, Lns. 399-420; Transcript, P. 111, Lns. 15-16). Despite the evidence of the Division, Carbon/Emery, and URTA the Commission states that "the Office's data shows that reasonably comparably non-subsidized telecom companies had debt positions of at least 43.79% during the test year and that Carbon/Emery had a very similar debt position of 41.86% in 2009." (Order, p. 13). The

Commission concluded that imputing a hypothetical capital structure of 43.79% debt to Carbon/Emery is just and reasonable. The Commission did not provide any distinguishing fact or reason to justify a fair and rational basis for not affording Carbon/Emery the same treatment that every other regulated telephone company has received and relied on since 2008. URTA respectfully requests that the Commission review and reconsider its determination on capital structure in compliance with 63G-4-403 of the Utah Code. Further, URTA implores the Commission to identify guidelines that can be applied consistently amongst the rural rate of return carriers.

D. The Commission Erred in its Depreciation Analysis.

1. The Commission's Conclusion that the Fiber to the Home Network Up-Grade is Not a Permissible Use of USF Is Not Supported By Substantial Evidence.

It is undisputed that Carbon/Emery is in the process of upgrading its network to provide fiber to the home ("FTTH") service to its existing customers. As set forth in detail in Section II(A) above, Carbon/Emery testified that the FTTH network upgrade is being undertaken because its current cable plant is reaching obsolescence. While it is undisputed that the FTTH network upgrade will permit Carbon/Emery to provide enhanced services to its customers including broadband access, Carbon/Emery testified that the upgrades are needed to continue to provide basic telephone service to its customers. (See supra Section II(A)).

Despite the extensive testimony in the record to the contrary, in determining the appropriate depreciation expense for Carbon/Emery, the Commission determined that "the benefit of the FTTH build-out goes to customers whose rates, by statute, may not be subsidized through the UUSF." (Order, p. 19). The Commission further found that the "FTTH network

upgrade is not a permissible or appropriate use of UUSF," and that the FTTH build-out amounts to "investment in assets whose primary purpose is not basic telephone service." (Order, p. 20). These conclusions, which form the basis of the Commission's depreciation expense adjustment are not supported by substantial evidence and are in error.

As this Commission is aware, pursuant to Public Service Commission Rule, R746-100-11.F.1:

> "a party asking the Commission to modify a fact finding must marshal the record evidence that supports the challenged finding, as set forth in State v. Nielsen, 2014 UT 10, paragraphs 33-44."

After marshalling the supportive evidence, it is the challenger's burden to show the "fatal flaw" in that supportive evidence. *Kimball v. Kimball,* 2009 UT App 233, FN 4, citing *West Valley City v. Majestic Inv.Co.*, 818 P.2d 1311, 1315 (Utah Ct. App. 1991). The challenger must then explain why the evidence is legally insufficient to support the finding. According to the Utah Court of Appeals, "examples of such legal insufficiency might include that testimony was later stricken by the court or that testimony that seems to support a finding was recanted on cross-examination." *Id.*

Marshaling. To meet its burden under Rule R746-100-11.F, URTA identifies the evidence supporting the Commission's conclusion that the FTTH network upgrade's primary purpose is not basic telephone service in Section II(A) above. As demonstrated, the testimony identified in Section A above lacks foundation and does not support the Commission's conclusions that the FTTH build out's primary purpose is not basic telephone service; that the benefit of the FTTH build out goes to customers whose rates, by statute, may not be subsidized through the UUSF; or that the FTTH network upgrade is not permissible or appropriate use of

UUSF. URTA requests that the Commission review and reconsider this erroneous and unsupported conclusion.

2. If a Rate of Return Company Selects a Method of Depreciation that is Within the Pasture of Reasonable, That Depreciation Method Should Not Be Cast Off in Favor of Another Method.

The Division identified five acceptable methods of depreciation, and suggested a depreciation expense reduction, based on a single asset straight-line method of depreciation. (Hellewell Direct Testimony, Lns., 42, 188-190). URTA and Carbon/Emery resisted the elimination of the group method of depreciation as being contrary to FCC Part 32, and proposed application of the FCC Method of depreciation identified by Mr. Hellewell in his Direct Testimony. The FCC Method of depreciation recalculates the depreciation rate based on the plants average remaining life, future net salvage value, and depreciation reserve ratios. (Hellewell Direct Testimony, Lns. 223-229).

