Kira M. Slawson (7081)
BLACKBURN & STOLL, LC
257 East 200 South, Suite 800
Salt Lake City, Utah 84111
Telephone (801) 521-7900
kslawson@blackburn-stoll.com

Attorneys for Utah Rural Telecom Association
and its Members

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH	
In the Matter of the 2019 Utah Universal Service Recommendations	UTAH RURAL TELECOM ASSOCIATION'S REPLY COMMENTS DOCKET NO. 18-040-01; 18-043-01; 18-046-01; 18-051-01; 18-052-01; 18-053-02; 18-054-01; 18-576-01; 18-2180-01; 18-2201-01; 18-2302-02; 18-2303-01; 18-2419-01

The Utah Rural Telecom Association ("URTA"), on behalf of itself and URTA members, All West Communications, Inc., Bear Lake Communications, Inc., Beehive Telephone Company, Carbon/Emery Telcom, Inc., Central Utah Telephone, Inc., Direct Communications Cedar Valley, LLC, Emery Telephone, Gunnison Telephone Company, Hanksville Telcom, Inc., Manti Telephone Company, Skyline Telecom, South Central Utah Telephone Association, Inc., UBTA-UBET Communications, Inc. dba Strata Networks, [1] and Union Telephone Company ("Members" or "URTA Members") hereby file these Reply Comments related to the Recommendations made on October 4, 2018 by the Division of Public Utilities ("Division") for Utah Universal Public Telecommunications Service Support Fund ("UUSF") disbursements for rate-of-return providers.

[1] URTA's initial Comments filed on October 30, 2018 inadvertently omitted Strata Networks. This was the unintentional error of counsel for URTA. The Comments filed by URTA were, and these Reply Comments are, filed on behalf of all URTA members, including Strata Networks.

BACKGROUND

On or about October 4, 2018, the Division filed recommendations for each of the URTA Members with the Commission (the "Recommendations"), based on its review of the annual report for each provider. Simultaneously with the filing of the Recommendations, on October 4, 2018, the Division filed Comments alerting the Commission to several issues where there is disagreement between the Division and the URTA members. Pursuant to the Scheduling Order issued in these dockets, on October 30, 2018, the URTA, the Division, the Office of Consumer Services (the "Office"), filed Comments in these dockets ("URTA Comments," the "Division Comments," and the "Office Comments," respectively). Additionally, All West Communications, Inc. and Union Telephone Company each filed comments specific to their companies ("All West Comments" and "Union Comments" respectively). The purpose of these URTA Reply Comments are to respond to the Comments of the Division, the Office, and Union[2] that were filed on October 30, 2018.

REPLY COMMENTS OF URTA

The Division in its Comments recommends that the Commission continue the Utah UUSF on a prospective basis and continue to apply the tax interest synchronization adjustment.[3] The Division further seeks Commission guidance on the treatment of excess deferred income tax ("EDIT") where it cannot be offset against UUSF payments because a carrier with an EDIT account is not receiving UUSF.

[2] All West has withdrawn its Comments.
[3] Division Comments, p. 2.

1. THE COMMISSION SHOULD EMPLOY A HISTORIC REVIEW FOR DETERMINING UUSF.

A. Establishing an Efficient UUSF.

As the Commission is aware, URTA believes SB 130 enacted a paradigm shift with regard to UUSF which was intended to make rate-of-return regulation and UUSF disbursements more efficient, predictable, and cost-effective. In a letter from the Commission to Mr. Adam Sweet at the Office of Legislative Research and General Counsel, dated October 4, 2016 ("PSC Letter") attached hereto as Exhibit 1, the Commission acknowledged that statutory clarification with respect to rate of return and depreciation "would reduce the complexity and administrative costs of a Utah USF proceeding."[4] SB 130 reduced the complexity and administrative costs of UUSF proceeding in at least two ways:

- SB 130 clarified the language regarding UUSF disbursements; and
- SB 130 adopted the federal rate of return for state purposes.

1. Clarification of UUSF Disbursement Process.

One of the means of streamlining the UUSF review process was to clarify the language of Utah Code § 54-8b-15 related to disbursements from the UUSF. Specifically, the Legislature eliminated the previous language found in Utah Code §54-89-15(7) (Utah 2016) that provided:

> To the extent not funded by a federal universal service fund or other federal jurisdictional revenues, the fund shall be used to defray the costs, as determined by the commission, of any qualifying telecommunications corporation in providing public telecommunications services to:
>
> > (a) customers that qualify for a commission-approved lifeline program; and

[4] *Id.* at p. 4.

> (b) customers, where the basic telephone service rate considered affordable by the commission in a particular geographic area is less than the costs, as determined by the commission for that geographic area, of basic telephone service.[5]

Under the previous UUSF statute quoted above, the Commission promulgated rules for rate-of-return carriers. These administrative rules spoke in terms of "embedded costs." Specifically, Utah R746-360-8.A(1) (Utah 2016) provided:

> (A) Determination of Support Amounts —
>
> (1) Incumbent telephone corporation - Monies from the fund will equal the numerical difference between the Incumbent telephone corporation's total embedded costs of providing public telecommunications services, for a designated support area, less the product of the Incumbent telephone corporation's Average Revenue Per Line, for the designated support area, times the Incumbent telephone corporation's active access lines in the designated support area. ''Total embedded costs'' shall include a weighted average rate of return on capital of the intrastate and interstate jurisdictions. . .

