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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

In the Matter of Application of Sierra Telephone Company, Inc. (U 1016 C) to Modify Intrastate Revenue Requirement and Rate Design and Adjust Selected Rates.	A.21-11-005

APPLICATION OF

SIERRA TELEPHONE COMPANY, INC. (U 1016 C) AND SIERRA TEL INTERNET

FOR REHEARING OF DECISION 23-01-004

Patrick M. Rosvall
Sarah J. Banola
Sean P. Beatty
BRB Law LLP
436 14th Street, Suite 1205
Oakland, California 94612
Telephone: (530) 231-5208
Mobile: (415) 518-4813
Email: patrick@brblawgroup.com

Attorneys for
Sierra Telephone Company, Inc.
and Sierra Tel Internet

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I. INTRODUCTION.

Pursuant to Rule 16.1 of the Rules of Practice and Procedure ("Rules") of the California Public Utilities Commission ("Commission"), Sierra Telephone Company, Inc. ("Sierra") and Sierra Tel Internet ("STI") (collectively, "Applicants") hereby apply for rehearing of Decision ("D.") 23-01-004 (the "Decision"), which was formally issued on January 13, 2023. This Application for Rehearing is timely because it is within the 30-day timeframe prescribed by Public Utilities Code Section 1731, as extended pursuant to Rule 1.15 where the "time limit for performance of an act" expires on a weekend. Applicants are authorized to seek rehearing because Sierra was a party to underlying proceeding and STI is an affiliated Internet Service Provider ("ISP") that is "pecuniarily interested in the public utility affected" by the Decision, which implements the Commission's broadband imputation policy as to Sierra and STI.[1]

Applicants seek rehearing of three aspects of the Decision, each of which merits adjustments to the Decision to avoid legal error.[2] *First*, the final revisions to the adopted Decision included a novel approach to Sierra's "Telephone Plant-in-Service" that provisionally disallows approximately $40 million of investment in Sierra's fiber projects associated with its Rural Utilities Service ("RUS") loan, but then permits Sierra to file a "Tier 2 Advice Letter" to restore the value of the projects if it "complete[s] the projects and put[s] them in service by the end of Test Year 2023."[3] While Sierra did not support the adoption of this unusual post-test year true-up mechanism, it is not challenging the use of the Tier 2 Advice Letter framework through this Application for Rehearing. Rather, Sierra seeks adjustments to the language of the Decision to clarify that the Tier 2 Advice Letter will provide a vehicle for updating Sierra's rate base, depreciation, and tax calculations to reflect the inclusion of the RUS fiber projects *for the*

[1] Any "other party pecuniarily interested in the public utility affected" by a Commission decision "may apply for a rehearing in respect to matters determined in the action or proceeding and specified in the application for rehearing." Pub. Util. Code § 1731(b); *see also* D.92-02-076, 1992 Cal.PUC LEXIS 937, *4-5 (Applicants who were not parties to the action "may apply for rehearing in their own rights" because the Resolutions at issue impacted "'other [parties] pecuniarily interested in the public utility affected'") (emphasis removed from original).

[2] In limiting rehearing to these three issues, neither Sierra nor STI concedes that the Decision is otherwise lawful. Sierra noted several other legal errors in its comments on the Proposed Decision that have not been corrected, and which remain in the Decision. Sierra reserves the right to challenge these other findings and conclusions in future proceedings and/or through means other than this Application for Rehearing. *See Sierra Opening Comments on Proposed Decision* at 10-16, 20-22.

[3] D.23-01-004 at 26, 44 (OP 7).

2023 test year. Without this clarification, the advice letter process presents legal error because it would facilitate a disconnect between costs, revenues, and rates that is at odds with test year ratemaking principles and inconsistent with the 2015 rate case plan, as updated through D.20-08-011.[4] As written, the Tier 2 Advice Letter procedure reflects material ambiguities that constitute a failure to "proceed[] in the manner required by law," a directive without adequate findings, and a departure from substantial record evidence.[5]

Second, in implementing the Commission's "broadband imputation" policy and incorporating STI's non-regulated net revenues from 2020 into Sierra's regulated rate design, the Commission creates an unlawful shortfall in Sierra's California High Cost Fund A ("CHCF-A") support amount, rendering Sierra's revenues $1,110,392 lower than necessary to recover Sierra's revenue requirement.[6] This results in an unconstitutional taking of utility property that conflicts with binding United States Supreme Court authority confirming that state utility commissions cannot force public utilities to fulfill their regulated revenue requirements through non-regulated affiliate revenues.[7] For the same reasons, the implementation of broadband imputation in this rate case violates statutory requirements mandating that revenue requirement and rate design must be equal.[8] Moreover, in indirectly confiscating STI's revenues through this regulated ratemaking mechanism, the Decision

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[4] *See* D.15-06-048, Appendix A (establishing rate case cycle and confirming the use of future test years for measuring results of operations); D.20-08-011, Appendix C (prescribing 2023 test year for Sierra's rate case).

[5] Pub. Util. Code §§ 1757(a)(2), 1757(a)(3), 1757(a)(4).

[6] *See* D.23-01-004, Appendix A. Applicants note that the Fifth District Court of Appeal has recently rendered a partially published Opinion upholding the Commission's broadband imputation policy in connection with the CHCF-A rulemaking. *See Calaveras, et al. v. Pub. Util. Comm'n* (2022) 2022 Cal.App.LEXIS 1086 (published version). Sierra and STI have nevertheless included the legal errors related to broadband imputation in this Application for Rehearing because their appellate rights have not been exhausted in connection with the facial challenge to broadband imputation. In addition, the Fifth District found that Sierra's takings claims were unripe pending implementation of broadband imputation in a rate case, so those claims are within the scope of the Decision challenged here. *See Calaveras, et al. v. Pub. Util. Comm'n* (2022) 2022 Cal.App.Unpub.LEXIS 7816 at *49 (unpublished version).

[7] *Brooks-Scanlon Co. v. Railroad Comm'n of Louisiana* (1920) 251 U.S. 396, 397, 399 (striking down state commission order measuring public utility revenue by including non-utility revenue); *see also* U.S. Const., amends. V, XIV; Cal. Const., art. I, § 19; *Duquesne Light Company v. Barasch* (1989) 488 U.S. 299, 308 ("If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation."); *Federal Power Commission v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603.

[8] Pub. Util. Code §§ 275.6(b)(4), (b)(3), (b)(5); *see also Pacific Tel. & Tel. Co. v. Pub. Util. Comm'n* (1965) 62 Cal.2d 644-645; *City and County of San Francisco v. Pub. Util. Comm'n* (1985) 39 Cal.3d 523, 531.

irreconcilably conflicts with the Federal Communications Commission's ("FCC") classification of broadband Internet access service as an "information service," thereby triggering conflict preemption.[9] In endorsing these outcomes, the commission has "acted . . . in excess of . . . its powers or jurisdiction," "not proceeded in the manner required by law," abused its discretion, and violated Sierra and STI's constitutional rights.[10]

Third, the Commission abused its discretion in refusing to incorporate a mechanism into the Decision to reverse the effects of broadband imputation if the policy is deemed unlawful by a reviewing court. While the Fifth District Court of Appeal recently rendered an Opinion that rejected Sierra's statutory arguments, found its federal preemption arguments inapplicable, and found its takings arguments "unripe,"[11] Sierra's rights to appellate review of the decisions adopting broadband imputation are not exhausted, and the takings argument remains a viable basis for challenging the outcome of this rate case under the Fifth District's Opinion.[12] Sierra made a reasonable proposal to incorporate into the Decision a procedural mechanism for restoring Sierra's full CHCF-A draw through a Tier 2 advice letter process in the event that broadband imputation is reversed or annulled.[13] The Decision rejects that proposal without acknowledgment or explanation, thereby making its determination an arbitrary and capricious abuse of discretion without any supporting findings.[14]

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[9] *In the Matter of Restoring Internet Freedom*, WC Docket No. 17-108, *Report and Order, et al.,* FCC 17-166 (rel. Jan. 4, 2018) (*Restoring Internet Freedom Order*) at ¶ 20 (vacated on other grounds by *Mozilla v. FCC* (D.C. Cir. 2019), 940 F.3d 1.); *Geier v. American Honda Motor Co.* (2000) 529 U.S. 861, 873 (conflict preemption applies where a regulation "'under the circumstances of a particular case . . . stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress—whether that 'obstacle' goes by the name of conflicting; contrary to; . . . repugnance; difference; irreconcilability; inconsistency; violation; curtailment; interference, or the like.") (quoting *Hines* v. *Davidowitz,* (1941) 312 U.S. 52, 67).

