

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF NORTH CENTRAL)	
TELEPHONE COOPERATIVE CORPORATION)	CASE NO.
TO ADJUST RATES AND CHARGES FOR)	2007-00162
BASIC LOCAL EXCHANGE SERVICE)	

O R D E R

This matter is before the Commission on the application of North Central Telephone Cooperative Corporation (“North Central”) to increase the rates and charges for local exchange service for residential and business customers. The Commission, having heard the testimony and having reviewed the record, exhibits, and applicable law, and through other sufficient advice, finds that the rate request should be granted. The Commission's findings in this matter are outlined as follows:

BACKGROUND

North Central is an incumbent local exchange carrier providing local telephone service to the predominantly rural areas of Allen County, Kentucky, surrounding the city of Scottsville, along with a small portion of Warren County, Kentucky. North Central serves approximately 5,200 residential and 488 business customers in Kentucky. North Central also has approximately 13,500 residential customers and 2,300 business customers in Tennessee.¹ Approximately 80 percent of its customer access lines are located in Tennessee; however, that state does not regulate any of its cooperative

¹ See Case No. 2007-00432, The Application of North Central Telephone Cooperative Corporation for a Certificate of Public Convenience and Necessity for the Construction of Fiber Optic Cable in Allen County, Kentucky.

utilities. Although North Central operates within two different states, the cooperative operates in a consolidated manner wherein all end-user rates are uniform between all service areas. North Central intends to modify any rates in Tennessee concurrently and consistently with any rates approved and modified within Kentucky.²

Pursuant to KRS 278.192(1), North Central submitted its rate application based on a historical test period of calendar year 2006. The Commission, by Order,³ suspended North Central's proposed rates for a period of 5 months, ending April 25, 2008. North Central last filed a rate case with the Commission in 1983, wherein its current rates were set by Commission Order.⁴ During the last 25 years, the telecommunications industry has undergone massive technological and regulatory changes. Under Kentucky law, non-basic services provided by telecommunications utilities are not regulated by the Commission. However, the Commission retains jurisdiction over the rates for basic local exchange service and switched access.⁵ During the last 5 to 10 years, competition from wireless service, cable television providers, and Internet service providers has drawn customer demand away from public switched networks, thereby placing pressure on the traditional retail service revenues for many small telephone companies, such as North Central.

² See June 28, 2007 letter from North Central Telephone Cooperative Corporation to the Executive Director of the Kentucky Public Service Commission.

³ See Commission's November 21, 2007 Order.

⁴ See Case No. 8864, The Application of North Central Telephone Cooperative, Inc. for Authority to Adjust Its Rates and Charges, Order dated December 20, 1983.

⁵ KRS 278.512 and KRS 278.543.

North Central provided notice to its customers as to the pending rate request, as required under 807 KAR 5:001, Section 10. North Central also published advanced notice of the formal hearing in a newspaper of general circulation in its service area, as required under 807 KAR 5:011, Section 8. MCImetro Transmission Access Transmission Services LLC d/b/a Verizon Access Transmission Services, MCI Communications Services, Inc. d/b/a Verizon Business Services, Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance, NYNEX Long Distance Company d/b/a Verizon Enterprise Solutions, TTI National, Inc. Teleconnect Long Distance & Systems d/b/a Telecom*USA and Verizon Select Services, Inc. (collectively, "Verizon") served as the only Intervenor in this matter. Verizon operates in Kentucky as an interexchange carrier and is subject to North Central's tariffed access rates. On March 11, 2008, the Commission held a formal hearing to determine the reasonableness of North Central's rate request. In support of its proposed rate increase, North Central provided the testimonies of F. Thomas Rowland, President and CEO of North Central; Gentry B. Underhill, North Central's outside auditor; and Thomas Strait, a public utility consultant. Each of those witnesses was subject to cross-examination at the formal hearing.

RATE REQUEST AND REVENUE REQUIREMENTS

North Central's operating revenues for the base period were \$16,250,749. North Central states that its revenue requirement just to cover its expenses and no component of rate of return for the base period would be \$17,430,213, an increase of \$1,179,464.⁶

⁶ Prefiled testimony of Gentry B. Underhill at 6-7.

North Central has proposed to increase its charges for residential and business basic local exchange service as noted in the following table:

	<u>Residential</u>	<u>Business</u>	<u>Annualized</u>
Kentucky Access Lines	5,218	488	—
Tennessee Access Lines	13,545	2,343	—
Current Rates	\$11.90	\$18.03	—
Rate Increase	\$3.00	\$5.00	—
Proposed Rates	\$14.90	\$23.03	—
Additional Revenue	\$56,289.00	\$14,155.00	\$842,052.00

North Central chose the calendar year 2006 as the test period for this case. The company did not propose any adjustments to the test period, and the Commission has not made any adjustments to the test period. North Central had a net loss of \$1,184,800 for the test period, resulting in a times earned interest ratio (“TIER”) of negative 0.35. The proposed rate increase will produce a net loss of \$342,748, resulting in a TIER of 0.61.

