

JUSTIN C. JETTER (#13257)  
 PATRICIA E. SCHMID (#4908)  
 Assistant Attorney Generals  
 Counsel for the DIVISION OF PUBLIC UTILITIES  
 SEAN D. REYES (#7969)  
 Attorney General of Utah  
 160 E 300 S, 5<sup>th</sup> Floor  
 P.O. Box 140857  
 Salt Lake City, UT 84114-0857  
 Telephone (801) 366-0335  
 jjetter@agutah.gov  
 Attorneys for the Utah Division of Public Utilities

**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

2019 Utah Universal Service Fund Preliminary Recommendation for Central Utah Telephone, Inc.	DOCKET NO. 18-040-01
2019 Utah Universal Service Fund Recommendation for Citizens Telecommunications Company of Utah dba Frontier Communications of Utah	DOCKET NO. 18-041-02
2019 Utah Universal Service Fund Recommendation for Emery Telephone	DOCKET NO. 18-042-01
2019 Utah Universal Service Fund Preliminary Recommendation for Gunnison Telephone Company	DOCKET NO. 18-043-01
2019 Utah Universal Service Fund Recommendation for Manti Telephone Company	DOCKET NO. 18-046-01
2019 Utah Universal Service Fund Recommendation for Navajo Communications Company, Inc. dba Frontier Navajo Communications Company	DOCKET NO. 18-050-02
2019 Utah Universal Service Fund Preliminary Recommendation for Beehive Telephone Company, Inc.	DOCKET NO. 18-051-01
2019 Utah Universal Service Fund Recommendation for South Central Utah Telephone Association, Inc.	DOCKET NO. 18-052-01
2019 Utah Universal Service Fund Recommendation for UBTA-UBET Communications, Inc. dba Strata Networks	DOCKET NO. 18-053-02

2019 Utah Universal Service Fund Recommendation for Union Telephone Company, Inc.	DOCKET NO. 18-054-01
2019 Utah Universal Service Fund Preliminary Recommendation for Skyline Telecom	DOCKET NO. 18-576-01
2019 Utah Universal Service Fund Recommendation for All West Communications, Inc.	DOCKET NO. 18-2180-01
2019 Utah Universal Service Fund Preliminary Recommendation for Bear Lake Communications, Inc.	DOCKET NO. 18-2201-01
2019 Utah Universal Service Fund Recommendation for Carbon/Emery Telcom, Inc.	DOCKET NO. 18-2302-02
2019 Utah Universal Service Fund Recommendation for Hanksville Telcom, Inc.	DOCKET NO. 18-2303-01
2019 Utah Universal Service Fund Preliminary Recommendation for Direct Communications Cedar Valley, LLC	DOCKET NO. 18-2419-01
	<b>DIVISION OF PUBLIC UTILITES COMMENTS IN RESPONSE TO URTA</b>

Pursuant to Utah Code Ann. §54-4a-1 and Utah Admin. Code r.746-1, the Division of Public Utilities (“Division”) submits these Comments in Response to the Utah Rural Telecom Association (“URTA”). The Division recommends that the Public Service Commission of Utah (“Commission”) continue the Utah Public Telecommunications Service Support Fund (“UUSF”) on a prospective basis, continue to apply the tax interest synchronization adjustment, and provide guidance on the treatment of EDIT where it cannot be offset against UUSF payments.

## **INTRODUCTION**

Pursuant to Utah Admin Code r.746-8-401 the Division filed preliminary recommendations regarding UUSF adjustments in the above captioned 16 dockets on October 4, 2018. On October 5, 2018 the Division filed related Comments in Docket No. 18-999-09 addressing the cumulative impacts on the UUSF of those recommendations. On October 11, 2018 the Commission held a scheduling conference in the above captioned dockets. Pursuant to the Scheduling Order, on October 30, 2018 the Division and other parties filed Comments. The Scheduling Order set November 15, 2018 for responsive Comments. The Division files these Comments in response to the October 30, 2018 comments.

## **DISCUSSION**

In its October 30, 2018 Comments the Utah Rural Telecom Association (“URTA”) addressed the following issues in response to the Division’s preliminary recommendations on UUSF for its members. URTA argues that the UUSF should be an historic cost-recovery mechanism and as such should apply 2017 tax rates and the 2017 rate of return to the 2017 results of operations and use that as the calculation for 2019 UUSF payments. URTA further requests that the UUSF payments not be a true-up based on actual known tax payments for 2017, but rather use a tax gross up to estimate taxes that are already known. URTA opposes tax interest synchronization adjustments made by the Division. And URTA requests additional process to determine the appropriate treatment of EDIT.