[10] Pub. Util. Code §§ 1757(a)(1), (2), (5), (6).

[11] *Calaveras, et al. v. Pub. Util. Comm'n* (2022) 2022 Cal.App.Unpub.LEXIS 7816 at *49, *51-52 (unpublished version) (finding that the "takings claims are unripe" and that the "writ proceeding does not address a decision by the Commission that sets a telephone company's rates after applying broadband imputation.").

[12] *Id.* at *53 ("[a]t this point, the 'total effect' . . . of broadband imputation on the telephone companies' rates cannot be determined because the Commission has not made the foregoing reasonableness determinations and established a telephone company's rate design and CHCF-A subsidy.").

[13] *Sierra Opening Comments on Proposed Decision* at 25.

[14] D.23-01-004 (reflecting no discussion of Sierra's Tier 2 advice letter proposal to update the results of the rate case if broadband imputation is found unlawful); *see* Pub. Util. Code § 1757(a)(3), (5); *City of Stockton v. Marina Towers LLC* (2009) 171 Cal.App.4th 93, 114 (finding that "[a] gross abuse of discretion occurs where the public agency acts arbitrarily or capriciously, [or] renders findings that are lacking in evidentiary support . . .").

To avoid subjecting the Decision to judicial annulment, the Commission should: (1) clarify the Tier 2 Advice Letter process in the Decision to confirm that it will facilitate a restoration of rate base, depreciation expense, and associated tax impacts to Sierra's test year 2023 revenue requirement calculations *for 2023*, consistent with test year ratemaking and the Commission's determination in D.20-08-011 that Sierra's rate case should utilize a 2023 test year; and (2) remove the $1,110,392 in STI's revenues from Sierra's rate design and increase Sierra's CHCF-A support for 2023 by that same amount. Even if the Commission does not immediately restore the $1,110,392 in wrongful CHCF-A reductions to Sierra, it should create a reasonable mechanism for reversing broadband imputation if and when a judicial determination is reached that the policy or its application are unlawful. The Commission should act expeditiously on this Application for Rehearing to avoid the material and growing injuries that Sierra and STI will experience from the legal errors identified herein.

II. RELEVANT PROCEDURAL HISTORY AND FACTUAL BACKGROUND.

a. Procedural Events Leading to the Final Decision.

Sierra filed the Application that initiated this proceeding on November 1, 2022, in accordance with the 2015 rate case plan, the 2020 decision modifying the rate case plan, and the one-month extension of time authorized by the Commission's Executive Director.[15] Consistent with longstanding Commission precedent and the directives in D.20-08-011, Sierra used a 2023 test year to measure its costs and revenues and fashion a revenue requirement and rate design that would allow it to meet statutory and constitutional standards.[16] Cal Advocates protested the Application on December 1, 2022, and remained the only other party to the proceeding throughout its duration. The Commission determined the scope of the proceeding and established a procedural schedule in a Scoping Ruling issued on March 1, 2022.[17] Evidentiary hearings occurred on July 27, 2022 through August 1, 2022, during which the Commission accepted written, prepared direct testimony from the parties, heard live testimony

[15] D.15-06-048, Appendix A (prescribing rate case cycle for the telephone companies); D.20-08-011 at 55, Appendix C (modifying rate case cycle); *July 26, 2021 Letter from Executive Director Peterson Granting Rule 16.6 Extension Request* (establishing Nov. 1, 2021 filing deadline).
[16] Pub. Util. Code §§ 275.6(c)(2), 275.6(b)(4); *Duquesne Light Co. v. Barasch* (1989) 488 U.S. 299, 308 ("If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation."); *see also Federal Power Commission v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603; *Bluefield Water Works & Improvement Co. v. Pub. Service Comm'n of West Virginia* (1923) 262 U.S. 679, 690-693; U.S. Const., amends. V, XIV; Cal. Const., art. I, § 19.
[17] *Assigned Commissioner's Scoping Memo and Ruling* at 5-7.

on cross-examination and re-direct, and accepted other documentary exhibits into the record.[18] Briefing took place in September 2022, and a Proposed Decision was issued on December 2, 2022. Parties submitted comments on the Proposed Decision during December 2022, and the Commission conducted an oral argument before three of the Commissioners on December 8, 2022. A Revised Proposed Decision was issued on January 9, 2023, and it was adopted without further revision as the final Decision at the Commission's meeting on January 12, 2023. It was formally issued on January 13, 2023.

b. The Commission's Disposition of Sierra's RUS Fiber Investments.

In its testimony, Sierra proposed a total intrastate rate base of $49,688,395 including total plant in service of $176,731,981.[19] This plant in service figure included investments in Fiber to the Premises ("FTTP") totaling more than $40 million that Sierra is actively pursuing and which are targeted for completion during the 2023 test year.[20] These fiber projects will be funded in part by RUS loan funds,[21] which Sierra has authorization to borrow and which it will have to pay back, plus carrying charges.[22] The record reflects that these FTTP investments are critically necessary to ensure Sierra's compliance with evolving broadband speed requirements promulgated by the FCC,[23] and the record confirms that these plant additions are important to

[18] *See ALJ Ruling Revising Proceeding Schedule* (July 14, 2022) at 2.
[19] D.23-01-004*,* Appendix A at A-2; Exhibit STC-07-C, Exhibit CD-R1 at 92, Line 19.
[20] The inclusion of these investments in rate base also impacts the calculation of depreciation expense and taxes for the test year. *See Sierra Reply Brief* at 25-26; *Cal Advocates Opening Brief* at A-1, Line 2(b) (reflecting "Cal Advocates Proposal without RUS Loan Adjustment," including depreciation expense calculated using appropriate plant in service figures for the test year).
[21] Exhibit STC-02 at 17-18 (*Montgomery Opening Testimony*) ("We also have a large FTTP project that we will be funded with an RUS loan that will provide Fiber Services to the Mariposa town area . . . The Central Office department will also be responsible for additional projects associated and funded by the RUS loan."); Exh. STC-01 (*Huber Opening Testimony*) at 14:1-6 (noting that Sierra has obtained $40.228 million in debt financing to "provide some of the capital" for Sierra's "vision" to "extend fiber all the way to customer premises.").
[22] *See* D.21-07-009 at 3 ("Sierra Tel proposes to issue and execute a Loan Agreement, Mortgage Note(s), Restated Mortgage, Security Agreement, and Financing Statement as part of the RUS loan process. The RUS would then advance funds to Sierra Tel after execution of the Mortgage Notes. Each advance under the Mortgage Note would bear interest at various rates, which would be determined for each advance by reference to the Rural Electrification Act of 1936 and implementing regulations.").
[23] *See* FCC DOC-385322A1, *July 15, 2022 News Release* (noting that FCC Chairwoman Rosenworcel has circulated a "Notice of Inquiry" that "proposes to increase the national broadband standard to 100 megabits per second for download and 20 megabits per second for upload" and "proposes to set a separate national goal of 1 Gbps/500 Mbps for the future."), available at: https://www.fcc.gov/document/chairwomanrosenworcel-proposes-increase-minimum-broadband-speeds.