Embedded costs are, by definition, historic. Notwithstanding the prior statutory language and prior Commission rules, the actual practice prior to SB 130 by the companies, Division, and Commission was to consider UUSF disbursements as a quasi-rate-case determination and use rate case procedures and timelines set forth in Utah Code §54-7-12 and R746-344.[6] In such rate case proceedings the Commission looked to and relied upon predictions and estimates in forecasted test period cases, and "known and measurable" changes to historic test period costs in historic test period cases to determine support.

SB 130 was expressly drafted to remove these predictions, estimates, and known and measurable changes in order to make UUSF determinations more efficient and to revise disbursements annually—thereby protecting the public interest and consumers from higher than

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[5] Utah Code Section 54-8b-15(7) (Utah 2016).

[6] Prior to the Commission establishing a base affordable rate these proceedings were in fact rate cases since end-user rates were affected. Thus, the rate-case framework and procedures were perpetuated.

necessary UUSF surcharges, while ensuring that UUSF support is sufficient and predictable over time for companies. Specifically, the Legislature in SB 130 enacted Utah Code § 54-8b-15(4)(a) that provides:

> (4) A rate-of-return regulated carrier of last resort is eligible for payment form the Universal Public Telecommunications Service Support Fund if:
>
> > (i) the rate-of-return regulated carrier of last resort provides the services described in Subsections (3)(c)(i) through (iii); and
> >
> > (ii) the rate-of-return regulated carrier of last resort's reasonable costs, as determined by the commission, to provide public telecommunications service and wholesale broadband Internet access service are greater than the sum of:
> >
> > > (A) the rate-of-return regulated carrier of last resort's revenue from basic residential service considered affordable by the commission;
> > >
> > > (B) the rate-of-return regulated carrier of last resort's regulated revenue derived from providing other public telecommunications service;
> > >
> > > (C) the rate-of-return regulated carrier of last resort's revenue from rates approved by the Federal Communications Commission for wholesale broadband Internet access service; and
> > >
> > > (D) the amount the rate-of-return regulated carrier of last resort receives from federal universal service funds.

This language clarifies how the UUSF disbursements shall be calculated. None of the enacted language discusses that such determination is to be prospective, estimated, or forecasted.

Rather, given the history of the legislation and the express purpose of such to streamline the UUSF process, as confirmed by URTA and the Commission in its communications to the Legislature, the term "costs" expressed in the current enacted language must of necessity be actual realized costs since there isn't any provision for cost forecasts or projections, nor is there allowance for known and measurable changes affecting such costs. Reviewing costs from a historic period and eliminating known and measurable changes, however, does not eliminate prudence reviews of the reasonableness of the costs incurred. As URTA previously noted in its initial Comments, the prudence of actual costs realized by the applicant should be reviewed by the Division and the Commission for reasonableness, and if unreasonable costs are found on the applicant's books supporting its request, such costs should be removed by the Division and Commission from the UUSF calculation for the historic period. By reviewing actual realized costs from a historic period, consumers are protected from the effects of erroneous projections.

Additionally, under Commission Rule R746-8-401, the review of the previous historic cost period through the annual report filed with the Commission is to be completed annually, and the UUSF disbursement shall be updated annually. As a result, no "known and measurable" adjustments are required, and the UUSF disbursement process is simplified, predictable, and substantially more accurate than a process based on projections and estimates. Further, this process is efficient because the risk of a company over earning (or receiving too much from the UUSF) is eliminated since the UUSF disbursement is based on reasonable costs and revenue from a historic period.[7] Annual review of the operations of the company and automatic annual adjustment of the UUSF disbursement ensures the UUSF will be operated efficiently for companies and consumers. Additionally, any imprudent behavior by companies can be checked by the Division and the Commission's disallowance of unreasonable or imprudent booked costs retroactively.

As the Commission is aware, the Division's Recommendations for UUSF support filed on October 4, 2018, are based on each company's 2017 Annual Report as required by R746-8-401. If the Division were correct that the UUSF should remain "prospective in nature," the Division would be obligated to include known and measurable changes to the test period based on projections for the distribution period and invite carriers to submit their known and

[7] Under the previous process UUSF disbursements were based on a test year adjusted for known and measurable changes, and those UUSF disbursement would remain in effect indefinitely until the company or the Division sought a change in UUSF.

measurable changes. It did not do this: there was no provision for carriers to include known and measurable changes to reflect a prospective rate-making/UUSF disbursement period. While the Division made some "prudence" adjustment to certain companies' numbers from the Annual Reports, these adjustments were, by and large, to disallow costs incurred during 2017 or to apply the tax rates and rate of return in effect during 2019 (the disbursement period). It does not appear that the Division sought, requested or included any "known and measurable" changes from any company that would be in effect during the "prospective" period when the UUSF funds are to be distributed (2019) – as it would have prior to SB 130. If the Commission agrees with the Division that the UUSF disbursement remains a prospective model, it would be appropriate for URTA's members to include known and measurable changes based on 2018 numbers that will be applicable during the disbursement period of 2019.