The Division disagrees with URTA that the UUSF was converted to an historic cost recovery mechanism as a result of SB 130 and does not support converting the UUSF to an historic cost recovery mechanism. 2019 UUSF payments should continue as a prospective

subsidy for 2019 operations using 2017 actual numbers as a basis for adjusting 2019 UUSF rates. If 2019 is a cost recovery period for 2017 operations, the 2017 actual taxes should be used. Additionally, the Division requests guidance on whether 2017 subsidy payments should be included in the analysis of 2017. The Division continues to support the prudence adjustment for tax interest synchronization because it is applied by the FCC and Utah historically and SB 130 did not eliminate its application. Finally, the Division supports additional process to seek a solution for the appropriate treatment of EDIT.

### **Utility Cost Recovery Is Prospective**

In its Comments URTA asserts that one of the primary effects of SB130 was to transform the UUSF program from one where UUSF is calculated on a forward looking basis providing the utility an opportunity to earn its authorized rate of return on an ongoing basis to “an historic cost-recovery process similar to federal high cost loop support (HCLS)...”<sup>1</sup> URTA explains that HCLS support “reviews reasonable expenses incurred in a past period and determines a revenue requirement based on those reasonable expenses.” And that calculated “revenue requirement is then paid during a future period.”

The Division finds no support in Utah law or Commission precedent for URTA’s proposal to follow the FCC’s HCLS method of paying for prior costs in future periods as a true up mechanism. As the Division’s initial Comments explained, the Utah UUSF has been prospective in nature and SB130 did nothing to reverse that process. Utah Code Ann. §54-8b-15 provides for two types of subsidies: “reimbursement of reasonable costs” for one-time funding under §54-8b-15(4)(a) and support for ongoing costs exceeding revenue for rate of return

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<sup>1</sup> URTA Comments at p.5.

regulated carriers of last resort under §54-8b-15(4)(b). There is no mention of alignment with the federal HCLS timing or payment methods.

In addition to not being supported in state law, URTA's arguments do not completely reflect the FCC programs. The FCC has repeatedly raised the concern that the HCLS program was encouraging a "race to the top" where HCLS recipients were incentivized to spend inefficiently.<sup>2</sup> This was one of the primary reasons for the FCC shift toward model-based support. Moreover, the FCC actions have not supported the view that federal USF funds are necessarily a cost recovery entitlement for prior periods. Recently when the FCC explained that HCLS is not an entitlement for past periods.<sup>3</sup>

[A]pplication of these rules may affect the amount of support a carrier receives for expenditures made in 2013, it does not change the legal landscape in which those expenditures were made. Rather, as the Commission observed in the *USF/ICC Transformation Order*, "section 254 directs the Commission to provide support that is sufficient to achieve universal service goals, [but] that obligation does not create any entitlement or expectation that ETCs will receive any particular level of support or even any support at all..."

Using the UUSF as an historic mechanism for cost recovery to true up any of the costs in prior periods the FCC intentionally chose to reduce would act to directly thwart the FCC's implementation of changes to the HCLS that encourage efficiency. The Division recognizes that the UUSF program does have the effect of canceling out FCC incentives regardless of whether it is prospective or historical because it effectively offsets the FCC's changes, however a guaranteed historical true up would do so to a greater degree than a prospectively set UUSF.

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<sup>2</sup> *In the Matter of Connect America Fund*, 29 FCC Rcd. 15644 ¶ 101 ("we continue to have significant concerns regarding the structure and incentives created under the existing high-cost mechanisms for rate-of-return carriers, such as the 'race to the top' incentives that exist under HCLS.")

<sup>3</sup> *Id.* at ¶ 111.

## **Tax Gross-Up Should Only be Applied to Estimate Future Tax Costs**

URTA recommends that the Commission apply the 2017 tax rate for the 2019 year UUSF calculation, but also suggests that the Commission not use actual 2017 tax bills as a basis for calculating the 2017 taxes. Forward looking cost estimates that are projected to provide a fair return on equity have long been the standard for the reasons explained in the Division's initial Comments. Using forward looking cost estimates under the traditional rate making approach to calculating UUSF requires the use of estimated tax expense. For this reason, using a tax gross up factor is the standard method for such a calculation.