meet increased demand for broadband-capable service connections in the rural area that Sierra serves, where there are few alternatives for service, if any.[24] The record also demonstrates that the projects are carefully-conceived, cost-effective, and on track for completion during the test year.[25] On December 9, Sierra offered additional information corroborating its timetable for completion of the projects, and the Commission accepted these materials into the record in an Administrative Law Judge ("ALJ") Ruling dated December 15, 2022.[26]

No party expressed opposition to the RUS fiber projects until Cal Advocates' opening brief, which was submitted on September 6, 2022.[27] Cal Advocates offered no testimony to counter Sierra's extensive showing that the projects are critically needed and on pace for completion during 2023.[28] Based on the updated list of action items and completion dates

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See also Exh. STC-02 (*Montgomery Opening Testimony*) at 17 ("I also believe that regulatory requirements are likely to advance rapidly, so Sierra will find itself in a precarious situation if it does not act now to further advance its fiber deployments."); Exh. STC-12 (*Thompson Opening Testimony*) at 6 ("Sierra's current network design and planned future deployments . . . are necessary to meet forward-looking customer demand and comply with foreseeable regulatory requirements.").

[24] Exh. STC-02 (*Montgomery Opening Testimony*) at 7-8 ("Since 2017, we have also had 429 requests for fiber services, with only a few being fulfilled, and most being denied because the facilities do not exist in the requested locations . . . From 2018 through 2021, Sierra Tel Internet ('STI') has steadily increased its subscribership, and its customers have also shown increased interest in plans that deliver higher speeds."); *see also* Exh STC-03 (*Montgomery Rebuttal Testimony*) at 3 (demonstrating continued customer demand for broadband-capable connections).

[25] *See* Exh. STC-02 (*Montgomery Opening Testimony*), Exhibit MM-7 (providing extensive details regarding test year projects); Exh. STC-03-C (*Montgomery Rebuttal Testimony*), Exhibit MM-2 (providing supplemental details regarding projects, including technical configurations, maps, and an identification of specific equipment and materials); Exh. PAO-13 (Sierra Response to Cal PA DR 11.2) (confirming that all pending project milestones are within 2022 or 2023, and that all 2021 tasks were completed); RT at 184:16-19 (Montgomery) ("So if you look at the Vantage Point timeline, you'll see that we are still on-track. So construction has not began, but the plan was not to begin construction yet."); RT at 82:20- 24 (Huber) (confirming that project completion by the end of 2023 is "still realistic" and that Sierra has "been meeting the timeline that was set with [its] consultant."); RT at 82:25-83:1 (Huber) (noting that Sierra "did hire a consultant" rather than "do the engineering inhouse"); RT at 85:14-86:12 (Huber) (explaining that Sierra began paying for the project costs "out of its general funds" to endure that the project design could proceed in a timely manner).

[26] *See Sierra Motion to Reopen the Record to Admit New Evidence* (Dec. 9, 2022) at 1-2, Attachment A; *ALJ Ruling Granting Motion to Supplement the Record* (Dec. 15, 2022) at 2.

[27] *Cal Advocates Opening Brief* at 9 ("The Commission must remove the projects that Sierra expected to fund with RUS loans from Sierra's plant-in-service rate base calculations until the projects are fully constructed and provide broadband service to its customers. Only then will the RUS loan projects be used and useful and qualify for inclusion in rate base as plant in service.").

[28] The record reflects that Cal Advocates' submissions included no testimony on Sierra's network design, construction plans, or build-out initiatives. Moreover, based on their "Statements of Qualifications" and their testimony during hearings, none of Cal Advocates' three witnesses had relevant background that

reflected in the materials accepted into the record on December 15, 2022, the "Phase 1" outside plant investments are on track to be completed on July 31, 2023 and the "Phase 2" outside plant installations are expected to be completed no later than December 22, 2023.[29] The steps toward finalizing the central office electronics investments were largely completed, and the ultimate completion date for those upgrades is September 29, 2023.[30] Cal Advocates offered nothing to counteract these milestones, deadlines, and action items, but it nevertheless argued that the RUS fiber investments should be disallowed because they were not *already* installed prior to the test year,[31] and because Cal Advocates did not believe that Sierra could complete the projects by the end of 2023.[32] The proposed disallowances equaled a reduction in intrastate rate base of more than $15 million, and corresponding reductions to depreciation expense and test year income tax recovery that would collectively decrease Sierra's revenue requirement and CHCF-A support by approximately $3 million.[33] Cal Advocates did not address the harms that Sierra's customers would experience if these vital investments were not made.

While the Proposed Decision originally endorsed Cal Advocates' categorical disallowances,[34] the Revised Proposed Decision advanced an alternative approach. Under the Revised Proposed Decision, the RUS fiber investments would be provisionally disallowed, but Sierra would have an opportunity to later demonstrate that it had completed the construction, using the following mechanism:

> Should Sierra Telephone Company complete and place into service the Telephone Plant-in-Service projects admitted to the record by the end of 2023, Sierra Telephone Company may file a Tier 2 Advice Letter for the Test Year ending December 31, 2023, by no later than January 15, 2024, to confirm which projects have been completed, and to request adjustment of its rate base amount up to $176,731,981, revenue requirement and CHCF-A support.[35]

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would allow them to provide informed testimony on these topics. Exhs. PAO-01 (*Ahlstedt Testimony*), Attachment A; PAO-03 (*Ye Testimony*), Attachment A; PAO-05 (*Corona Testimony*), Attachment A; RT at 714:6-715:1 (Corona), 620:9-10 (Ye), 449:13-20 (Ahlstedt) (confirming lack of relevant experience to inform testimony opposing Sierra's proposal).

[29] *Sierra Motion to Reopen the Record to Admit New Evidence*, Attachment A.

[30] *Id.*

[31] *Cal Advocates Opening Brief* at 9 (suggesting that the value of test year projects cannot be included in rate base until they are "fully constructed and provide broadband service to . . . customers.")

[32] *Id.* at 8-9.

[33] D.23-01-004, Appendix A at A-2, Lines 6, 8, 10 (comparing parties' proposals for rate base, revenue requirement, and CHCF-A). The underlying calculations confirm that $3 million of the difference in revenue requirement and CHCF-A are attributable to the disallowance in rate base. *Id.*, Appendix A.

[34] *Proposed Decision* at 25-26.

[35] D.23-01-004 at 44 (OP 7).

The Findings of Fact and Conclusions of Law echo this approach, and the text of the Revised Proposed Decision further explained that the advice letter "will be subject to a reasonableness review conducted by the Communications Division" and that "any resulting increase in the revenue requirement will be met by CHCF-A support."[36] Although the Revised Proposed Decision attributed the new advice letter process to "the Test Year ending December 31, 2023," it does not clarify the effective date of the proposed adjustments, nor does it confirm that the adjustments authorized by the Tier 2 advice letter, if approved, would include depreciation expense and tax recovery associated with the adjustment in rate base.

No comments or formal input was permitted in response to the Revised Proposed Decision's new language. The final Decision adopted the language of the Revised Proposed Decision without any substantive changes.[37]

c. Broadband Imputation and Its Implementation in Sierra's Rate Case.

