COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE REASONABLENESS OF THE EARNINGS OF BRANDENBURG TELEPHONE COMPANY, INC.) CASE NO. 92-563

O R D E R

The Commission regularly monitors the financial performance of all of the small local exchange companies in Kentucky relative to the return on equity, return on net investment, or times interest earned ratio found reasonable in each company's last rate proceeding. The results of this monitoring, which are based upon quarterly and annual reports filed with the Commission, reveal that Brandenburg Telephone Company ("Brandenburg") has consistently and significantly exceeded authorized return levels established in Case No. 9859,[1] its last rate proceeding.

BACKGROUND

On March 3, 1987, the Commission ordered Brandenburg to provide the Commission with reasons why Brandenburg's rates should not be reduced to achieve a more reasonable return on its investment. The Commission also ordered Brandenburg to provide certain financial exhibits. In that Order, the Commission cited its November 2, 1981 Order which gave Brandenburg the authority to earn 9 percent on its net investment. The Commission further noted

[1] Case No. 9859, An Investigation Into the Reasonableness of the Earnings of Brandenburg Telephone Company, Inc., Order dated March 3, 1987.

that in the years following that Order, Brandenburg's earnings consistently exceeded the authorized return. The 1987 case was settled by agreement which authorized Brandenburg to earn a 12.5 percent return on its equity capital and an overall return on its net investment of 10.08 percent. Revenue was reduced by $280,000. In spite of this reduction and significant plant additions since 1988, Brandenburg has continued to exceed its currently authorized returns of 12.5 percent on equity capital and 10.08 percent on net investment.

The Commission is aware that Brandenburg's basic residential and business rates are among the lowest in the state. Only those of Ballard Rural Telephone Cooperative Corporation, Inc. and Thacker-Grigsby Telephone Company, Inc. are comparable.

However, there are other rates that could be reduced or eliminated, including access rates, touchtone rates, and zone charges, which could benefit Brandenburg's ratepayers and fulfill Commission policy objectives. In addition, the ability of Brandenburg to achieve consistently high earnings strongly suggests to the Commission that Brandenburg's shareholders and ratepayers might benefit from the formal adoption of an incentive regulation plan, similar to that adopted in Case No. 10105[2] for South Central Bell Telephone Company. The Commission would welcome such a proposal by Brandenburg, as well as proposals to reduce or eliminate the above-mentioned charges. However, allowing

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[2] Case No. 10105, Investigation of the Kentucky Intrastate Rates of South Central Bell Telephone Company, Inc.

Brandenburg to earn at the levels cited in the analysis to follow would be a violation of this Commission's legislative mandate.

ANALYSIS

Based upon the Commission's analysis of the annual and quarterly reports, Brandenburg's earned return on year-end net investment has ranged between approximately 17.9 percent for the 12-month period ended December 31, 1988 - the first year following the Commission's Order in Case No. 9859 - and approximately 15.6 percent for the 12-month period ended December 31, 1991. For the 12-month periods ended March 31, 1992, June 31, 1992, and September 30, 1992 Brandenburg has earned approximately 16.4 percent, 16.5 percent and 17.6 percent, respectively. The 17.6 percent return on net investment at September 30, 1992 equates to an effective equity return of approximately 22 percent. At September 30, 1992, Brandenburg's equity ratio stood at approximately 70 percent and dividends to common shareholders for the year ended December 31, 1991 were $10 per share on an annual basis. These dividends represent a 20 percent dividend yield to shareholders. The earnings levels attained by Brandenburg have allowed it to accumulate retained earnings sufficient enough to invest approximately $4.3 million in cellular activities and accumulate approximately $6.5 million in temporary cash investments.

IT IS THEREFORE ORDERED that:

1. Within 45 days of the date of this Order, Brandenburg shall file comments stating the reasons, if any, why it should not

lower rates to earn no more than its authorized rate of return of 12.5 percent on equity capital and 10.08 percent on net investment.

2. Brandenburg shall file the following information to support its comments:

a. A detailed income statement for a 12-month period ending not more than 90 days prior to the date the response is filed. The income statement shall conform to the Uniform System of Accounts.

b. A balance sheet prepared to correspond to the end of the 12-month period referenced in (a). The balance sheet shall conform to the Uniform System of Accounts.

c. Calculations of Brandenburg's return on net investment and return on capital at the end of the same 12-month period.

d. A reconciliation of Brandenburg's net investment and capital at the end of the same 12-month period.

e. A schedule of rates with supporting documentation and testimony reflecting any proposed rate reduction.

f. A discussion of Brandenburg's opinions on the merits of Incentive Regulation, including whether Brandenburg is willing to consider adopting some form of Incentive Regulation Plan.

Done at Frankfort, Kentucky, this 11th day of January, 1993.

PUBLIC SERVICE COMMISSION

Chairman

Thomas M. Dorman

Vice Chairman

Robert M. Davis

Commissioner

ATTEST:

Don Mills

Executive Director