Adopting the Division's argument and including known and measurable changes, however, comes with a cost. The cost of adopting the Division's view is to place the UUSF disbursement in the same position it was before SB 130 and negate the procedural efficiencies envisioned by SB 130 and Commission Rule R746-8-401. Under the Division's reading of SB 130, SB 130 would have only applied technical changes, such as the calculation of the rate of return and cost of capital. Such reading belies the change in regime envisioned by SB 130 and would result in a rate case like process every year. URTA believes that SB 130 and its changes to Utah Code § 54-8b-15 now require: 1) the review of a historic cost period; 2) determination of reasonable costs incurred during that period; 3) application of the rate of return applicable to that historical period; and 4) review of the revenues received during that period to determine the revenue requirement for the historic period.

2. Adoption of the Federal Rate of Return

The second means of achieving a predictable, efficient, cost-effective UUSF disbursement methodology was to adopt the federal rate of return. This single action by the Legislature served to eliminate three routinely contested, and highly unpredictable issues:

1. Capital structure determinations
2. Cost of capital determinations; and
3. Cost of debt determinations.

By adopting the federal rate of return for state purposes, the Commission no longer has to determine any individual company's rate of return, which in turn means, the Commission does not have to determine what capital structure to apply to a company; what cost of capital a company should be entitled to; and what cost of debt to use in the calculation.

Utah Code § 54-8b-15(5)(a) now provides:

> (5) A rate-of-return regulated carrier of last resort that qualifies for funds under this section:
>
> > (a) is entitled to a rate of return equal to the weighted average cost of capital rate of return prescribed by the Federal Communications Commission for rate-of-return regulated carriers.

URTA believes the current law which mandates a rate of return equal to the federal rate of return, and the language that requires a determination of the reasonable costs to provide service, requires that the Commission review a historic cost period from which reasonable costs and revenues can be determined and to which the prescribed rate of return can be applied. The Division disagrees in conclusory fashion stating "the language in the current law does not support this conclusion," even as the Division quotes the "support" directly from the current law. The Division also claims that the language in Utah Code § 54-8b-15(2)(b) which states that the

UUSF shall provide a mechanism for carriers of last resort to obtain "specific, predictable, and sufficient funds" suggests prospective application. Finally, the Division claims that a prospective analysis promotes efficiency because "if the utility operates efficiently it has the opportunity to earn its authorized rate of return."[8] The Division is incorrect that a prospective view including known and measurable projections is required by the current statute or that the language regarding "specific, predictable, and sufficient funds" suggests prospective application. The "specific, predictable, and sufficient" language found in Utah code, comes directly from the Federal Universal Service statute and as indicated previously, the FCC uses a historic cost recovery method for high cost support. Further, as described above, URTA does not believe that a prospective analysis is the best way to promote efficiency, or that a prospective approach is consistent with the Utah Code § 54-8b-15.

These two modifications to the statute (statutory changes to UUSF distribution calculation and adoption of the federal rate of return) represent a substantial shift in the regulatory scheme as it related to UUSF, and together result in a more efficient streamlined UUSF process. The change in regulatory scheme is evident by the action of the Commission. In the PSC Letter referenced above, the Commission indicated that it has administered the UUSF "using traditional cost-of-service and rate-of-return principles, established in administrative rule (R76-360)."[9] While the Commission indicated it was "neutral on whether the statute should be modified to establish Utah USF distributions using some other methodology," the Commission indicated that absent statutory changes, the Commission did "not anticipate modifications to that rule."[10] However, the Commission did, in fact, promulgate and adopt a completely new rule

[8] Division Comments, p. 6.
[9] PSC Letter, p. 3.
[10] *Id.*

related to UUSF disbursements (initially R746-360; and ultimately renumbered as R746-8-401). This demonstrates that the Commission views SB 130 and the modifications to Utah Code §54-8b-15 as significant statutory change to the UUSF disbursement methodology that warranted a corresponding change of the administrative rules. This change in the UUSF process to a historic cost-recovery methodology is evident from the intent and language of the statute quoted herein, which has been acknowledged and bolstered by the Commission in its adoption of R746-8-401.

As indicated above, based on the language changes of Utah Code §54-8b-15(4) and (5), and based on Commission Rule R746-8-401, the proper analysis by the Commission is on the company's "reasonable costs." Once the Commission has determined a company's reasonable costs for the historic period, the appropriate rate of return is applied to determine the revenue requirement for the historic period, without alteration for known and measurable changes since such changes will be reflected in the subsequent year's review. To the extent the revenue requirement is not met by revenues received by the company during the historic period, UUSF is appropriate. This approach is consistent with the statute and the rules and protects consumers by setting the UUSF on actual *reasonably determined* costs, rather than estimates and projections. Additionally, this is also the only way to ensure that a company receives the prescribed rate of return as required by Utah Code §54-8b-15(5).

B. Modifications to the UUSF Disbursement Methodology Does Not Constitute Retroactive Ratemaking.

The Division states that "Utah law has long followed the standard method of utility regulation where revenue recovery whether through rates or other revenue sources, is prospective in nature."[11] The Division states that "the prospective nature of ratemaking or rate recovery serves a critical public interest by providing incentives for utilities to operate efficiently."[12] Specifically, the Division cites to *MCI Telecommunications Corp. v. Public Service Commission of Utah*, which states "the prohibition against retroactive rate making is designed to provide utilities with an incentive to operate efficiently."[13] While URTA does not disagree with these statements, they have limited application and/or utility in the context of this matter.