As part of the CHCF-A rulemaking, the Commission adopted a policy termed "broadband imputation," which mandates a dollar-for-dollar reduction in "small independent telephone corporations'"[38] CHCF-A support in the amount of the positive net revenue that their ISP affiliates earn by providing Internet access service over the telephone companies' wireline networks within their service territories.[39] In effect, this policy incorporates ISP net revenue into telephone company rate design, even though the telephone company neither generates nor receives the broadband revenue; through this fiction, imputation creates systematic shortfalls for all CHCF-A recipients with profitable ISP affiliates. Broadband imputation applies to all CHCF-A recipients, but the Commission deferred implementation of the policy to each company's next rate case, including the instant case that is the subject of this Application for Rehearing.[40]

Sierra and the other "small independent telephone corporations" impacted by the

[36] *Id.* at 26, 40 (FOF 13), 41-42 (OPs 5-6).
[37] *Ibid.*
[38] "Small independent telephone corporations" are defined in Public Utilities Code Section 275.6 to refer to "rural incumbent local exchange carriers subject to commission regulation."
[39] D.21-04-005 at 19, 23-24 (OP 1).
[40] *Id*. (OP 1) (deferring the implementation of broadband imputation to the next "general rate case" for Sierra and the other "Small ILEC[s].").

broadband imputation policy filed a petition for writ of review before the Fifth District Court of Appeal to challenge the decisions requiring broadband imputation.[41] Each of the ISP affiliates, including STI, joined the writ petition and the underlying application for rehearing.[42] The Court granted the petition, ordered the Commission to certify the record on appeal, and conducted oral argument on December 15, 2022.[43] On December 20, 2022, the Court rendered an unpublished Opinion upholding the broadband imputation policy against the petitioners' facial challenge on statutory and jurisdictional grounds, but the Court found that the petitioners' constitutional takings claims were "unripe" because the Commission had not yet implemented the imputation policy in telephone company rate cases.[44] One of the "real parties in interest," The Utility Reform Network ("TURN"), requested publication of the Opinion on January 9, 2023.[45] Separately, the petitioners sought rehearing to correct specific errors in the Court's Opinion.[46] In response to these requests, the Court ordered partial publication of the Opinion, focusing the published elements on the Court's statutory interpretation of Public Utilities Code Section 275.6.[47] The Court also ordered several corrections to the Opinion that correspond to petitioners' requested adjustments, although it formally denied rehearing.[48] The petitioners' rights to seek California Supreme Court review or pursue other avenues to challenge the Opinion or the underlying broadband imputation policy remain open.

While petitioners' writ challenge was pending, Sierra faithfully complied with the

[41] The petition was filed on September 22, 2022 and docketed as Case No. F083339. As reflected in Sierra's January 31, 2022 Motion for Official Notice, the Court granted review on January 7, 2022. *See Sierra Motion for Official Notice*, Attachment A.
[42] *See* D.21-08-042 at 1 (noting that Sierra and STI were both parties to the application for rehearing of D.21-04-005, which led to the Fifth District writ petition).
[43] *Id.,* Fifth District Court of Appeal, Case No. F083339; *see also Calaveras, et al. v. Pub. Util. Comm'n* (2022) 2022 Cal.App.LEXIS 1086 (published version).
[44] *See Calaveras, et al. v. Pub. Util. Comm'n* (2022) 2022 Cal.App.Unpub.LEXIS 7816 at *49-50 (unpublished version) ("At this point, the 'total effect' . . . of broadband imputation on the telephone companies' rates cannot be determined because the Commission has not made the foregoing reasonableness determinations and established a telephone company's rate design and CHCF-A subsidy. Consequently, we cannot determine that the rates will be so unreasonably low as to be confiscatory in violation of the telephone companies' constitutional rights.")
[45] Fifth District Court of Appeal, Case No. F083339, *TURN Request for Publication* (Jan. 9, 2023).
[46] Fifth District Court of Appeal, Case No. F083339, *Petitioners Petition for Rehearing* (Jan. 4, 2023).
[47] Fifth District Court of Appeal, Case No. F083339, *Modification of Opinion* (Jan. 18, 2023).
[48] *Id.*

broadband imputation policy in its ratemaking calculations.[49] Its Application identified the net revenue derived from STI's provision of Internet access service over Sierra's wireline network during 2020, which was the year prescribed by the broadband imputation decisions.[50] Sierra also left its revenue requirement unchanged, as the broadband imputation decisions require.[51] It implemented broadband imputation as a dollar-for-dollar reduction in its CHCF-A draw, and neither the Commission nor Cal Advocates contested the manner in which it performed this calculation.[52] However, Sierra maintained its legal position that the imputation policy is unlawful, and it requested in its Application, its opening brief, and its comments on the proposed decision for the Commission to create a procedural vehicle to reverse broadband imputation,[53] should a reviewing court agree with Sierra and STI's position that the imputation policy is contrary to law.

In the Decision, the Commission adopted the $1,110,392 broadband imputation figure identified by Sierra, which Cal Advocates did not oppose.[54] The Commission also adopted a tax calculation that acknowledges the shortfall created by broadband imputation, noting that "if taxes are estimated on a CHCF-A draw that is calculated before broadband revenues are imputed, tax liability will be overstated."[55] In addition, the Commission rejected Sierra's

[49] *Application*, Exhibit B (providing all information necessary to compute broadband imputation adjustment, in the template supplied by Communications Division); *see also* D.21-04-005 at 24 (OP 2) (requiring "the Small ILEC" to "submit with its GRC Application a financial statement in a format to be provided by the California Public Utilities Commission Communications Division" to address broadband imputation.).
[50] *See Application* at 28; D.21-04-005 at 23 (OP 1) (the ISP revenue for imputation is the net revenue "or the calendar year immediately preceding the filing of the GRC application."); *see also* D.21-08-042 at 19.
[51] *See* D.21-04-005 at 18 ("we decline to consider ISP affiliate operations in the determination of the Small ILECs' revenue requirements.").
[52] D.23-01-004, Appendix A at A-1, Line 1(b); *see also* Exh. PAO-01-C (*Ahlstedt Opening Testimony*) at 1-35 (confirming agreement on broadband imputation figure).
[53] *Application* at 3, n. 9; *Sierra Opening Brief* at 95; *Sierra Opening Comments on Proposed Decision* at 24-25.
[54] D.23-01-004, Appendix A at A-1, Line 1(b). Sierra notes that this imputation figure is based on purely historical figures from calendar year 2020, and STI's expenses have increased significantly since that time, making the $1,110,392 an unrealistic measurement of STI's net revenues for the test year. The broadband imputation policy has no apparatus for addressing this disconnect or updating imputation figures for forward-looking impacts. *See* D.21-04-005 at 24 (OP 1) (the financials that inform the broadband imputation adjustment must be calculated using the net revenue "for the calendar year immediately preceding the filing of the GRC application.").
[55] D.23-01-004 at 23.

request to create a vehicle to reverse broadband imputation in response to a successful appeal.[56] Based on the final Decision, Sierra's forecasted revenues from regulated telephone operations are $19,051,743 and its regulated costs, as manifested in revenue requirement, are $20,162,135.[57] This equates to a revenue shortfall of $1,110,392 in exactly the amount of the broadband imputation.[58]

III. STANDARD OF REVIEW AND SUMMARY OF LEGAL ERRORS.

The standard of review for this Decision is set forth in Public Utilities Code Section 1757, which provides the grounds under which Commission ratemaking decisions are subject to annulment.[59] The Decision commits the following legal errors according to this statutory standard:

1. Absent clarification, the Decision contains material ambiguities that could be interpreted to foreclose the inclusion of Sierra's legitimate investments in the 2023 test year, improperly delaying the rate base adjustment until 2024. The Decision therefore constitutes a failure to "proceed[] in the manner required by law," a determination unsupported by adequate findings, and a departure from substantial record evidence.[60]
2. By implementing broadband imputation, the Decision creates a shortfall between Sierra's regulated costs and its regulated revenues, effectuating a taking of utility property.[61] If, alternatively, the shortfall is attributed to STI, it results in a 100% confiscation of STI's profits.[62] Either way, this result constitutes a failure to

