

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

SOUTH CENTRAL RURAL TELEPHONE)	
COOPERATIVE CORPORATION, INC.'S)	CASE NO.
AVOIDED COST METHODOLOGY AND)	2001-014
STUDY)	

ORDER

INTRODUCTION

On April 19, 2001, the Commission issued an Order in this case finding that the appropriate wholesale discount rate for South Central Rural Telephone Cooperative Corporation, Inc. ("South Central") was 9.60 percent. On May 11, 2001, South Central filed a petition for rehearing of the April 19, 2001 Order based on several grounds. First, South Central argues that the Commission included indirect costs in its calculation and therefore disregarded the Eighth Circuit's holding in Iowa Utilities Board¹ that only costs that would be avoided as opposed to costs that might be avoided were to be included in the determination of a wholesale discount rate. South Central further argues that the Commission did not permit South Central to use an alternative method to develop a wholesale discount rate that South Central alleges was established in Case No. 99-376.² Finally, South Central argues that the Commission mistakenly concluded

¹ Iowa Utilities Board v. Federal Communications Commission, 219 F.3d 744, 754-756 (2000).

² Case No. 99-376, Approving Duo County's Avoided Cost Methodology and Study.

that South Central had subtracted uncollectibles in its wholesale discount rate computation when it should have been added to the computation.

DISCUSSION

Eighth Circuit's Decision

South Central has argued that the Commission erred in its determination of which costs would be avoided in its resale market. The issue, according to South Central, is whether the Commission based its determination of the wholesale discount rate on costs that would actually be avoided as opposed to costs that could potentially be avoided. South Central accurately quotes the Iowa Utilities Board to state that the Eighth Circuit agrees that “the phrase ‘will be avoided’ refers to those costs that the ILEC [incumbent local exchange carrier] will actually avoid incurring in the future, because of its wholesale efforts, not costs that ‘can be avoided.’” Id. at 755. The Commission’s decisions in this proceeding reflect its best efforts to evaluate costs that South Central will actually be avoiding in the future. Because the Commission’s task is to determine future events, it must necessarily evaluate whether South Central would reasonably be avoiding such costs. The Commission made its best determination of future events in this proceeding.

South Central claims that the Commission’s wholesale discount computation is flawed because it fails to recognize that South Central will continue to operate as a retail provider, and relies on the Federal Communications Commission’s (“FCC’s”) incorrect interpretation of avoided retail costs. In doing so, the Commission failed to recognize the continuing nature of South Central’s retail sales and as a result assumed that South Central’s indirect costs could be expected to decrease. By including indirect cost in the

wholesale discount rate, the Commission treated South Central as a wholesaler that no longer would incur retail-related expenses. South Central also states that there is absolutely no evidence that its overall operations will be lower in a wholesale environment and that the Commission's assumption that South Central's indirect costs will decrease is erroneous. Finally, South Central claims that it has presented evidence that it will remain a retailer of telephone services with approximately the same overall level of operations and associated indirect expenses.

The Commission has been consistent with its treatment of indirect costs in every avoided cost study it has reviewed. As stated in the Commission's response to South Central's allegation that the Commission's methodology was in conflict with the Iowa Utilities Board's ruling, inclusion of indirect costs are the Commission's best determination of future events in this proceeding.

Contrary to South Central's allegation, the Commission has not treated the company as a wholesaler that would no longer have any retail-related expenses. Except for a small allocation of indirect expenses to avoided costs, which the Commission has cast as a rebuttable presumption,³ the Commission has used in its computation the avoided cost percentages used by South Central, including the 83.02 percent for Account 6623 computed by the company. Therefore, the rehearing on this issue should be denied.

³ Order 2001-014 at pages 3 and 4.

Alternative Methodology

In its motion for rehearing, South Central alleged that the Commission did not allow it to use an alternative avoided cost methodology established by the Commission in the Duo County case.

In the Duo County case, the Commission noted that Duo County had applied the avoided cost factors to expenses associated with intraLATA toll and local service activities and that the Commission did not agree with this method. The Commission then stated that if Duo County intended to develop an avoided cost percentage for only intraLATA tolls and local, it should have included only those expenses in its determination of the avoided cost percentage. Nowhere in the Duo County case did the Commission adopt this as an alternative methodology for determining avoided costs. In fact, the Commission stated clearly that it would apply the methodology that it has consistently used. Therefore, South Central is mistaken that the Commission established an alternative to the cost methodology it has used in previous cases. In addition, South Central failed to provide any analysis to substantiate its determination of the intraLATA toll and local expenses used in their computation or the derivation of the avoided cost factors. Instead, South Central used the intraLATA toll and local expenses of some unnamed "similarly situated LEC" in the computation. Therefore, the Commission will not grant rehearing on this issue.

AVOIDED COSTS

There are two accounts at issue, Product Advertising-6613 and Customer Services-6623. South Central claims that there are no avoided costs in Number Services-6622 and the Commission agreed therefore it will not address this account.

For Account 6613, South Central estimated that 51 percent of the account is related to local and intraLATA toll, and based this estimate on the costs of a similarly situated local exchange carrier. South Central also determined that 100 percent of this 51 percent of the account should be avoided. South Central provided no supporting schedule or analysis to verify its assumptions. The Commission's calculations took 100 percent of the total account balance and treated it as avoided. If South Central had intended to show that anything less than 100 percent of the total account balance was avoided, it should have provided an analysis of its account for the Commission to review.

