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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 UNIVERSAL SERVICE FUND SUPPORT	CARBON/EMERY TELCOM, INC.'S POST-HEARING REPLY BRIEF DOCKET NO. 15-2302-01

Carbon/Emery Telcom, Inc. ("Carbon") hereby files this Post-Hearing Reply Brief as permitted by the Utah Public Service Commission ("PSC").

I. RATE OF RETURN[1]

Although Carbon has no debt, the Division of Public Utilities ("DPU") and Carbon agree that it is reasonable for the PSC to adopt a hypothetical capital structure of 35% debt. This hypothetical capital structure balances Carbon's debt free position with the premise that equity is more costly than debt, so companies should consider cheaper debt financing. The Office of Consumer Services ("OCS") argues that assuming only 35% debt in the capital structure unreasonably and artificially raises the overall rate of return requested by Carbon. However, this is not accurate. Because Carbon currently has no debt, assuming a 35% debt structure in fact lowers the overall rate of return that Carbon would receive if its actual debt structure was utilized in the calculation. While it may be true that assuming a 35% debt structure for Carbon lower's the overall rate of return when compared to using a 50% debt structure, the OCS offers no

1 The OCS has incorrectly identified its supported rate of return in its Post-Closing Brief as 8.45%. Brevitz' states at hearing that the calculation should have been 8.46% (T. 250, Lns 2-9). Also, Carbon is seeking $570,643 in additional UUSF (T. 15, L3).

credible evidence to support use of a 50% debt structure for Carbon. Rather, the OCS looks at several very large companies to come up with an average debt ratio of 70%. (Brevitz Rev. Dir., L 163). Of the companies selected in Brevitz analysis, it is undisputed that the only company remoted comparable to Carbon is SHEN, which has a debt ratio of 43% (Meredith Rev. Reb., Lns 414-418). Nevertheless, Brevitz then uses this large company debt ratio to support imputing a 50% debt structure to Carbon. Imputing a 50% debt structure on a company with no debt is overreaching. But this testimony demonstrates the OCS's guiding principal that any adjustment that lowers the UUSF is in the public interest.[2] The PSC should reject this and adopt the just and reasonable hypothetical debt structure of 35% proposed by the DPU and Carbon because it balances the competing interests. The DPU and Carbon also agree that the correct interstate rate of return to use from Form 492 is 11.45% (T. 174, Ln 9). NECA provides two Form 492 reports: one applies to companies in NECA's Common Line pool; and another that applies to companies that participate in traffic sensitive pools (Meredith Surreb., Lns 18-21). Carbon only participates in the NECA common line pool (T. 186, Ln 21-24). Therefore, pursuant to R746-360-8 and NECA, 11.45% is the appropriate interstate rate to use for Carbon.

With regard to return on equity, Carbon filed its Application using a 12.13% return on equity based on the uncontested return on equity contained in the DPU's Application for Increase in UUSF for Hanksville Telecom, Inc. filed and approved shortly before Carbon's Application. The DPU and the OCS base their return on equity rate on CAPM calculations using betas from other companies. CAPM calculations use betas from selected companies, and such betas capture

2 OCS states: adjustment for landline loss projected out three years is too far outside the effective period (Ostrander Rev. Dir., Lns 1015-1030); TPUC must be reduced by 50% because the accounts are overstated due to the current fiber construction project (Ostrander Rev. Dir., Lns 943-949) but construction will undisputedly continue for at least five years (T. 40, Lns 2-8); contrast the Office's depreciation expense adjustment which proposes to eliminates group accounts that fully depreciate in 3 years (Ostrander Reb., Lns 597-601).

everything the market knows about such company. Thus, the betas are market efficient as to such company. However, when applying a beta from a much larger company to Carbon, adjustments must be made to account for real differences between the companies. Carbon is a much smaller, rural company than the companies used in the DPU's CAPM model (Meredith Rev. Reb, Lns 297-300). As a result, the PSC should adjust the CAPM calculation, using, for example, a small company premium to derive a reasonable return on equity for Carbon.