[56] *Compare Sierra Opening Comments on Proposed Decision* at 25 (requesting that the Commission "incorporate a mechanism in the Proposed Decision to reverse broadband imputation if it is ultimately deemed unlawful.") to D.23-01-004 (making no mention of Sierra's proposed mechanism to reverse imputation).
[57] D.23-01-004, Appendix A at A-1, A-2, Lines 1(a), 1(c), 9.
[58] *Id.*, Appendix A at A-1, Line 1(b).
[59] Pub. Util. Code § 1757 (addressing the standard of review for Commission ratemaking decisions).
[60] Pub. Util. Code §§ 1757(a)(2), 1757(a)(3), 1757(a)(4).
[61] *See* U.S. Const., amends. V, XIV; Cal. Const., art. I, § 19; *Duquesne Light Company v. Barasch* (1989) 488 U.S. 299, 308; *Federal Power Commission v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603; *Bluefield Water Works v. Pub. Serv. Comm'n* (1923) 262 U.S. 679, 690-693; *see also Brooks-Scanlon, supra*. 251 U.S. at 399 (reversing a state commission ratemaking calculation that relied on non-regulated revenue to depict the profitability of utility operations).
[62] *Ponderosa v. Pub. Util. Comm'n* (2011) 197 Cal.App.4th at 48, 59-60 (seizure of returns on unregulated investments unconstitutional); *Brown v. Legal Foundation of Washington* (2003) 538 U.S. 216, 233-234

"proceed[] in the manner required by law, a violation of Sierra and/or STI's constitutional rights, an action in excess of the Commission's jurisdiction, and an abuse of discretion.[63]

3. By failing to incorporate a vehicle to reverse broadband imputation if it is deemed unlawful, the Decision effectuates an abuse of discretion and reaches a result that is "not supported by the findings."[64]

Individually and collectively, these errors inflict material injuries on Sierra and/or STI. Rehearing must be granted to incorporate appropriate adjustments and clarifications into the Decision, which is otherwise unlawful and subject to annulment through a petition for writ of review.

IV. THE TIER 2 ADVICE LETTER PROCESS MUST BE CLARIFIED TO AVOID LEGAL ERROR.

The Commission's last-minute changes to the Decision created material ambiguities in the treatment of Sierra's rate base that must be corrected to avoid legal error.[65] Two aspects of the true-up mechanism adopted in Ordering Paragraph 7 are ambiguous:

First, the effective date of the potential changes to "rate base, . . . revenue requirement, and CHCF-A support" is not explicit.[66] By specifying that the advice letter is "for the Test Year ending in December 31, 2023," the Commission appears to be signaling that the true-up would be effective for the 2023 test year as a whole.[67] This is the appropriate outcome based on Commission precedent,[68] and it should result in an averaging of Sierra's ultimate rate base as of December 31, 2023 with its rate base on January 1, 2023,[69] thereby producing an updated

(transfer of interest on client trust accounts to government accounts constituted a "per se" taking, not judged according to a utility ratemaking takings standard).

[63] Pub. Util. Code §§ 1757(a)(1), 1757(a)(2), 1757(a)(5), 1757(a)(6).

[64] Pub. Util. Code §§ 1757(a)(3),1757(a)(5).

[65] The Tier 2 Advice Letter approach to rate base adjustments did not appear until the Revised Proposed Decision was released on January 9, 2023. *See Revised Proposed Decision* (redline version) at 26-27, 45. While it is not included in the online docket of the proceeding, the Revised Proposed Decision is available here: https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M500/K984/500984731.pdf

[66] D.23-01-004 at 44 (OP 7).

[67] *Id.*

[68] *See* D.15-06-048, Appendix A (establishing rate case cycle and confirming the use of future test years for measuring results of operations); D.20-08-011, Appendix C (prescribing 2023 test year for Sierra's rate case).

[69] *See* D.05-07-044 at 28-29 (explaining standard averaging methodology to calculating rate base

rate base figure for the test year, subject to the maximum plant-in-service of $176,731,981 noted in the Decision.[70] While this appears to be the Commission's intent, absent clarification, Ordering Paragraph 7 could be read to suggest that Sierra's rate base, revenue requirement, and CHCF-A would be updated in 2024, not 2023. If this occurs, the Commission would create a disconnect between all of the other ratemaking determinations in the rate case, contrary to its own stated directives, which require Sierra to use a 2023 test year.

Second, while Ordering Paragraph 7 mentions that the "adjustment of its rate base amount" would also trigger adjustments to Sierra's "revenue requirement" and "CHCF-A," the true-up language does not specifically include depreciation expense or the tax impacts of any change in rate base. These are essential components of any valid ratemaking decision, as acknowledged in numerous Commission decisions and as reflected in the methodology already incorporated into the Decision for calculating Sierra's revenue requirement.[71] However, absent clarification, the language in Ordering Paragraph 7 could be interpreted to apply only to rate base, without addressing the necessary adjustments to the other elements of revenue requirement that change in tandem with the rate base.

Simple changes to Ordering Paragraph 7 can resolve these ambiguities and avoid legal error. There are multiple ways to fix these omissions, but Sierra proposes the following:

> 7. Should Sierra Telephone Company complete and place into service the Telephone Plant-in-Service projects admitted to the record by the end of 2023, Sierra Telephone Company may file a Tier 2 Advice Letter for the Test Year ending December 31, 2023, by no later than January 15, 2024, to confirm which projects have been completed, and to request adjustment of its rate base amount up to $176,731,981 <u>in intrastate telecommunications plant in service</u>, revenue requirement and CHCF-A support <u>for 2023. The revenue requirement adjustments permitted through this true-up mechanism shall include any changes to depreciation expense and income tax calculations triggered by any approved change in rate base. Each of these adjustments shall be effective for test year 2023 and each year thereafter, and any resulting increases to Sierra's 2023 CHCF-A beyond the amounts adopted in this decision shall be addressed through additional distributions from the CHCF-A in 2024.</u>

employed in Commission ratemaking decisions); *see* Exh. STC-07 (*Duval Rebuttal Testimony*), Exhibit CD-R1 at 34 (reflecting use of "2023 average" for Sierra's rate base calculations).

[70] *See* D.23-01-004 at 44 (OP 7). The "rate base amount" referenced in Ordering Paragraph 7 is actually a representation of "telephone plant in service," which is confirmed through the "results of operations" table attached to the Decision. *See* D.23-01-004*,* Appendix A at A-2.

[71] D.16-06-054 at 219; D.23-01-004 at 5.

With these additions, there will be no doubt regarding the intended timeframe and scope of the CHCF-A adjustments that will be examined in the Tier 2 Advice Letter procedure. If these changes are not made, the advice letters will be fatally ambiguous and likely lead to additional disputes and further legal problems with the Decision's approach to Sierra's rate base.