For Account 6623, South Central estimated that 64 percent of the account is related to local and intraLATA toll. South Central bases this estimate on the costs of a similarly situated local exchange carrier not its actual costs. South Central also determined that 100 percent of this 64 percent of the account should be avoided. However, contrary to this assertion, South Central provided an exhibit that showed that 83.02 percent of the total account would be avoided. The Commission considers South Central's direct analysis of its own Account 6623 to be a more accurate estimate of its avoided costs. South Central's application of a 100 percent avoided cost to only 64 percent of the total account fails to recognize costs that it says are avoided in its own exhibit. Therefore, the Commission will apply the methodology it has used in previous cases including the Duo County case.

Uncollectibles

In its petition for rehearing, South Central alleged that the Commission erroneously asserted that the company had subtracted uncollectibles from direct costs.

South Central further stated that it agreed with the Commission's position that the correct methodology requires that avoided costs associated with uncollectibles be added to directly avoided costs. According to South Central, it followed this methodology. South Central further points out that due to certain appropriate adjustments within South Central's uncollectible account, a negative balance resulted for the study year and that the Commission's adjustment vastly overstated South Central's level of uncollectibles.

The uncollectible revenues account is meant to provide for bad debts and therefore present a fair measurement of net income. As such, the account should carry a debit balance. A review of South Central's annual reports for the years 1996-2000 reveals that for 3 out of the 5 years including the test year the account showed a credit balance. This situation clearly reflects a problem with the company's method of estimating for uncollectible revenues and distorts the financial results of the company. In the future, the Commission expects South Central to be more diligent in its estimation of uncollectible revenues, thereby maintaining a debit balance in the account, which will more accurately show the company's net income. However, South Central's claim that the Commission did not treat the uncollectibles credit balance correctly is well taken. Therefore, the Commission will grant South Central's claim for rehearing on that issue and use the credit balance in its calculations. However, in keeping with the Commission's earlier finding that indirect costs will be included in the wholesale discount computation, uncollectibles will be treated as an indirect account. This change reduces the 9.60 percent wholesale discount rate to 9.54 percent.

CONCLUSION

For the foregoing reasons, the Commission grants in part and denies in part South Central's petition for rehearing. Attached is the Commission's revised calculation of South Central's wholesale discount rate consistent with the decisions reached herein.

IT IS THEREFORE ORDERED that South Central's petition is granted in part and denied in part as described herein.

Done at Frankfort, Kentucky, this 30th day of May, 2001.

By the Commission

ATTEST:


Executive Director

1998 South Central

	Account #	Regulated Amount	Direct Costs by Account	Direct Avoid %	Direct Avoid Cost	Indirect Costs by Account	Indirect Avoid %	Indirect Avoid Cost	
Basic Local Service	520	7,406,880							
LD Network Services	525	1,056,015							
Revenues Subject to Resale		8,462,895							
Uncollectibles	5301	(39,374)				(39,374)	7.02%	(2,765)	
Uncollectibles - Other	5302	0				0	0.00%	0	
Uncollectible Revenue		(39,374)				(39,374)		(2,765)	
Network Support	6110	1,178	1,178	0.00%	0				
Land & Building	6121	250,320				250,320	7.02%	17,576	
Furniture & Artworks	6122	4,147				4,147	7.02%	291	
Office Equipment	6123	43,902				43,902	7.02%	3,083	
Gen. Purpose Computer	6124	86,684				86,684	7.02%	6,087	
General Support	6120	385,053				385,053	7.02%	27,037	
Central Office Switch	6210	318,058	318,058	0.00%	0				
Operator Systems	6220	0	0	#DIV/0!	0				
Central Office Trans.	6230	434,545	434,545	0.00%	0				
Information O/T	6310	0	0	0.00%	0				
Cable & Wire	6410	1,572,997	1,572,997	0.00%	0				
Other PP&E	6510	0	0	0.00%	0				
Power	6531	0	0	0.00%	0				
Network Adm.	6532	1,360,247	1,360,247	0.00%	0				
Testing	6533	0	0	0.00%	0				
Plant Operations Admin.	6534	0	0	0.00%	0				
Engineering	6535	0	0	0.00%	0				
Network Oper.	6530	1,360,247	1,360,247	0.00%	0				
Access	6540	0	0	0.00%	0				
Depr. / Amort.	6560	5,246,366	5,246,366	0.00%	0				
Product Management	6611	0	0	0.00%	0				
Sales	6612	0	0	0.00%	0				
Product Advertising	6613	16,299	16,299	100.00%	16,299				
Marketing	6610	16,299	16,299	100.00%	16,299				
Call Completion	6621	0	0	0.00%	0				
Number Services	6622	159,133	159,133	0.00%	0				
Customer Service	6623	820,130	820,130	83.02%	680,872				
Service Expense	6620	979,263	979,263	69.53%	680,872				
Executive	6711	286,176				286,176	7.02%	20,094	
Planning	6712	1,812				1,812	7.02%	127	
Exec. & Planning	6710	287,988				287,988	7.02%	20,221	
Accounting & Finance	6721	262,707				262,707	7.02%	18,446	
External Relations	6722	73,547				73,547	7.02%	5,164	
Human Resources	6723	79,087				79,087	7.02%	5,553	
Information Management	6724	98,343				98,343	7.02%	6,905	
Legal	6725	37,546				37,546	7.02%	2,636	
Procurement	6726	85,392				85,392	7.02%	5,996	
Research & Development	6727	12,223				12,223	7.02%	858	
Other General & Administrative	6728	281,328				281,328	7.02%	19,754	
General & Administrative	6720	930,173				930,173	7.02%	65,313	
Prov. Uncollect. Notes	6790	0				0	7.02%	0	
Total Expenses		11,532,167	9,928,953	7.02%	697,171	1,563,840	7.02%	109,807	806,978
									9.54%

ATTACHMENT