In a general rate proceeding, utility rates are fixed on the basis of projected costs and revenues. The proscription on retroactive ratemaking says you can't have retroactive revenue adjustments in order to guarantee shareholders the rate of return initially anticipated.[14] In cost-based ratemaking, the Division is correct that the Commission sets rates for a future period. However, in Utah telecommunications rates are no longer "cost-based rates" in the traditional sense of the term. Rather, the Commission has, by rule, previously set the affordable base rate for basic telephone service at $18.00 to be consistent with the federal benchmark rate floor.[15] As a result, all companies in Utah must either charge customers $18.00 for basic telephone service; petition the Commission for deviation from that rate; or impute that base rate into their "revenues" before being eligible for distributions from the UUSF.[16] As a result, rates for telephone service are not at issue in this matter.

As the Commission is aware, the proscription against retroactive ratemaking implies that modifications to a utility's filed tariffs and service contracts must be prospective, not

[11] Division Comments, p. 5, *citing MCI Telecommunications Corp. v. Public Service Comm'n of Utah*, 840 P.2d 765,770 (Utah 1992) ("As a general proposition, a utility's recoupment of costs that were greater than projected or revenues that were less than projected from future rates constitutes retroactive ratemaking").
[12] Division Comments, p.5.
[13] 870 P.2. 765, 770 (Utah 1992).
[14] *MCI Telecommunications,* 840 P.2d at 770.
[15] R746-8-401(1)(c).
[16] R746-8-401(2)(b).

retroactive.[17] The "rule against retroactive ratemaking is premised on the implicit understanding that an established rate is not made illegal if it is later found to be impermissible or unreasonable."[18] Because rates for service are not at issue in this matter, the proscription against retroactive ratemaking is not applicable in this analysis. The UUSF disbursement determination does not impact the rates previously approved by the Commission and charged to the ratepayers; it also does not affect the tariffs previously approved or service contracts previously executed. Rather, the issue in this docket is the UUSF disbursements to which each of the companies is entitled.

As demonstrated above, the paradigm shift that has resulted from SB 130 is that UUSF disbursements are no longer determined on projections of costs, adjusted for known and measurable changes. Rather, under Utah Code § 54-8b-15 and R746-8-401, a company's UUSF is based on the company's reasonable costs, as determined by the Commission, the rate of return as prescribed by the FCC, and the revenues received by the company. Therefore, these cases do not involve a retroactive rate adjustment. Rather, URTA is suggesting that the appropriate UUSF determination after SB 130 is the determination of a company's revenue requirement based on a review of 2017's numbers. Because the Commission has not previously conducted a review of any company's 2017 numbers, nor previously made a determination of any company's 2017 revenue requirement, this is a review and determination of each company's revenue requirement for a particular period, and is not retroactive ratemaking.

There are no prohibitions in Utah or federal law that prohibits the UUSF distributions from being based on review of a historical period, with the payment due for that period in some

[17] Filed Rate Doctrine in Kentucky by William Steven Seelye, The Prime Group, LLC, https://psc.ky.gov/pscecf/2018-00050/mmalone@hdmfirm.com/05072018025426/Seelye_Exhibit_4.pdf.
[18] Verizon Tel. Cos. v. FCC, 348 U.S.App. D.C. 98, 107, 269 F.3d 1098, 1107 (2001).

future year due to regulatory lag. In fact, this is exactly what the FCC does with high-cost support. The FCC reviews a company's financial information for a historic period; determines a company's reasonable costs for that historic period; applies the FCC's rate of return; and determines the high-cost support that said company is entitled to for that period. The Federal high-cost support, if any, is paid to the company approximately eighteen (18) months later, due to regulatory lag. This program of support certainly does not amount to retroactive ratemaking and has been in effect at the FCC for some years. URTA is suggesting that the State mirror this process. Such mirroring is consistent with the purpose of SB 130.

C. Practical Considerations Do Not Require Forward Looking UUSF.

The Division suggests there are practical consideration that require a forward looking UUSF. This is not true. The Division argues that "each company has received the full amount that it is entitled to through the end of 2018 as of the final 2018 payment," and that "under prior precedent, those payments would not be subject to true-up whether up or down outside of an extraordinary and unforeseen event. "In short," the Division contends, "the 2018 revenue shortfall was provided to the UUSF recipients during 2018."[19] The Division states that "assuming 2017 and 2018 payments were prospective, should companies receive payments from the UUSF during 2019 to pay for costs incurred in 2017 or 2018 again?"[20] Although, the point is not entirely clear, it appears that the Division seems to be laboring under two mistaken assumptions: 1) that the UUSF payments received in 2018 were calculated using the 2017 historical period; and 2) that a current calculation of UUSF payments based on the operations

[19] Division Comments, p. 7.
[20] *Id.*

from 2017 will somehow result in a company receiving additional payments to which the company is not entitled.