These requested clarifications are not just for efficiency and ease of administration; they are essential to avoid legal error. If the Tier 2 Advice Letter process is susceptible to an interpretation that rate base would be adjusted in 2024, the Decision would be inconsistent with the test year ratemaking rules under which telephone company rate cases must be conducted. As both the Commission and the Court of Appeal have recognized, the "[t]he basic approach of the commission in rate making . . . is to take a test year and determine the revenues, expense, and investment for the test year."[72] For Sierra, the Commission expressly prescribed a test year of 2023, so that is the year in which its revenues, investments, costs, and rates must be examined.[73] The Decision acknowledges this focus, expressing each of its ratemaking determinations as appropriate for "Test Year 2023" and consistently referencing the test year as 2023.[74] The discussion of rate base maintains this scope, with repeated references to Sierra's investments in 2023.[75] The updates addressed through the Tier 2 Advice Letter rate base "true up" must be consistent with test year ratemaking and align any adjustments with the other ratemaking metrics adopted *for 2023*; if the adjustments were to take place in a future period, there would be an unlawful disconnect between Sierra's costs and revenues, jeopardizing the statutory sufficiency and constitutionality of Sierra's rate design.[76]

Similarly, if the Tier 2 Advice Letter process does not specify that depreciation and tax adjustments are within the scope of the "revenue requirement" modifications available through this process, critical components necessary to a legitimate 2023 revenue requirement could be

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[72] *See City of Los Angeles v. Pub. Util. Comm'n* (1975) 7 Cal.3d 331, 346; *see also Ponderosa v. Pub. Util. Comm'n* (2011) 197 Cal.App.4th 48, 51 ("the Commission examines the company's costs in a test year and determines the company's revenue requirement during that test year"); D.04-06-018 at 6 (a "test year" is "the period over which the cost of service and the proposed rates will be evaluated.").
[73] *See* D.15-06-048, Appendix A (establishing rate case cycle and confirming the use of future test years for measuring results of operations); D.20-08-011, Appendix C (prescribing 2023 test year for Sierra).
[74] D.23-01-004 at 3, 5, 25, 26, 39-43.
[75] *Id.* at 25-27.
[76] *See* Pub. Util. Code § 275.6(b)(3) ("'Rate design' means the mix of end user rates, high-cost support, and other revenue sources that are targeted to provide a fair opportunity to meet the revenue requirement of the telephone corporation."); *see also Duquesne Light Co. v. Barasch* (1989) 488 U.S. 299, 308; *Federal Power Comm'n v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603.

excluded, leaving Sierra without revenues sufficient to meet its revenue requirement, recover its costs, and earn a reasonable rate of return on its investments. As the Commission has recognized, "return on rate base is added to the [operating and maintenance cost], *depreciation*, and *taxes*, which results in the total revenue requirement."[77] The Decision echoes these basic components, noting that the "level of revenue requirement" necessary for the test year would include an examination of "depreciation expenses, rate base and new plant additions and tax liabilities."[78] The Decision also specifically recognizes the relationship between the test year RUS fiber investments and depreciation expense, as well as the role that rate base plays in the income tax calculation for the test year.[79]

As noted above, Sierra does not believe its proposed clarifications are any different than the Commission's intent in adopting the Tier 2 Advice Letter process, and if Sierra were given the opportunity to comment on the Revised Proposed Decision, it would have provided these suggestions so that the ambiguities could be corrected before the Decision was adopted. Since that opportunity was not provided, and because the Decision would be unlawful without these clarifications, Sierra is offering these proposed adjustments through this process and preserving its rights to seek judicial redress if appropriate clarifications are not made.

V. THE DECISION'S APPLICATION OF BROADBAND IMPUTATION RESULTS IN AN UNCONSTITUTIONAL TAKING BY CREATING AN ANNUAL SHORTFALL IN SIERRA'S RATE DESIGN IN VIOLATION OF STATUTORY AND CONSITUTIONAL REQUIREMENTS.

In accordance with the "broadband imputation" policy adopted in Phase 2 of the CHCF-A rulemaking, the Decision reduces Sierra's CHCF-A draw on a dollar-for-dollar basis based on the net positive retail broadband-related revenues from Sierra's ISP-affiliate, STI.[80] The Commission's application of this policy in Sierra's rate case is unlawful because it produces an

[77] D.16-06-054 at 219 (emphasis added).
[78] D.23-01-004 at 5.
[79] *Id.* at 20 (noting dispute between the parties over the calculation of depreciation based on Cal Advocates' proposed "plant disallowances" and recognizing the reduction in depreciation that follows from adopting Cal Advocates' proposal), 21 (acknowledging that income tax relies on inputs regarding "intrastate rate base" and "cost of capital").
[80] D.21-04-005 at 19, 23-24 (". . . each dollar increase in the broadband imputation amount will result in a corresponding dollar decrease in CHCF-A support."); D.23-01-004 at Appendix A, Line 1(b).

overall rate design that is insufficient to recover Sierra's revenue requirement.[81] This outcome is an unlawful taking,[82] a violation of statutory mandates,[83] and an improper imposition of public utility-type regulation on broadband service, which the FCC has deemed an "information service."[84]

While the Fifth District Court of Appeal has recently rendered a partially published opinion rejecting some of the Independent Small LECs' arguments regarding the Commission's broadband imputation policy, it found that the unconstitutional takings claim was "unripe," and therefore it remains unresolved pending the outcome of this rate case.[85] Because the policy has now been implemented in Sierra's rate case and the numerical results confirm an undeniable revenue shortfall that leaves Sierra's revenue requirement unrecovered—or, alternatively, an unlawful *per se* taking of STI's broadband revenues—Sierra and STI now challenge the application of this policy as an unlawful taking.

As applied in this rate case, broadband imputation has created a gap of approximately $1.1 million between Sierra's *costs* and *cost recovery*.[86] The governing statute and binding constitutional takings authorities prohibit this result. The legal framework for "small independent telephone corporation" ratemaking is outlined in Public Utilities Code Section 275.6. Based on the Legislature's instructions, the Commission must first determine the telephone company's costs, and then fashion a rate structure that will give the company a "fair

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[81] Pub. Util. Code § 275.6(b)(4) ("rate-of-return regulation" requires a rate design that will "provide the company a fair opportunity to meet the revenue requirement."); Pub. Util. Code § 275.6(c)(4) (CHCF-A must be provided "in an amount sufficient to supply the portion of the revenue requirement that cannot reasonably be provided by the customers of each small independent telephone corporation after receipt of federal universal service rate support."); *see also Brooks-Scanlon*, *supra*, 251 U.S. at 399 (state commissions cannot force utilities to recover their regulated costs from unregulated operations).

[82] *Id.*

[83] Pub. Util. Code §§ 275.6(b)(3); 275.6(b)(4), 275.6(c)(4).

[84] *In the Matter of Restoring Internet Freedom*, WC Docket No. 17-108, *Declaratory Ruling, Report and Order, and Order,* FCC 17-166 (rel. Jan. 4, 2018) at ¶ 20 ("We reinstate the information service classification of broadband Internet access service."), *reversed in part on other grounds by Mozilla Corp. v. Fed. Commc'ns Comm'n* (D.C. Cir. 2019) 940 F.3d 1, 35 (upholding the FCC's classification of broadband Internet access as an "information service"); *see also* Pub. Util. Code § 202 (prohibiting Commission jurisdiction over "interstate commerce").

[85] *Calaveras, et al. v. Pub. Util. Comm'n* (2022) 2022 Cal.App.Unpub.LEXIS 7816 at *49, *51-52 (unpublished version) (finding that the "takings claims are unripe" and that the "writ proceeding does not address a decision by the Commission that sets a telephone company's rates after applying broadband imputation.").