Although the Division acknowledged that the FCC Method, when properly applied is an acceptable method of depreciation, the Division did not utilize the FCC method to calculate the depreciation expense. (Transcript, P. 220, L. 22). Rather, the Division used a vintage method of depreciation (Hellewell Sur-Surrebuttal Testimony, L. 257), which the Commission adopted in its Order (Order, p. 21).

In discussing the Group-Vintage Method of depreciation, the Division testified that:

> "*vintage depreciation would allow for assets capitalized within a certain date range to be grouped and depreciated together, any new assets purchased outside that date range would then be placed in a new group. Groups would then be depreciated using a straight-line method until the group is fully depreciated. Once fully depreciated, if still used and useful, the group would remain intact and no further depreciation expense would be generated...The clear benefit of vintage groups is the significant reduction in*

> *the variation between depreciable life and actual asset useful life."* (Hellewell Sur-Surrebuttal Testimony, L. 195-202).

However, the record is devoid of any testimony showing that the vintage method, as employed by the Division and the Commission actually reduces the variation between the depreciable life and the actual asset useful life because there is no testimony showing the actual useful life of the assets in the Commission's vintage method. It does not appear from the record that the Division calculated or determined the actual useful lives of Carbon/Emery's assets when performing the vintage method calculation. Thus, the record is lacking evidentiary support for the Commission's conclusion that the vintage method reduces the variation between the depreciable life and the actual asset useful life.

The Division glosses over this and testifies that *"determining how large the vintages should be remains a question that will produce varied results. A one year vintage would produce depreciation expense similar to single-asset depreciation; groups with too wide a date range would accelerate depreciation expense on new assets similar to Carbon/Emery's current groups."* (Hellewell Sur-Surrebuttal Testimony, Lns. 222-225). To address these issues, the Division applied a flat percentage of 20% against the current depreciable life of the asset group to determine the appropriate "vintage." (See Hellewell Sur-Surrebuttal Testimony, Lns. 225-230). According to the Division, this method results in one year vintages for vehicles, which normally have a 5 year life; and 4 year vintages for assets like buried cable or buildings that normally have a 20 year life. (See Hellewell Sur-Surrebuttal Testimony, Lns. 227-230). The Division then configured *"the vintage groups to allow each unit in its group to reach its depreciable life within the group timeline."* (Hellewell Sur-Surrebuttal Testimony, Lns. 243-244). The Division testified that utilizing this method "*there would be no spikes in depreciation*

expense at the end of the group's depreciable life, and no acceleration; each year would be reasonably representative of the future and past years." (Sur-Surrebuttal of Hellewell, L. 222-250).

If the Commission's goal is actually to match the assets depreciable lives with the actual service lives, as indicated on page 19 of the Commission's Order, the only depreciation method in the record that included a calculation of the remaining useful lives of the assets is the FCC Method proposed by Carbon/Emery in its Sur-Surrebuttal Testimony. While all methods of depreciation are approximations of the diminution of value of the assets, proper adjustments within Carbon/Emery's chosen depreciation method will yield the best approximation of the actual diminution of value of Carbon/Emery's assets without creating an artificial distortion by changing the depreciation method in the middle of the life of the asset group. The FCC method requires an approximation of the actual diminution of value of the assets, by evaluating the remaining service lives of the groups. Whereas, the vintage method adopted by the Commission, as calculated by the Division is arbitrary in its use of a 20 percent adjustment factor, and did not consider the actual remaining life of the group asset.

Because the FCC Method is identified by the Division as an acceptable method of depreciation, and because the FCC Method maintains group asset depreciation as approved for the interstate jurisdiction, URTA requests that the Commission review and reconsider its decision to employ vintage depreciation to calculate the depreciation expense. Carbon/Emery requests that the Commission review and reconsider its Order and adopt the FCC Method which provides for consideration of average remaining life in the asset groups. This is also consistent with Utah Code Section 54-7-12.1 which provides:

In determining depreciation expense of a telephone corporation in any proceeding under Section 54-7-12, the Commission shall consider all reasonable factors, include the alteration of asset lives to better reflect changes in the economic life of plant and equipment used to provide telecommunications services.[4]

This approach also addresses the concerns that the Commission has about matching depreciation lives with actual service life. URTA requests that the Commission review and reconsider its determination on this issue.