In fact, the payments received by companies in 2018 were based on the calculations performed by the Division and Commission at each company's last UUSF case or rate case. In some instances, the amount of such support was determined 5, 10, or even more years ago, and has virtually no connection to the operational realities and actual revenue shortfall at the companies today. To say that the 2018 revenue shortfall was provided to UUSF recipients in 2018 is a substantial over simplification of the matter. In reality, it is only accurate to say that the companies received UUSF payments in 2018 that were, at some time, representative of the revenue shortfall of the company. The "revenue shortfall" received by companies in 2018 certainly were not based on a review of 2017 or 2018 operational numbers.

Moreover, even if the Commission were to assume that the payments received in 2017 or 2018 were representative of the shortfall experienced by the companies because, as the Division frequently states, no company sought an increase in UUSF in 2017 or 2018, calculating the companies' UUSF based on 2017 numbers does not result in a windfall to the companies. If the Commission were to move to the historic cost-recovery program contemplated by SB 130 and Utah Code §54-8b-15, and as urged by URTA, reviewing 2017 annual reports and basing the UUSF on this historical period will ensure that the UUSF is based on actual reasonable costs reported. Beginning with the annual report of 2017 and calculating the UUSF on 2017 historical (and reasonable costs), will not result in the company's receiving UUSF payments for 2017 or 2018 "again". Nor will such approach result in a company receiving any "extra" UUSF payments. Rather the companies received what they received in 2018, regardless of how it was historically calculated, and in 2019 they will receive UUSF payments based on 2017 numbers.

Next year, the Division will review the 2018 annual reports and the companies will receive the UUSF based on those annual report numbers from 2018 but paid in 2020 (regulatory lag). URTA is not suggesting a "true -up" process whereby the UUSF is based on projections for 2017, and then upon review of 2017 numbers, the UUSF is "trued-up" to the actual 2017 numbers, therefore no balancing account is needed. Rather, URTA is stating that SB 130 and R746-8-401 ask the regulators to determine UUSF by looking at historical costs. Because this process cannot be completed immediately at the end of the historic cost period, the payments based on those calculations are paid approximately 12 months after the close of the historic period. The process does not "true-up" the payments to projections previously made. In fact, no projections are involved in the calculation. The process calculates the UUSF payments based on the reasonable costs expended by the companies, with no adjustment needed for known and measurable changes (because it's a historic review), plus the annual rate of return, minus revenues received. The review process is completed every year, so companies cannot over earn or underearn—resulting in a more efficient UUSF.

D. Tax Rates and Rate of Return Applied in a Historic Cost-Recovery Model Should Be the Rates in Effect During the Historic Period Reviewed.

As indicated in URTA's Comments, historically a company's revenue requirement has been "grossed-up" for taxes that will be owed based on the tax rate in effect during the historic period reviewed. The Division used the 2019 tax rate to gross-up the revenue requirement for the 2017 historic cost-recovery period because, according to the Division, these are the "tax rates that will be in effect during the rate effective period."[21] URTA has argued that Utah Code § 54-8b-15, and Commission rule R746-8-401 contemplate a historic cost-recovery method of

[21] Division Comments, p. 2.

determining the UUSF. If the Commission agrees with this approach, the tax gross-up of the revenue requirement must be based on the tax rate in effect during the historic period being reviewed for the reasons described above and set forth in URTA's original Comments. Utilization of the tax rate for the period of historic cost-recovery (2017 in this instance) will provide predictability for the providers; will be consistent with federal treatment of this issue; and because the UUSF review is being done annually, any changes in the tax rates will be factored in during the Division's review of the providers subsequent annual report for the year the tax rate actually becomes effective. This historic review process ensures consistent treatment year after year, regardless of whether tax rates go up or down.

If the Commission does not apply a historic review process, the Commission must ensure that the differences between USF calculations and federal and state tax return calculations, as well as book to tax timing difference, are properly addressed and accounted for as discussed more fully in URTA's Comments. URTA believes that a change from the current state and federal practice of "grossing-up" the revenue requirement for taxes based on the tax rate for the historic cost-recovery period, would create more problems than it would solve.

Similar to the applicable tax rate issue, the rate of return to be applied should be the rate in effect during the historic review period. This is consistent with the federal HCLS process. As discussed more fully in URTA's initial Comments, the FCC applies the rate of return that matches the period of historic cost-recovery as required by Utah Code § 54-8b-15(5)(a), and consistent with the Utah Legislature's directive that the providers shall be entitled to the rate of return as prescribed by the FCC. As previously stated in URTA's Comments, if the Division's method is employed, the providers will receive 10.375% rate of return[22] from the State based on 2017 operations, while receiving 10.875% from the FCC for the same period.

2. INTEREST SYNCHRONIZATION IS NOT APPLICABLE OR APPROPRIATE AS A RESULT OF SB 130.

The Division is correct that as of recently, prior to SB 130, interest synchronization was used in UUSF disbursement determinations for telecommunications providers. However, because SB 130 has mandated that the rate of return in Utah mirror the FCC's prescribed rate of return, interest synchronization is no longer appropriate or applicable. In URTA's Comments, URTA discussed, at length the mechanics of interest synchronization and its inapplicability to the UUSF calculation as a result of SB 130. Those arguments are incorporated herein and will not be repeated.

The Division has indicated that eliminating interest synchronization would exclude prudence review by the Commission. The Division is partially correct in that SB 130 and adoption of the FCC's rate of return eliminated the need for any review of a company's capital structure, and the prudence associated with any particular capital structure. The "prudence" of a particular capital structure was considered by the FCC in determining its prescribed rate of return, and no further analysis of that is permitted or required.

