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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	CARBON/EMERY TELCOM, INC.'S REDACTED 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, Carbon/Emery Telcom, Inc. ("Carbon/Emery") 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). At the outset, Carbon/Emery 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 as follows: (1) the cost of debt is 5.636%; (2) the cost of equity is 10.75%; (3) a capital structure of 43.79% debt and 56.21% equity shall be imputed to Carbon/Emery; (4) the appropriate interstate rate of return is 11.45%; (5) Carbon/Emery's overall rate of return shall be 9.697%; (6) test year investments, including telephone plant under construction ("TPUC"), materials and supplies are reasonably allowed in rate base through December 31, 2019, but on January 1, 2020, the TPUC rate base account shall be reduced by and Materials and Supplies rate base account shall be reduced by if no further action is pursued by Carbon; (7) Carbon's depreciation expense for the test year should be reduced by as calculated using the Division's vintage method of depreciation; (8) Carbon's test year rate base shall be increased by to correlate with the single year depreciation expense adjustment; (9) Carbon's corporate overhead allocation method is acceptable and the factors proposed by the Office (and the resulting adjustment to regulated corporate overhead) are not accepted by the Commission; (10) Carbon's test year revenue should be increased by to account for the projected new accounts that will transition from Carbon's non-regulated cable

network to its regulated fiber to the home ("FTTH") network; (11) Carbon's test year revenues should be reduced to account for projected access line loss; (12) the Commission adopted an interest synchronization amount to impute hypothetical interest expense deductions of [redacted] for Carbon's income tax calculation; (13) the Commission calculates Carbon's net income after taxes for the test period at [redacted]; (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.

Carbon/Emery 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 accurate depreciation expense adjustment to Carbon's test year; (5) the amount of UUSF to which Carbon/Emery in entitled based on 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 Carbon/Emery including the effect of interstate separations on such imputed expense. Additionally, Carbon/Emery 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.

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.

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 Carbon/Emery identifies the facts in italic by their number in the Order. Citations to the record containing contrary evidence are provided after each such fact.

> *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.*

Carbon/Emery's telecommunications network has not been adequate to provide basic telephone service **at all relevant times.** First, it is unclear what the Commission means by "all relevant times." However, as the testimony at hearing demonstrates, some of Carbon/Emery's buried copper cable is currently experiencing moisture and degradation of the line resulting therefrom. Specifically, Mr. Johansen testified at the Hearing that:

> On buried and copper networks it requires a lot of maintenance because -- especially since you figure a lot of those are going out. It's really interesting on how the plant works. A lot of buried copper, and because it's buried you're out in fields where moisture gets in, the lines get old, more moisture gets in. Those are our hardest to maintain, but we're trying to do the biggest bang for the buck. We're cutting the towns first and then we'll go into those areas, but they need to be cut because it's hard to provide telecommunications services when their lines aren't as good of quality.
>
> (Transcript, p. 56, Lns.3-13).

The testimony in the record is that the copper is being replaced because it is difficult to provide telephone service over the old degraded lines. There is no testimony in the record to dispute that Carbon/Emery's legacy copper plant is reaching the end of its useful life and deteriorating. In fact, it is undisputed that neither the Office nor the Division inspected the plant

in connection with this UUSF request to determine the condition of the plant or the actual remaining life of the plant. (Transcript, P. 53, Lns. 12-15; P. 216, L.15). Therefore, it is not accurate to state that Carbon/Emery's telecommunications service has been adequate at all relevant times to provide basic telephone service when Carbon/Emery specifically testified to the contrary. The testimony is that the old copper lines are reaching the end of their useful life and need to be replaced. Thus, this "fact" is disputed and should be reviewed by the Commission.

> *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 █% 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 needed to maintain

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

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, 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).

Replacing the copper with fiber will allow Carbon/Emery to continue to provide basic telephone service to its residential customers Additionally, as Mr. Johansen testified, the network is 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 largest 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).

As identified above, there is ample testimony in the record to dispute the Commission's conclusion that Carbon/Emery has undertaken the FTTH network upgrade so it can deliver internet and cable television services. Carbon/Emery requests the Commission review and reconsider this conclusion.