[86] D.23-01-004 at Appendix A, Lines 1(a), 1(b), 1(c), 9.

opportunity" to recover those costs.[87] As the Decision recognizes, "revenue requirement is a measurement of cost, reflecting the amount that a telephone corporation requires in order to recover its 'reasonable expenses and tax liabilities and earn a reasonable rate of return on its rate base.'"[88] By statute, "rate design" is the mix of end user rates, high-cost support, and other revenue sources that are targeted to provide a fair opportunity to meet the revenue requirement of *the telephone corporation*."[89] As a matter of constitutional and statutory law, "revenue requirement" and "rate design" must be equal.[90] If the rate design falls short of the revenue requirement, the company is denied a "fair opportunity to earn a reasonable rate of return on its investments."[91]

The Commission does not have discretion to adopt a revenue requirement and then refuse to fulfill it, but the Decision's application of broadband imputation produces precisely this result. The adopted revenue requirement is $20,162,135,[92] but the rate design is only targeted to generate $19,051,743 from regulated revenue sources.[93] The Decision's application of broadband imputation reduced Sierra's CHCF-A figure by $1,110,392, which is exactly the amount of the disconnect between its revenue requirement and the revenue conferred by its rate design.[94] This annual revenue shortfall reduces Sierra expected rate of return to 5.98%, significantly lower than the 9.22% return that the Commission itself deemed necessary for Sierra.[95] This outcome is forbidden by the governing statute and creates an unconstitutional

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[87] Pub. Util. Code § 275.6(b)(4).
[88] D.23-01-004 at 8; *see also* Pub. Util. Code § 275.6(b)(5).
[89] Pub. Util. Code § 275.6(b)(3) (emphasis added).
[90] Pub. Util. Code §§ 275.6(b)(4), (b)(3), (b)(5); *see also Pacific Tel. & Tel. Co. v. Pub. Util. Comm'n* (1965) 62 Cal.2d 644-645; *City & Cty. of San Francisco*, *supra*, 39 Cal.3d at 531; *see also* Exh. STC-06 (*Duval Opening Testimony*) at 17:5-20, 54:17-20.
[91] Pub. Util. Code § 275.6(c)(2).
[92] D.23-01-004 at 2.
[93] *Id.*, Appendix A, Lines 1(a)(1)-(6) plus Line 1(c); *see also id.* at 8 ("Sierra's proposed rate design includes the five categories of regulated revenue used in intrastate ratemaking, consistent with Commission precedent over the past three decades: (1) $5,624,143 in local network services revenue from Sierra's end user customers based on anticipated demand at current rates; (2) $250,186 in intrastate switched and special access; (3) $3,886,647 in High Cost Loop Support ("HCLS"), forecasted by applying the FCC's algorithm in 47 C.F.R. Section 54.1300, et seq. to the best available information regarding the inputs to that formula; (4) $714,139 in miscellaneous revenues classified as intrastate; and (5) $13,164,028 in CHCF-A, prior to applying broadband imputation.").
[94] D.23-01-004 at Appendix A, Line 1(b).
[95] *Id.* at 8, Appendix A, Lines 1, 1(b), 2, 4, 5, 6 (reflecting 5.98% rate of return by subtracting expenses, property taxes, and income taxes from the regulated revenue conferred by the rate design, and dividing

taking.

The Decision imposes a rate design that includes revenue that does not belong to Sierra, and which Sierra will not actually receive.[96] By "imputing" this ISP affiliate revenue into regulated ratemaking calculations, the Decision creates the illusion that sufficient funds will be available to recover Sierra's costs, but they will not. In fact, STI's retail broadband revenues belong to STI, which is engaged in unregulated retail broadband operations and which has its own separate cost structure and revenue needs.[97] By arbitrarily counting the broadband revenues as if they support Sierra's revenue requirement, the Commission artificially deflates the CHCF-A component of rate design, which by law must "supply the portion of revenue requirement that cannot reasonably be provided" by end user customers, federal support, and other legitimate intrastate funding sources.[98] With STI's revenues counted—but not actually received—as Sierra's revenue, the residual function of CHCF-A is disrupted, resulting in an annual shortfall of approximately $1.1 million in this critical funding source.

This ratemaking shortfall is not just a statutory violation, it constitutes an unconstitutional

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that figure by the rate base); D.16-12-035 at 55-58 (COL 1-4, OP 1(h)) (establishing Commission-authorized rates of return necessary to generate capital for investment); D.23-01-004 at 39 (FOF 6) ("The parties stipulated that, pursuant to D.16-12-035, Sierra would utilize a cost of capital figure of 9.22 percent in this GRC, subject to adjustment following conclusion of the pending cost of capital proceeding in A.22-09-003.").

[96] *Id.* at Line 1(b); D.21-08-042 at 11 (Broadband imputation does not require "the ISP affiliate to transfer funds to the Small ILEC."). Even if the Commission's purpose is to capture ISP profits, the seizure of these funds is a "per se" unconstitutional taking of unregulated, non-utility property. *See Ponderosa v. Pub. Util. Comm'n* (2011) 197 Cal.App.4th 48, 59-60 (seizure of returns on unregulated investments unconstitutional); *Brown v. Legal Foundation of Washington* (2003) 538 U.S. 216, 233-234.

[97] *See* Exh. STC-01 (*Huber Opening Testimony*) at 8:21-24 (STI is an Internet Service Provider ('ISP') providing Internet access or 'broadband' service in Sierra's service territory. STI provides service by purchasing Sierra's interstate, wholesale DSL transmission service, which is available on a tariffed basis to all ISPs regardless of any affiliation with Sierra."); Exh. STC-03 (*Montgomery Rebuttal Testimony*) at 10:19-20 ("Sierra's revenue requirement includes only Sierra's costs of service, not STI's separate costs related to the provision of Internet access or "broadband" services.").

[98] Pub. Util. Code § 275.6(c)(4); *see also* D.23-01-004 at 8 (confirming that "Sierra's proposed rate design includes the five categories of regulated revenue used in intrastate ratemaking, consistent with Commission precedent over the past three decades," *i.e.*, (1) local network services revenue; (2) intrastate switched and special access; (3) HCLS; (4) miscellaneous revenues; and (5) CHCF-A); Exh. STC-06 (*Duval Opening Testimony*) at 54:17-20 ("The rate design is made up of the revenues that are designed to recover the revenue requirement. In California, the revenues that are designed to recover the revenue requirement generally come from: local rates, intrastate switched access rates, intrastate special access rates, federal HCLS, miscellaneous intrastate service rates, and the CHCF-A.").

taking of Sierra's property interest in CHCF-A support,[99] in violation of state and federal constitutional requirements.[100] Sierra will be forced to operate *every year* without sufficient revenue to meet its revenue requirement and without a reasonable opportunity to achieve its authorized rate of return.[101]

The Commission cannot evade this constitutional requirement by claiming that Sierra's shortfall will be recouped through its ISP affiliate's operations. In *Brooks-Scanlon,* the Supreme Court struck down similar efforts by state commissions to compel a regulated entity to suffer under unprofitable operations because the "net result of the whole enterprise" was profitable if the commission's calculations included a non-utility business.[102] *Brooks-Scanlon* concerned an unprofitable railroad with a profitable lumber affiliate whose goods traversed the railroad.[103] The Commission's application of broadband imputation is just a modern version of the same unlawful scheme presented by *Brooks-Scanlon*, where the utility was illegally compelled to continue its unprofitable utility operation based on a state commission's inferences about the profitability of its unregulated affiliated business.[104] The ratemaking requirements applicable to Sierra contain no exceptions by which "revenue requirement" and "rate design" can be calculated with reference to non-utility operations—even if those operations happen to be affiliated with the telephone company and even if the affiliate's goods or services utilize the

[99] Property interests encompass any "legally enforceable right to receive a government benefit" that may be established under state law or rules. *See Board of Regents of State Colleges v. Roth* (1972) 408 U.S. 564, 576 ("The Court has held that a person receiving welfare benefits under statutory and administrative standards defining eligibility for them has an interest in continued receipt of those benefits that is safeguarded by procedural due process."), *citing Goldberg v. Kelly* (1970) 397 U.S. 254; *American Federation of Labor v. Employment* (1979) 88 Cal.App.3d 811, 819 (Property rights are not limited to property physically possessed by a party, but also include the '"legally enforceable right to receive a government benefit."'), *quoting Goldberg*, *supra*, 397 U.S. at 261-262.

[100] *See* U.S. Const., amends. V, XIV; Cal. Const., art. I, § 19; *Duquesne Light Company v. Barasch* (1989) 488 U.S. 299, 308; *Federal Power Commission v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603; *Bluefield Water Works v. Pub. Serv. Comm'n* (1923) 262 U.S. 679, 690-693.