E. The Commission Failed to Consider the Interstate Revenue Impact of Its Depreciation Expense Adjustment in Its Determination of Carbon/Emery's UUSF Distribution.

As the Commission is aware, the assets, revenues, and expenses of rate of return regulated companies, such as Carbon/Emery, are allocated between interstate and intrastate jurisdictions. As certain adjustments are made to rate base, revenues, and depreciation expense for the test period, the interstate revenue impact that of those adjustments should be considered and calculated by the Commission. URTA requests that the Commission review its Order and address the interstate revenue impact for any affected adjustments approved by the Commission.

F. The Commission Committed an Error of Law When it Imputed an Interest Expense Based on the Hypothetical Capital Structure Imputed to Carbon/Emery.

The Commission concluded that "before taxes are calculated, interest expense, if any, should be deducted." (Order, p. 24). The Office suggested imputing interest expense based on the hypothetical capital structure approved by the Commission in this docket. The Commission adopted the Office's proposed interest adjustment, and calculated a hypothetical interest expense

4 The Commission, in its Order, FN 11, states that this is not a proceeding under Section 54-7-12, however, the Commission can take judicial notice of the fact that the Commission has routinely looked to the statutes governing rate cases for instruction in UUSF proceedings.

to be imputed to Carbon/Emery to account for interest synchronization. Interest synchronization proposes to make an adjustment for tax deductions for interest paid on debt. However, when a company has no debt, it cannot realize the interest expense tax deduction, thus it is not appropriate to utilize an interest expense deduction that cannot be realized by the company. URTA requests that the Commission review this conclusion of law.

Further, the Commission has calculated the imputation of interest based upon the entire rate base balance of Carbon/Emery which includes both interstate and intrastate assets. Interest imputation is not utilized or allowed for interstate rate making or a revenue requirement determination (a fact supported by the FCC's use of a single rate of return (historically targeted at 11.25%) which encompasses both cost of debt and cost of equity without regard to the debt/equity mix of individual companies and without tax implications of related interest). Because there is no interest synchronization adjustment related to interstate assets, the Commission's interest synchronization adjustment (if pursued) needs, at the very least, to recognize the federal calculation and reduce the state UUSF adjustment accordingly to avoid Federal subsidization.

G. The Commission Committed an Error of Law When it Adopted a Change in Depreciation Methods to Calculate the Depreciation Expense for the Test Year.

The Commission committed a legal error in adopting a change in depreciation method for calculating the depreciation expense for the test period, rather than on a prospective basis. The evidence in the record demonstrates that Carbon/Emery selected the group method and applied it since the company's inception with no modifications from the Commission until this UUSF proceeding. Under Utah Code 54-4-4(4), if the Commission considers the prudence of an action

taken by a public utility, the Commission is required to focus on the reasonableness of the expense resulting from the action of the public utility judged as of the time the action was taken. In this case, Carbon/Emery carefully selected the method of depreciation – group asset depreciation—in 2001; has been using that method of depreciation in compliance with FCC Part 32; and has relied on that method to provide a stable predictable depreciation expense used by management to forecast and plan. If the Commission requires a change in depreciation methods for calculation of depreciation expense, it should be on a prospective basis for assets added after the change is adopted in compliance with Utah Code Section 54-4-4(4). URTA requests that the Commission review its application of the vintage method of depreciation to the test year, and instead, apply the change prospectively to assets added after the test period. This will enable Carbon/Emery to transition to the vintage method without experiencing an anomalous result in the near term.