B. Carbon's Cost of Equity is Supported by the Evidence.

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).

In fact, Carbon/Emery did offer empirical support for its 12.13% requested cost of equity which the Commission has 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 Carbon/Emery 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 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 issue in its Application by filing with 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 textbook 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).

Second, the record demonstrates that Mr. Coleman 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, 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." This conclusion is not supported by the evidence and should be reviewed. 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 Carbon/Emery would acknowledge that it is problematic to consider one company in a peer group, which is why Carbon/Emery 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).

Finally, 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).

It would appear that the Commission has overlooked this testimony offered by Mr. Meredith in reaching its conclusion that Carbon/Emery has not offered any empirical support for its proposed cost of equity of 12.13%. Carbon/Emery requests that the Commission review its determination on this issue in light of Mr. Meredith's testimony as 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

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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).

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.

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."

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 and Carbon/Emery, 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 █████% 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. Carbon/Emery respectfully requests that the Commission review and reconsider its determination on capital structure in compliance with 63G-4-403 of the Utah Code.

D. The Commission Erred in Determining the Accurate Depreciation Expense Adjustment to Carbon/Emery's Test Year.

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 above, Carbon/Emery testified that the FTTH network upgrade is being undertaken because its current copper 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, Carbon/Emery 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 conclusion 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. Carbon/Emery requests that the Commission review and reconsider this erroneous and unsupported conclusion.

2. The Depreciation Expense Calculation as Determined by the Commission to be Representative of the USF Period is not Supported by Substantial Evidence.

Pursuant to Utah Code Section 54-4-4, "if in the Commission's determination of just and reasonable rates the commission uses a test period, the commission shall select a test period that, on the basis of evidence, the commission finds best reflects the conditions that a public utility will encounter during the period when the rates determined by the commission will be in effect." According to Utah Code, the Commission, in establishing the test period, may use: (1) a future test period; (2) an historic test period adjusted for known and measurable changes; or (3) a test period that combines future projections and historical data. *See U.C.A. Section 54-4-4(3).* However, if the Commission establishes a test period that is not based solely on future projections, the Commission "shall consider changes outside the test period that: (i) occur during a time period that is close in time to the test period; (ii) are known in nature; and (iii) are measurable in amount. *Id.* As suggested by Carbon/Emery, and agreed to by the Division and the Office, the Commission established 2014 as the effective test year. Carbon/Emery is **not** requesting review of the Commission's determination of the test year. Rather, Carbon/Emery is seeking review of the depreciation expense adjustment to the test year adopted by the Commission.

Pursuant to Carbon/Emery's Application, as supported by the testimony of Darren Woolsey, Carbon/Emery's depreciation expense for 2014 was [redacted]. (Woolsey Direct

Testimony, Exhibit 1, Cell D13). The Division resisted Carbon/Emery's group method of depreciation because the Division claimed that Group Depreciation as currently used by Carbon/Emery modifies the Commission approved rates of depreciation. (Hellewell Direct Testimony, Lns. 54-56). Specifically, the Division testified that the Commission approved certain rates of depreciation, but Carbon/Emery's use of group asset depreciation results in assets being depreciated faster than the rate approved by the Commission, resulting in a mismatch between the depreciation expense and the asset lives. (Hellewell Direct, Lns. 114-134).

To combat this, the Division identified five acceptable methods of depreciation, and suggested a depreciation expense reduction, based on a single asset straight-line method of depreciation, of [redacted] (Hellewell Direct Testimony, Lns., 42, 188-190). 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).

Carbon/Emery recalculated its test year depreciation expense utilizing the FCC Method, which resulted in a test year depreciation expense very similar to that contained in Carbon/Emery's application. The Division did not calculate the depreciation expense using the FCC Method (Transcript, P. 220, L. 22). Rather, the Division used a vintage method of depreciation, and calculated the test year depreciation expense adjustment at [redacted] (Hellewell Sur-Surrebuttal Testimony, L. 257), which the Commission adopted in its Order (Order, p. 21).