However, it is wholly inaccurate to say that eliminating interest synchronization excludes prudence review by the Commission. In fact, as demonstrated in URTA's initial Comments, and as demonstrated herein, Utah Code § 54-8b-15 requires the Commission to determine each company's reasonable costs, and allows—even requires—that imprudent costs be eliminated.

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[22] Assuming interest synchronization is not applied to lower the effective rate of return.

The Division's application of an interest synchronization adjustment attempts to take the hypothetical capital structure used by the FCC in the determination of the federal rate of return and use it to determine a hypothetical interest expense, using a hypothetical cost of debt. This is not appropriate because the FCC already took these issues into consideration in determining the FCC prescribed rate of return. The FCC prescribed rate was adopted in the FCC's March 23, 2016 Report and Order.[23] In determining the rate of return, the FCC indicated that "there is a zone of reasonableness within which reasonable rates may fall, and that the regulatory agencies are entitled to exercise judgment in selecting a rate of return within that zone."[24] Further, the FCC noted that "in general, the zone of reasonableness balances financial interests of the regulated company and relevant public interests."[25] In represcribing the rate of return, the FCC expanded the zone of reasonableness and adopted the rate of return from the upper end of the zone. [26] In particular, the FCC stated "there are hundreds of rate-of-return incumbent LECs. Some will have a relatively high and some a relatively low cost of capital. At the same time, we adopt an authorized rate of return that applies to all of these carriers."[27] Further, the FCC noted that the rate of return is supposed to "compensate equity holders and debtholder who provide funds used to finance the firm's assets. Given a rate of return set equal to 9.75 percent, an **average capital structure** based on our **estimates** of 54.34 percent debt, and a cost of debt based on our **estimates** of 5.87 percent, the implied cost of equity is 14.37 percent."[28] This language demonstrates that the FCC already factored a prudent capital structure into the prescribed rate, and the prescribed rate is applicable to all carriers regardless of their debt

[23] FCC Report and Order, Order and Order on Reconsideration, and Further Notice of Proposed Rulemaking, Docket WC 10-90; WC 14-58; CC 01-92, ¶323 ("FCC Order").
[24] FCC Order at ¶319
[25] *Id.*
[26] *Id.* at ¶321.
[27] *Id.*
[28] *Id.* at ¶322.

structure or cost of debt. As previously discussed in URTA's Comments, the Division's inclusion of interest synchronization takes the mandated rate of return and effectively reduces it for a provider with no debt. Because the application of an interest synchronization adjustment effectively lowers the rate of return, it is not appropriate for State purposes.

3. EXCESS DEFERRED INCOME TAX

URTA, the Division, and the Office of Consumer Services ("Office") have met to discuss EDIT. The parties are close to resolution of these issues and hereby ask the Commission to refrain from addressing this issue at this time. The Parties anticipate an agreement on this issue will be reached with further discussion.

4. URTA'S RESPONSE TO THE COMMENTS FILED BY UNION TELEPHONE COMPANY.

In Union's Comments, Union Telephone Company ("Union"), indicated it has opted into the Alternative Connect America Cost Model ("A-CAM"), and identified an issue relating to the Division's inclusion of A-CAM revenues received by Union in the Division's analysis of UUSF for Union. Specifically, Union expressed concerns that the Division's analysis for UUSF purposes failed to account for the method Union uses to submit its financial results. Union states that it removes all costs associated with broadband deployment[29] in the separations process and such costs are not included in Union's annual report. The total federal USF revenues, including A-CAM support were, however, reported in Union's annual report submitted to the Commission. As a result, in the Division's recommendation for Union, federal broadband revenues have been included without a corresponding inclusion of the associated costs. Union indicates, and URTA agrees, that for UUSF analysis, there must be a correlation between revenues and expenses. As a

[29] Union uses the term "broadband internet service." However, Union provides wholesale broadband internet access service as that term is used in Utah Code §54-8b-15.

result, URTA believes that the costs associated with Union's wholesale broadband internet access service deployment[30] should be included in Union's annual report and the Division's analysis for UUSF purposes.

Union's Comments also identify what Union sees as an inconsistency between the Utah legislature and federal law. Union states that Utah Code § 54-8b-15(1)(a), which identified "broadband internet access service" as defined in 47 C.F.R. § 8.2 is now inconsistent with federal law because in the FCC's Net Neutrality Order, the FCC removed the definition of "broadband internet access service" from 47 C.F.R. § 8.2. While Union is correct that the FCC removed that definition from 47 C.F.R. Sec. 8.2, that rule change is currently under review.[31] Additionally, while the definition was removed from 47 C.F.R. § 8.2, the same definition is currently found in 47 C.F.R. § 8.1(b) so while Utah's citation in the statute may be inaccurate,[32] Utah's inclusion of this definition and the service identified is not in conflict with the FCC.