If the Commission does choose to provide UUSF as an historical cost recovery mechanism as suggested by URTA, the test year is no longer a test year, but rather the actual year. In light of that view, the meaning of reasonable costs when such costs are known does not support the use of a tax gross up. In an historical recovery UUSF model, reasonable costs are those costs actually incurred during the year that is being recovered. Using a tax gross up when actual tax expenses are known would introduce an entirely unnecessary step in the process of calculating the UUSF amounts.

The request that the UUSF compensate carriers again in 2019 at a 34% tax rate that ended on January 1, 2018 is not reasonable. Other regulated utilities in Utah have already agreed to refund the tax savings to customers for the 2018 year.<sup>4</sup> Even if the Commission chooses to adopt

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<sup>4</sup> See *Investigation of Revenue Requirement Impacts of the New Federal Tax Legislation Titled: "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution of the budget for fiscal year 2018"* Docket No. 17-035-69 and *Investigation of Revenue Requirement Impacts of the New Federal Tax Legislation Titled: "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution of the budget for fiscal year 2018"* Docket No. 17-057-26.

an historic cost recovery mechanism, the desire to use a 34% tax rate for payments in 2019 continues to be a perplexing request. The UUSF has already provided payment for the 2017 year of service. 2017 tax costs have already been provided. There is no public policy justification or statutory support for paying a 34% tax gross up in 2019.

### **The Rate of Return Should Match the UUSF Subsidy Payment Year**

The Division applied the rate of return set by the FCC for the year that the UUSF payments will be made. There is no dispute between the Division and URTA as to the appropriate WACC that the FCC has set for 2019. The dispute regarding the WACC used is similar to the tax rate issue. The UUSF has compensated carriers for the 2017 year's operations. The Division calculated the forward looking 2019 UUSF based on providing the carriers the opportunity to earn the 2019 rate of return in 2019. The Division did use the 2017 results of operations as provided by the carriers as the basis for projecting 2019 expenses and revenues.

The Division did not apply the 2019 rate of return retroactively to 2017 because the Division did not make a recommendation for a true-up of 2017 operations. If the Commission rules that the UUSF is an historical true-up mechanism, the Division's calculations would need significant revisions as well as additional guidance from the Commission. The Division will need guidance on whether the Division should include 2017 UUSF payments in its true-up calculation for the 2017 year's operations. The UUSF paid a subsidy to many carriers during the 2017 year to subsidize 2017 operations. It would be unreasonable not to include those revenues in the 2017 analysis if the UUSF is intended as a true-up to be paid in 2019. Additionally, the Division would need guidance on whether it should also be calculating a 2019 interim subsidy amount that would be trueed up in 2021.

## **Interest Synchronization is an Appropriate Prudence Adjustment**

URTA comments oppose the application of interest synchronization adjustments made by the Division. UTRA agrees that §54-8b-15 continues to provide the Commission authority to make prudence adjustments but disputes the imputation of interest synchronization. URTA argues that SB 130 was intended to eliminate arguments over capital structure by using the FCC prescribed rate of return. URTA suggests that the FCC “took into consideration a prudent level of equity and debt” when it calculated the cost of capital.

Interest synchronization is a common adjustment and is supported by the Utah Commission precedent and by the FCC. The FCC addressed the issue of interest synchronization when applying a uniform rate of return for cable television providers. In 1994 the FCC implemented the Cable Television Consumer Protection and Competition Act of 1992 the FCC chose to set “an overall rate of return for application to cable operators in individual cost-of-service proceedings.”<sup>5</sup> In this context the FCC addressed the question of interest synchronization.

The FCC reversed the local jurisdiction and required an interest synchronization adjustment. The FCC stated that;

In calculating federal and state taxes allowed to be recovered in rates, however, the Computed Return on Rate Base is reduced by the interest expenses so that it reflects only the equity portion of the return that is subject to income taxes. Because the 11.25% rate of return is based on an imputed debt/equity structure, the appropriate interest expense used in the calculation should be based on the same assumptions used in setting the rate of return, rather than on the operator's actual interest expense.<sup>6</sup>

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<sup>5</sup> *In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service*, 9 FCC Rcd. 4527, at ¶147 (1994).

<sup>6</sup> *In re Tele-Media Co. of Va.*, 15 FCC Rcd. 4351, at ¶ 20 (2000).