The Commission reached this conclusion using the Division's vintage method of depreciation for the test period. It is a fundamental goal of rate making to select a test year and adjust it for known and measurable changes such that it reasonably approximates the rate-effective period. *Mountain Fuel Supply Co. v. Public Service Commission*, 861 P.2d 414, 422 (Utah 1993), citing *Utah Dep't of Business Reg*., 614 P.2d at 1248; *see City & County of San Francisco v. Public Util. Comm'n*, 39 Cal. 3d 523, 703 P.2d 381, 387, 217 Cal. Rptr. 43 (Cal. 1985) (en banc); *L.S. Ayres & Co. v. Indianapolis Power & Light Co.*, 169 Ind. App. 652, 351 N.E.2d 814, 828-29 (Ind. Ct. App. 1976). Implicit in the Commission's adoption of the Division's depreciation expense adjustment is the Commission's determination that the test period with the depreciation expense adjustment reasonably approximates the effective period of Carbon/Emery's UUSF request. This conclusion is not supported by substantial evidence in the record. In fact, the record demonstrates that the depreciation expense adopted by the Commission does not reasonably approximate the depreciation expense of Carbon/Emery during the effective period of the UUSF request. Instead, the substantial evidence supports the calculation of Carbon/Emery using the Division's alternative approach that employs the FCC Method.

Marshaling. To meet its burden under Rule R746-100-11.F, in italics below, Carbon/Emery identifies the evidence that supports the Commission's finding that the depreciation expense adjustment of [redacted] reasonably approximates the depreciation expense that Carbon/Emery will incur in the UUSF effective period. The Division properly identifies the concept that depreciation expense should match the actual diminution in value of the assets being depreciated and the Commission adopts this fundamental ratemaking principal in

its order (Order, p. 19). In support of this conclusion by the Commission is the Division testimony which states:

> *The Division's calculation for depreciation expense was calculated this way [single asset straight-line] for the purpose of reaching a reasonable depreciation expense that would match actual diminution in value during the test year without rapidly accelerated depreciation (Hellewell Sur-Surrebuttal Testimony, Ls. 83-85).*

Further, during the hearing Mr. Hellewell was asked about the Division's depreciation expense adjustment:

> *Q. And you testified that the Division's depreciation expense was simply an adjustment of an unreasonably inflated depreciation expense to a reasonable depreciation expense that better matches the actual diminution in value of Carbon's assets during the test year, correct?*
> *A. Yes.*

However, while the Division claims that the purpose for making its depreciation adjustment was to match the actual diminution of value, Mr. Hellewell testified during cross examination, that the Division does not know what the actual diminution of value of Carbon's assets was during the test period[4], and in fact, as discussed above, neither the Division nor the Office examined the plant or facilities at Carbon/Emery to enable it to determine the condition of the plant or the actual remaining life of the plant. (Transcript, P. 53, Lns. 12-15; P. 216, L.15).

Moreover, Mr. Hellewell testified that the Division's depreciation expense adjustment is not representative of the depreciation expense going forward and that the depreciation expense of Carbon/Emery would continue to increase. (Transcript, P. 209, Lns. 22-25, P. 210, Lns. 1-25, P. 211, Lns. 1-25 and P.212, Lns. 1-22). There simply is no testimony that the depreciation expense

4 Transcript, P. 216, L. 25; P. 217, L. 1-2.

adjustment of $506,197 is a reasonable approximation of the depreciation expense that Carbon/Emery will have during the effective period of the UUSF request.

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). However, as demonstrated above, Mr. Hellewell admits that the depreciation expense suggested by the Division, and adopted by the Commission is not reasonably representative of the future and past years. The undisputed testimony is that the Carbon/Emery depreciation expense for subsequent years (at least through 2019) will be higher than that proposed by the Division for the test period (Transcript, P. 44, Lines 17-25, and P. 45, Lines 1-25; Woolsey Sur-Surrebuttal Testimony, Lines 172-176). Thus, while there may be evidence supporting the calculation of the $506,196.66 depreciation expense adjustment, there is not substantial evidentiary support for the finding that this depreciation expense adjustment results in a test year that reasonably approximates the effective period of the UUSF request as required by Utah law. This is the "fatal flaw" in the Commission's finding which leave the Commission's determination on this issue not supported by substantial evidence, and thus arbitrary. Carbon/Emery respectfully requests review of this issue.