Moreover, and more relevant for our purposes, this definition applies to retail broadband internet access service, not wholesale broadband internet access service, which is the applicable service. So while it may be accurate to say broadband internet access service is not regulated, wholesale broadband internet access service is a rate-of-return carrier of last resort service that is specifically supported by the UUSF, and as such, companies are entitled to UUSF support for deployment and management of networks capable of providing wholesale broadband internet

[30] Despite somewhat ambiguous statements found in Union's Comments, URTA believes that Union offers wholesale broadband internet access service.
[31] *Mozilla Corporation, et. al. v. Federal Communications Commission*, Docket No. 1801051, United States Court of Appeals, District of Columbia.
[32] URTA suggests that a change in the statute to correct this reference should not be undertaken until such time as the Rule has been reviewed and upheld. At that point the Utah Code §54-8b-15(1)(a) can be updated to reflect the accurate citation if needed.

access service.[33] As a result, the costs associated with the provision of such service should be included in Union's annual report, and should be subject to recovery by Union. URTA supports the inclusion of these reasonable costs in Union's annual report and UUSF analysis. To the extent further comment and/or a hearing is required on the issues specifically related to Union, URTA would support such action.

CONCLUSION

URTA again appreciates the opportunity to provide these Reply Comments. In short, URTA believes that Utah Code § 54-8b-15, and Commission rule R746-8-401 contemplate a historic cost recovery approach like the federal HCLS program which looks at operations for a particular year, applies the appropriate rate of return for that same year; and utilizes a tax gross-up based on the tax rates applicable for the same year. The Division's concerns about prudence and timing are unfounded and the Division seems to be making this process substantially more difficult than it needs to be. Under the method set forth in SB 130, and R746-8-401, there is no need for a transition period; there is no "true up" to projections; there are no known and measurable changes; there is no over or under earning; there is no retroactive ratemaking; and companies are incentivized to operate efficiently because their expenditures are reviewed for reasonableness after the fact. URTA further supports the incorporation of these issues into R746-8-401 as needed.

[33] Utah Code §54-8b-15(3)(c).

DATED this 15th day of November, 2018.

BLACKBURN & STOLL, LC

Kira M. Slawson
Attorneys for Utah Rural Telecom Association

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of URTA's Reply Comments on the Division's Recommendations, Docket 18-040-01, et. al., was served the 15th of November, 2018 as follows:

DIVISION OF PUBLIC UTILITIES (by email)

Justin Jetter
jjetter@agutah.gov

Chris Parker
chrisparker@utah.gov

Bill Duncan
wduncan@utah.gov

OFFICE OF CONSUMER SERVICES (by email)

Robert Moore
rmoore@agutah.gov

Michele Beck
mbeck@utah.gov

Cheryl Murray
cmurray@utah.gov

Steven Snarr
stevensnarr@agutah.gov

Kira M. Slawson

Exhibit 1

PSC Letter Dated October 4, 2016

State of Utah

GARY R. HERBERT
Governor

SPENCER J. COX
Lieutenant Governor

Public Service Commission

THAD LeVAR
Chair

DAVID R. CLARK
Commissioner

JORDAN A. WHITE
Commissioner

October 4, 2016

Adam Sweet
Policy Analyst
Office of Legislative Research and General Counsel
asweet@le.utah.gov

Re: Public Service Commission Input on Issue Matrix

Mr. Sweet,

As you requested, attached to this letter is the feedback from the Public Service Commission on the 12 questions you distributed to stakeholders participating with the Utah Universal Service Fund Working Group. Please let me know if you have any questions.

Sincerely,

Thad LeVar

Thad LeVar, Chair
Public Service Commission of Utah

1. Need for the Utah USF.

The statutory purpose of the Utah USF is to defray the costs of providing telecommunications services in high-cost areas of Utah. According to June 2015 FCC Form 477 data, the ratio of residential telephone lines to households was roughly equivalent between urban Utah (42.37%) and rural Utah (41.67%). Because the companies providing service in rural areas, and receiving Utah USF distributions, engage in both regulated and unregulated activities, the PSC does not have the data on which to opine on whether continued Utah USF distributions are necessary to maintain that level of telecommunications service at affordable rates. Our Utah USF cases demonstrate that when looking solely at the regulated activities, distributions continue to defray costs. Length of lines still has a direct impact on the cost to serve each customer.

2. Objectives for Utah USF.

Residential telephone service appears to have been adopted in rural Utah at levels roughly equivalent to urban Utah. Therefore, the relevant question may be whether continued Utah USF distributions are necessary to maintain that accomplishment. On that question the PSC defers to those who collect Utah USF surcharges and those who receive Utah USF distributions.

With respect to the Utah USF Objectives, the PSC has interpreted the statutory requirement to "defray" costs, through orders and administrative rules (R746-360), as full recovery of regulated costs. Absent legislative direction otherwise, the PSC would intend to continue that interpretation as long as available Utah USF funds allow that outcome.

3. USF reform - Is legislative action required at this time?

The position of the PSC is that legislative action is not necessary, but should be considered. In the absence of legislative action, the PSC will simply continue to maintain and administer the Utah USF as it has been doing. For the reasons outlined in the PSC's April letter to the legislative committee, and its June interim presentation, that scenario would be likely to include more frequent, and less gradual, increases to the Utah USF surcharge.