Carbon/Emery's use of the group method of depreciation is permitted by Part 32 (Transcript, P. 24, Lines 21-25; P. 25, Lines 1-4; P. 303, Lines 3-4); consideration of assets in terms of groups has historical and current relevance given the nature of telecommunications networks and plant assets; Carbon/Emery has used the group method of depreciation since 2001 without question (Transcript, P. 25, Lns. 1-4). The prudence of Carbon/Emery's choice to use the group method must, pursuant to Utah law, be judged at the time the action was taken. *U.C.A. Section 54-4-4(4).* There simply is no evidence to suggest that Carbon/Emery's choice of method of depreciation was imprudent when made and the Commission has made no such finding. In order to preserve a company's carefully considered choice of depreciation methods,

URTA suggests that any changes in depreciation method should be adopted on a prospective basis for assets added after the change is adopted.

H. The Commission's Order Constitutes a Rule Under the Administrative Rulemaking Act.

While the Commission's ruling is called an "Order", it amounts to a rule under the Utah Administrative Rulemaking Act (Section 63G-3-101 *et. seq.*)("UAPA") The UAPA defines a rule as an agency's written statement that (1) is explicitly or implicitly required by statute; (2) implements or interprets a state mandate; and (3) applies to a class of persons or another agency. See U.C.A. Section 63G-3-102(16)(a). Under this definition, the Order is a rule under UAPA.

In particular, Utah Code Section 54-8b-15(3) requires the Commission to "establish rules governing the administration of the [Universal Service] fund." Additionally, "the fund shall provide a mechanism for specific, predictable, and sufficient funds." U.C.A. Section 54-8b-15(9). In this case the first element of a rule is met because the Commission is implicitly required by U.C.A. Section 54-8b-15 to establish rules governing the administration of the UUSF. The second element of a rule is met because the Commission's Order interprets the state mandate that the Commission provide a mechanism for specific, predictable, and sufficient UUSF funds. In order to meet the third element of a rule, the Commission's Order would have to be applicable to a class of persons or other agency. Clearly, an order in one of the only fully litigated UUSF cases in recent Commission history could be interpreted as a statement of the Commission's position on UUSF proceedings that would be generally applicable to rural rate of return providers seeking UUSF disbursements. However, the Commission attempts to avoid a rulemaking argument by limiting the results in its Order to Carbon/Emery only. The fact of the matter is that either the

Commission's Order establishes generally applicable rules regarding UUSF applications, or all other rural rate of return companies in Utah are left without a mechanism for determining specific, predictable and sufficient disbursements from the state UUSF.

As requested by all parties to this docket, generally applicable rules adopted through a rulemaking proceeding would be appreciated and would provide rural telephone providers with the ability to better predict disbursements from the UUSF. As the Commission is aware, UUSF cases cost the companies thousands of dollars and significant devotion of corporate resources. Rules on issues such as capital structure, return on equity, and depreciation methods, would serve to greatly reduce the time and expenses the rural companies expend on these issues, thus saving rate payers in the State of Utah. URTA asks the Commission to reconsider its Order and consider opening a rulemaking docket on these issues consistent with the requirements of UAPA.

III. CONCLUSION

URTA respectfully requests review, rehearing or reconsideration of the Commission's Order as set forth herein.

Dated this 29th day of April, 2016.

BLACKBURN & STOLL, LC

____

Kira M. Slawson
Attorneys for Utah Rural Telecom Association

CERTIFICATE OF MAILING

I hereby certify that a true and correct copy of the Utah Rural Telecom Association's Petition for Review, Rehearing or Reconsideration, 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 29th day of April, 2016:

Justin Jetter
Assistant Attorney General
Division of Public Utilities
jjetter@utah.gov

Chris Parker
William Duncan
Dennis Miller
Joseph Hellewell
Paul Hicken
Division of Public Utilities
chrisparker@utah.gov
wduncan@utah.gov
dennismiller@utah.gov
jhellewell@utah.gov
phicken@utah.gov

Robert Moore
Assistant Attorney General
Office of Consumer Services
rmoore@utah.gov

Michele Beck
Danny Martinez
Office Of Consumer Services
mbeck@utah.gov
dannymartinez@utah.gov

Bion C. Ostrander
Ostrander Consulting
bionostrander@cox.net

David Brevitz
Ostrander Consulting
davidbrevitz@att.net

____
Kira M. Slawson