Additionally, with regard to depreciation expense, 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. There is no testimony disputing that the remaining useful lives of the assets as determined by Mr. Woolsey is calculated improperly. In fact, at the Hearing Mr. Hellewell for the Division testified (Transcript, P. 233, Lns. 7-11):

> *Q. And you haven't offered any testimony that the service life [sic] as determined by Mr. Woolsey in his [FCC Method] calculation do not properly represent the remaining service lives of Carbon's assets, is that correct?*
>
> *A. Yes.*

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. 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, Carbon/Emery 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, including the alteration of asset lives to better reflect changes in the economic life of plant and equipment used to provide telecommunications services.[5]

This approach also addresses the concerns that the Commission has about matching depreciation lives with actual service life. Carbon/Emery 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, Carbon/Emery's assets, revenues, and expenses are allocated between interstate and intrastate jurisdictions. In the test year of 2014, it is undisputed that ██████% of Carbon's plant is allocated to the interstate jurisdiction (Woolsey Direct Testimony, Exhibit 3; Coleman Direct Testimony, Lns. 90-92; Brevitz Direct Testimony, Lns. 106-110). As certain adjustments are made to rate base, revenues, and depreciation expense for the test period, Carbon/Emery identified an interstate revenue impact that should be considered and calculated by the Commission. Mr. Woolsey identified the interstate revenue impact associated with the Division's proposed ████████ depreciation expense adjustment, as a reduction of ████████ in interstate revenues (Woolsey Sur-Surrebuttal Testimony, Lns. 281-288). Mr. Woolsey's testimony is not disputed in the record, yet the Commission did not address the known and measurable interstate revenue impact associated with the reduction in test year depreciation expense in its Order. Again, as a result of the interstate effect of the depreciation

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5 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.

adjustment that has not been considered by the Commission, the 2014 test year depreciation expense adjustment adopted by the Commission does not accurately reflect the conditions that Carbon/Emery will encounter during the period when the UUSF distribution determined by the Commission will be in effect. Carbon/Emery requests that the Commission review its Order and address the interstate revenue impact for any depreciation expense adjustment 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 an interest expense tax deduction based on the hypothetical capital structure approved by the Commission in this docket. The Commission finds the Office's proposed interest adjustment to be appropriate, and calculates a hypothetical tax interest expense deduction of [REDACTED] to be imputed to Carbon/Emery to account for interest synchronization. The purpose of interest synchronization is to ensure that the revenue requirement reflects the tax savings generated by the interest component of the revenue requirement. However, when a company has no debt, there is no interest expense to synchronize, and it cannot realize any interest expense tax deduction. Thus it is not appropriate to utilize an interest expense deduction that cannot be realized by the company. Carbon/Emery 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 [REDACTED] 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.[6]

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

6 Based on the Commission's calculation, recognition of the interstate portion of the assets would result in a revised interest synchronization adjustment of [redacted] ([redacted] rate base X [redacted]% intrastate asset% X [redacted]% weighted cost of debt; or more simply [redacted] Commission adj. X [redacted]% intrastate asset%).

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). Carbon/Emery 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); and Carbon/Emery's application of the group method results in a depreciation expense that is consistent with the FCC Method (See Sur-Surrebuttal Testimony of Mr. Woolsey, Lines 378-402) which the Division has testified is an acceptable method of depreciation. (See Hellewell Direct Testimony, Lns. 223-234). 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 Carbon/Emery's carefully considered choice of depreciation methods, Carbon/Emery requests that the Commission reconsider and review its determination on depreciation methods, and apply any such decision, it should be 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. Carbon/Emery asks the Commission to reconsider its Order and consider opening a rulemaking docket on these issues consistent with the requirements of UAPA.

III. CONCLUSION

Carbon/Emery 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

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CERTIFICATE OF MAILING

I hereby certify that a true and correct copy of the Carbon/Emery Telcom, Inc.'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:

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