[101] D.20-08-011, Appendix C (Sierra's next rate case is due to be filed in 2026 with reference to a 2028 test year); D.15-06-048 at 19 (confirming that a company that does not file in accordance with the rate case plan "will be required to obtain an exemption from the Commission's Executive Director, pursuant to Rule 16.6, or wait until the first year of their next GRC cycle.")

[102] *Brooks-Scanlon Co., supra,* 251 U.S. at 397, 399 ("[a] carrier cannot be compelled to carry on even a branch of business at a loss.").

[103] *Id.*

[104] *Id.*

affiliate's regulated facilities.[105]

The Decision's unprecedented calculation of the income tax liability component of Sierra's revenue requirement further confirms that broadband imputation creates a shortfall that reduces Sierra's tax liability. Specifically, the Decision improperly reduces Sierra's revenue requirement by reducing test year taxable income in response to "broadband imputation."[106] The effect is to reduce Sierra's test year tax expense, even though the broadband imputation decision states unequivocally that imputation shall impact only rate design, and not revenue requirement.[107] As a matter of law based on Public Utilities Code Section 275.6, revenue requirement must be computed by adding the utility's expenses, plus its return on rate base, plus its income tax liabilities.[108] The Decision does not follow the Commission's own directives for determining the income tax liability component of Sierra's revenue requirement, but instead identifies Sierra's return on rate base (gross income), accounts for Sierra's tax deductions (taxable income), and then *deducts* the ISP affiliate's net revenues from taxable income before applying tax rates to calculate the tax liability component of Sierra's revenue requirement.[109] This deduction in income tax liability costs is premised on the assumption that Sierra is not actually receiving the ISP affiliate revenues, *i.e.*, that there is a shortfall in Sierra's rate design. This admission contradicts any notion that Sierra will be made whole under the fiction of broadband imputation. The Commission's refusal to fulfill its adopted revenue requirement for Sierra fails to proceed in the manner required by law and constitutes an abuse of discretion and

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[105] Pub. Util. Code §§ 275.6(b), 275.6(c) (ratemaking calculations concern "small independent telephone corporations," not their affiliates).
[106] D.23-01-004 at 25-26.
[107] D.21-04-005 at 18-19 (stating that "the rate design portion of the GRC is the proper time for consideration of broadband imputation" and that "each dollar increase in broadband imputation will result in a corresponding dollar decrease in CHCF-A support."); *see also id.* at 18 (rejecting TURN's proposals to adopt a pro forma approach to imputation that combines the telephone company and the ISP, noting that "we decline to consider ISP affiliate operations in the determination of the Small ILECs' revenue requirements.").
[108] Pub. Util. Code § 275.6(b)(5); *see also* D.23-01-004 at 15 (referencing this equation used by Sierra to compute its revenue requirement); D.19-06-025 (Ducor), Appendix B (computing "net-to-gross multiplier" to increase gross revenue by the tax impacts of earning the rate of return on rate base specified in the rate case); D.19-04-017 (Foresthill), Appendix B (applying "net-to-gross multiplier methodology)..
[109] The Decision refers generically to Cal Advocates' alleged "algebraic equations" that are the source for this improper methodology. D.23-01-004 at 23. Sierra's briefs exhaustively debunk these calculations, where are simply a way of manipulating the revenue requirement in the CHCF-A calculation to make an adjustment for broadband imputation that D.21-04-005 expressly prohibits. *Sierra Opening Brief* at 21-22; *Sierra Reply Brief* at 47-50.

unconstitutional taking.[110]

VI. THE DECISION'S FAILURE TO INCLUDE AN EXPLICIT MECHANISM FOR REVERSING BROADBAND IMPUTATION IF BROADBAND IMPUTATION IS DEEMED UNLAWFUL CONSTITUTES AN ABUSE OF DISCRETION AND IS UNSUPPORTED BY ANY FINDING.

Because the partially published Court of Appeal decision found Sierra's and the other Independent Small LECs' takings claim was unripe and the Independent Small LECs have not exhausted their appellate rights on the additional grounds challenging the Commission's broadband imputation policy,[111] the Commission abused its discretion in failing to incorporate a mechanism in the Decision to reverse broadband imputation if it is ultimately deemed unlawful.[112] In addition, the Commission's failure to incorporate such a mechanism is unsupported by any findings in the Decision itself.[113] The Decision should be modified to include an ordering paragraph to address this contingency, as Sierra appropriately and timely requested.[114] The Decision fails to offer any reasoning to support its refusal to include such an ordering paragraph, and none exists.

VII. CONCLUSION.

The Decision commits material legal errors that require correction under the standard of review in Public Utilities Code Section 1757. The Decision erects an ambiguous standard for measuring Sierra's rate base that conflicts with test year ratemaking precedent and the Commission's rate case plan for "small independent telephone corporations." By

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[110] Pub. Util. Code §§ 1757(a)(2), 1757(a)(5), 1757(a)(6); *see also Woodbury v. Brown-Dempsey* (2003) 108 Cal.App.4th 421, 438 (If an agency's interpretation of a law or rule is "arbitrary and capricious," that action is an abuse of discretion); *see also City of Stockton v. Marina Towers LLC* (2009) 171 Cal.App.4th 93, 114 (finding that "[a] gross abuse of discretion occurs where the public agency acts arbitrarily or capriciously, [or] renders findings that are lacking in evidentiary support . . ."); *Zuehlsdorf v. Simi Valley Unified Sch. Dist.* (2007) 148 Cal.App.4th 249, 256 (actions "not supported by a fair or substantial reason" are also arbitrary and capricious). An agency's departure from its own precedent without adequate explanation is arbitrary and capricious. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.* (1983) 463 U.S. 29, 42; *McPherson v. Pub. Employment Relations Bd.* (1987) 189 Cal.App.3d 293, 308-309.

[111] *Calaveras, et al. v. Pub. Util. Comm'n* (2022) 2022 Cal.App.Unpub.LEXIS 7816 at *49, *51-52 (unpublished version).

[112] Pub. Util. Code § 1757(a)(5); *see also City of Stockton*, *supra*, 171 Cal.App.4th at 114 (finding that "[a] gross abuse of discretion occurs where the public agency acts arbitrarily or capriciously, [or] renders findings that are lacking in evidentiary support . . ."); *Zuehlsdorf*, *supra*, 148 Cal.App.4th at 256 (actions that are "not supported by a fair or substantial reason" are arbitrary and capricious).

[113] Pub. Util. Code § 1757(a)(3).

[114] *See Sierra Opening Brief* at 95; *Sierra Opening Comments on Proposed Decision* at 24-25.

implementing broadband imputation, the Decision strips Sierra of necessary CHCF-A support that is essential to satisfying its revenue requirement, while subjecting STI to public utility regulations and manipulating its potential to derive profits from its Internet access service. The Decision also errs in failing to adopt a mechanism to reverse broadband imputation, even though Sierra proposed a reasonable vehicle for these adjustments, and the Fifth District Court of Appeal expressly recognized that the constitutional takings claims pertaining to broadband imputation are outside the scope of its Opinion addressing Sierra's facial challenge to imputation.[115] The Commission should correct each of these errors on rehearing and issue a new decision that is consistent with the law, while otherwise preserving the Decision.

Executed at Oakland, California on this 13th day of February, 2023.

Patrick M. Rosvall
Sarah J. Banola
Sean P. Beatty
BRB Law LLP
436 14th Street, Suite 1205
Oakland, CA 94612
Phone: (415) 518-4813
Email: patrick@brblawgroup.com

By: */s/ Patrick M. Rosvall*
Patrick M. Rosvall
Attorneys for Sierra Telephone Company, Inc. and Sierra Tel Internet

[115] *Calaveras, et al. v. Pub. Util. Comm'n* (2022) 2022 Cal.App.Unpub.LEXIS 7816 at *49, *51-52 (unpublished version).