Like the FCC, the Federal Energy Regulatory Commission also applies interest expense adjustments. “The interest expense deduction should be the same as the interest expense component of the cost of capital used to develop the return allowance... This procedure is commonly called interest synchronization.”<sup>7</sup>

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<sup>7</sup> *South Carolina Electric & Gas Company*, 63 FERC P 61218, 62600 (1993).

### **The Commission Should Allow Additional EDIT Process**

The Division agrees with URTA that the issue related to EDIT addressed in the Division's initial Comments and URTA's Comments require some additional process to determine if an equitable solution can be found by the parties. The Division remains concerned about the treatment of EDIT where the offset against UUSF is unavailable and how and to whom the EDIT should be refunded.

### **CONCLUSION**

SB 130 did not convert the UUSF into an historic cost recovery mechanism. Converting the UUSF to an historic cost recovery mechanism is not in the public interest based on current statute. Utah law and public policy considerations support the continuation as a prospective fund where the utilities are funded for current costs during the current period. As a prospective program, 2019 UUSF payments should be calculated to provide the subsidy for 2019 operations. 2017 actuals are the best basis for setting 2019 UUSF payments. In the alternative, if 2019 is a cost recovery period for 2017 operations the 2017 actual taxes should be used. The Commission retains authority under SB 130 to make prudence adjustments and tax interest synchronization is an applied prudence adjustment. The Commission should continue to apply tax interest synchronization. Finally, the Division supports additional process to seek a solution for the appropriate treatment of EDIT.

Submitted this 15th day of November 2018.

/s/ Justin C. Jetter

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Justin C. Jetter  
Assistant Attorney General  
Utah Division of Public Utilities

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing comments filed by the Utah Division of Public Utilities was emailed on 15 November 2018 to the following in Utah Dockets 18-040-01, 18-041-02, 18-042-01, 18-043-01, 18-046-01, 18-050-02, 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, and 18-2419-01.

### BY Electronic-Mail:

Kira Slawson <b><i>Blackburn &amp; Stoll, LC</i></b>	<a href="mailto:kiram@blackburn-stoll.com">kiram@blackburn-stoll.com</a>
Eddie Cox <b><i>Bear Lake Communications, Inc.</i></b> <b><i>Central Utah Telephone, Inc.</i></b> <b><i>Skyline Telecom</i></b>	<a href="mailto:ecox@cut.net">ecox@cut.net</a>
Jenny Prescott <b><i>All West Communications, Inc.</i></b>	<a href="mailto:Jenny.prescott@allwest.com">Jenny.prescott@allwest.com</a>
Natalie Gleave <b><i>Gunnison Telephone Company</i></b>	<a href="mailto:natalieg@gtelco.net">natalieg@gtelco.net</a>
Brock Johansen <b><i>Carbon/Emery Telcom, Inc.</i></b> <b><i>Emery Telephone</i></b> <b><i>Hanksville Telcom, Inc.</i></b>	<a href="mailto:bjohansen@emerytelcom.com">bjohansen@emerytelcom.com</a>
Bruce H. Todd <b><i>UBTA-UBET Communications,</i></b> <b><i>Inc. dba Strata Networks</i></b>	<a href="mailto:btodd@stratanetworks.com">btodd@stratanetworks.com</a>
James Woody <b><i>Union Telephone Company</i></b>	<a href="mailto:jwoody@union-tel.com">jwoody@union-tel.com</a>
Kip A. Wilson <b><i>Direct Communications Cedar</i></b> <b><i>Valley, LLC</i></b>	<a href="mailto:kip@directcom.com">kip@directcom.com</a>
Wendy Stewart <b><i>South Central Utah Telephone</i></b> <b><i>Association, Inc.</i></b>	<a href="mailto:wendyw@socen.com">wendyw@socen.com</a>
Dallas Cox <b><i>Manti Telephone Company</i></b>	<a href="mailto:dallasc@mail.manti.com">dallasc@mail.manti.com</a>
Ray Hendershot	<a href="mailto:Ray.hendershot@beehive.net">Ray.hendershot@beehive.net</a>

*Beehive Telephone Company, Inc.*

Leslie Zink

[Leslie.zink@ftr.com](mailto:Leslie.zink@ftr.com)

*Citizens Telecommunications  
Company of Utah dba Frontier  
Communications of Utah  
Navajo Communications Company,  
INC. dba Frontier Navajo  
Communications Company*

/S/

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Erika Tedder, Paralegal  
Utah Division of Public Utilities