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

Finally, Carbon has taken a very moderate position on return on equity. While it would be completely consistent with financial practice to apply a 5-7% adjustment to the DPU and/or OCS calculations (See Meredith Rev. Reb., Lns 122-155), Carbon has only suggested a return on equity of 12.13% as recently determined to be just, reasonable by the PSC in Hanksville's 2014

Application. Additionally, NECA's method, unrebutted in this case, of using free cash flow that parallels the DCF method supports Carbon's conservative ROE of 12.13%.

II. DEPRECIATION

The PSC should balance creating a depreciation policy that reflects the actual diminution of value of a company's assets over time, with a reflection of what the depreciation expense will be during the effective period of the UUSF distribution. Neither the DPU, nor the OCS presented evidence on what the actual diminution of value of Carbon's asset is. In fact, Hellewell testified that he did not know what the actual diminution of value of Carbon's assets is (T. 216-217, Lns 25, 1-2), but that the DPU's proposed depreciation expense does not accurately reflect Carbon's expected depreciation expense for 2016 or 2017. (T. 209-210, Lns 17-25, 1-5; T.212, Lns 16-20).

The OCS and Carbon have employed a group method of depreciation in this case. The DPU uses a different method, but agrees that considering assets as groups can result in reasonable depreciation expense if the groups are properly configured and an appropriate method is chosen. The calculation of depreciation expense presented by Carbon using the FCC Method of depreciation is undisputed, and results in a depreciation expense that is representative of Carbon's depreciation expense for the next several years. (Woolsey Sur-Surreb., Lns 381-420). Furthermore, the FCC Method as employed by Carbon eliminates errors in service life estimates and properly considers asset lives to reflect changes in the economic life of plant and equipment as required by Utah Code Section 54-7-12.1.

III. OCS ERRORS IN CALCULATIONS AND CONCLUSIONS

Carbon's testimony demonstrates the OCS's proposed adjustments are arbitrary, and the data and conclusions provided by Ostrander are riddled with errors (despite the attempt to correct certain errors with an inappropriate Errata). Specifically, but by no means exhaustively: (1) OCS

has failed to deduct the cable migration adjustment ($200k+), which it withdrew at hearing (T. 267, Lns 11-16); (2) Ostrander used inaccurate income figures to conclude that costs were shifted from non-regulated to regulated operations, and to inaccurately calculate profit margins (Woolsey Rev. Reb., Lns 158-256); (3) Ostrander incorrectly concluded that Carbon does not have any allocation factor that allocates 50%+ of expenses to non-regulated operations, but failed to consider that many costs are direct coded (Woolsey Rev. Reb., Lns 295-306) or that CSR labor is allocated 52% to non-regulated operations (T. 28, Ln 13); (4) the allocation factors used by the OCS improperly double counted payroll figures and did not properly weight factors to account for monthly vs annual figures, or dollars vs counts (T. 288, Lns 10-25); (5) Ostrander did not reallocate shared assets in his net plant number to account for assets held 100% by a non-regulated company (T.286, Lns 16-19); (6) even Ostrander's flawed calculation of the A&G allocation factor (53% regulated) does not support the OCS's proposed A&G allocation factor (50% regulated) (Ostrander Rev. Dir. Ln 729); and (7) Ostrander says allocation factors should be cost causative but offers no testimony that total revenues and total expenses are cost-causative (Ostrander Rev. Dir. Lns 658-665). In short, there are so many errors in Ostrander's testimony that the PSC should not give Ostrander's calculations, or conclusions, any weight.

IV. CONCLUSION

Carbon is entitled to $570,643 in additional UUSF disbursements plus the customary allowance of legal and consulting fees incurred in prosecuting this Application.

Dated this 9th day of March, 2016.

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CERTIFICATE OF MAILING

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

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