In the event legislative action does occur this year, there is one additional, but minor, recommendation that the PSC failed to include in its September letter to the Utah USF Working Group. Utah Code Ann. § 54-8b-15(2) establishes the Utah USF as an "expendable special revenue fund." Each year the Legislature has enacted intent language that the Utah USF should be nonlapsing. If the fund balance ever did lapse at the end of a fiscal year, both the surcharge and distributions could be significantly impacted. If the legislature modifies the Utah USF statute, the PSC recommends that the Legislature consider stronger language with respect to this issue. One template is currently in place for the Speech and Hearing (Telecommunications Relay) Fund the PSC administers. Utah Code Ann. § 54-8b-10(5) establishes the Speech and Hearing fund as "dedicated credits" and states that the "[m]oney received by the commission [through that statute] is nonlapsing."

4. USF surcharge parity.

Legislative clarification on the applicability of the Utah USF surcharge to VoIP could broaden the base and lower the rate for the surcharge in a way that would not subject the PSC to the litigation that would be possible if the PSC took action administratively.

5. USF per line/connection surcharge methodology.
As outlined in the September letter from the PSC to the Utah USF Working Group, the PSC supports a statutory modification of the Utah USF surcharge to a flat, per-line/account surcharge. This change could stabilize the surcharge necessitating less frequent increases. A statutory clarification could enable this outcome in a way that would not subject the PSC to the litigation that would be possible if the PSC took action administratively.

6. Should the Utah USF transition to support High Speed Internet (HSI)?
The PSC is neutral on whether this transition should occur in Utah to match action taken by the FCC with respect to the federal USF. However, if Utah USF distributions are to be used to support HSI, then the Utah USF surcharge also should be applied to HSI service.

Technology, infrastructure needs, and competition have changed significantly since the Utah USF was created. Currently, distributions are paying for infrastructure upgrades that support both telephone and HSI service. Maintaining or expanding that result impacts market competition.

Additionally, as outlined in the PSC's September letter to the Utah USF Working Group, using the Utah USF for HSI is likely to require PSC decisions that are more subjective than are the decisions the PSC currently makes. If the statute is modified in this way, the PSC hopes the Legislature will consider a modification to the appeal rights from that narrow type of decision to give the PSC somewhat more plenary authority in those instances.

7. Are changes to the Utah Lifeline program needed?
Because it is funded through Utah USF revenues, any changes to the Utah Lifeline program should run parallel to changes to the Utah USF. Lifeline expenses have been relatively small and declining. If the Utah USF is expanded or shifted to HSI, then the same should be done for Lifeline. If the Utah USF remains telephone-only, the same should occur for Lifeline. In the event that Utah Lifeline remains telephone-only, use of the Utah Lifeline program is expected to decrease (possibly to zero) as the federal Lifeline program shifts to HSI.

One way or the other, a statutory clarification with respect to Lifeline would be helpful. Currently in statute, there is only a passive reference to "a commission-approved lifeline program." (Utah Code Ann. § 54-8b-15(7)(a))

8. Obligations associated with receiving Utah USF funding.
The PSC has administered those obligations using traditional utility cost-of-service and rate-of-return principles, established in administrative rule (R746-360). The PSC is neutral on whether the statute should be modified to establish Utah USF distributions using some other methodology, but absent statutory changes, does not anticipate modifications to that rule.

9. Should the TRS and USF surcharges be combined?
As stated in its September letter to the Utah USF Working Group, the PSC does not oppose that change.

10. Reducing costs/Evaluating cost vs. benefits.

The PSC recognizes that administering Utah USF distributions through cost-of-service and rate-of-return principles involves both time and litigation expenses (typically paid from Utah USF distributions). Current statutory language, based heavily on the concept of costs, requires individual evaluations. Moving to a more simple statutory methodology (for example, a standard distribution amount based on total residential and business lines) would be less time consuming and less expensive, but would not recognize that costs to serve customers in some areas are higher than in others. Length of lines still has a direct impact on the cost to serve each customer.

11. Supporting wireless cell sites in rural high cost areas.

The PSC does not oppose a statutory modification to make one-time Utah USF distributions available for this purpose. However, as noted in the PSC's September letter to the Utah USF Working Group, that kind of a distribution would require PSC decisions that are more subjective than are the decisions the PSC currently makes. If the statute is modified in this way, the PSC hopes the Legislature will consider a modification to the appeal rights from that narrow type of decision to give the PSC somewhat more plenary authority in those instances. The PSC does not have the data to estimate the precise fiscal impact of this change on the Utah USF, but it would certainly increase both distributions and the surcharge.

12. Streamlined Rate-of-Return (ROR) regulation: Involving ROR, depreciation and administrative costs of a USF proceeding.

The PSC does not oppose statutory clarification with respect to rate of return and depreciation, which would reduce the complexity and administrative costs of a Utah USF proceeding.

By way of background, in a recent Utah USF case, the PSC did not adopt the methodologies proposed by the utility with respect to rate of return and depreciation. That case is currently on appeal to the Utah Court of Appeals.

While the PSC is neutral on the policy issue, it is important to inform the Utah USF Working Group of the financial implications of that change. The PSC has not seen any statutory language proposed by anyone. Even if we could evaluate specific statutory language, it is difficult to predict accurately how the changes would affect individual Utah USF distributions. However, some recent rough calculations, based on data available, indicate that if the rate of return and depreciation methodologies recently rejected by the PSC were applied to each utility currently receiving Utah USF distributions, total distributions (and correspondingly, the surcharge) could double.