North Central primarily receives capital from its members and debt obtained from the Rural Utilities Service (“RUS”). RUS requires its borrowers to meet and maintain certain financial conditions. In 2003, RUS directed North Central to maintain a minimum TIER of 1.0 through December 31, 2007 and a minimum TIER of at least 1.42 thereafter.⁷ RUS includes in its calculation for the TIER the non-regulated income of the company. In 2006, North Central had a TIER of 1.51 as calculated for RUS. In 2007, North Central had a TIER of 2.64 as calculated by RUS. Although North Central is maintaining a TIER at a level acceptable to RUS, it is being done so by the performance of its non-regulated subsidiaries. The Commission does not consider the performance of non-regulated entities when approving or setting rates for regulated entities.

⁷ Prefiled testimony of Thomas Strait at 9.

Therefore, the Commission will only consider those rates and earnings derived from regulated endeavors.

As noted above, North Central's regulated TIER for the test period after the inclusion of the proposed rates will be 0.61. This is well below the RUS lending requirements and the TIERs historically granted for telephone companies. For example, in North Central's last rate case, the Commission granted North Central a rate increase to produce a TIER of 1.4.⁸ In the present matter, North Central did not propose a certain TIER level, but proposed only dollar-specific rate increases. Given the historical performance of North Central's non-regulated entities, the proposed rate increase will enable North Central to maintain a TIER level that will not put it in default of its lending requirements, even though the rate increase requested will produce a TIER level well below those requirements. Based on this analysis, the Commission finds that the proposed rate increases will contribute toward the improvement of North Central's financial position.

OTHER SERVICE RATES

North Central has not proposed any adjustments to its access service rates in its application. Verizon intervened in this matter and cross-examined North Central's witnesses at the hearing regarding its current access service rates; however, it did not sponsor any witnesses or propose any specific adjustments to North Central's access service rates. In its post-hearing brief, Verizon recommended that the Commission

⁸ See Case No. 8864, The Application of North Central Telephone Cooperative, Inc. for Authority to Adjust its Rates and Charges, Order dated December 20, 1983.

eliminate the Non-Traffic Sensitive Revenue Requirement (“NTSRR”)⁹ of North Central. Verizon states that elimination of the NTSRR would make North Central’s intrastate access rates closer to the actual cost of providing the service because the NTSRR is a non-cost-based rate.¹⁰ Although Verizon is correct that the Commission has eliminated or reduced the NTSRR for other carriers in the state, the Commission has made such decisions in cases where there had been full participation of all parties and competitors directly affected by the access rates charged by a particular carrier.¹¹ Such is not the case in this matter, as Verizon is the only carrier to intervene. The issue of charges for access services is very detailed in scope and application, and any changes ordered by this Commission would affect a number of parties that are not participating in this case. Therefore, the Commission declines to address or evaluate any changes to the access services or charges implemented by North Central.

As to the issue of non-basic services, in 2007, North Central increased rates for non-basic services, including Caller ID, Call Waiting, Non-published/Non-listed numbers

⁹ NTSRR costs are, in general, recovered through fixed, flat-rate fees. Unlike other types of switched access services, generally, the costs of facilities used for both interstate and intrastate traffic do not vary with the amount of traffic carried over the facilities – hence the name “non-traffic sensitive revenue requirement.” See generally Administrative Case No. 323, An Inquiry into IntraLATA Toll Competition, An Appropriate Compensation Scheme for Completion of IntraLATA Calls by Interexchange Carriers and WATS Jurisdictionality, Order dated May 6, 1991.

¹⁰ Verizon’s Post-Hearing Brief at 4-5. Brief filed April 4, 2008.

¹¹ See generally Administrative Case No. 360, Inquiry into Universal Service and Funding Issues; Case No. 1994-00121, Application of BellSouth Telecommunications, Inc. d/b/a South Central Bell Telephone to Modify Its Method of Regulation; and Case No. 1999-00434, Review of BellSouth Telecommunications, Inc.’s Price Regulation Plan.

and Directory Assistance.¹² Increases for these services yielded a revenue increase of approximately \$335,000.¹³ The Commission notes that these increases in North Central's non-basic rates will contribute to helping improve the financial condition of North Central's jurisdictional services, although they have not been used as a factor by the Commission in rendering a determination on the rate increase requests.

CAPITAL CREDITS

As a membership cooperative, North Central is obligated to return to its members any excess profits earned by the cooperative. It does so by paying capital credits. The Board of Directors makes the determination of when and how many capital credits to pay back to its membership so long as the redemption will not impair the financial integrity of the cooperative. North Central has paid back capital credits for all years prior to 1998. North Central stated in its testimony that the national average redemption cycle for capital credits is 13.5 years, and North Central is on a 20-year redemption cycle.¹⁴ North Central has not paid any capital credits to its membership in the years 2007 or 2008 due to the financial condition of the cooperative.¹⁵

COST ALLOCATION

As noted above, the inclusion of non-regulated results has a positive effect on the overall earnings level of North Central. The Commission cautions North Central to

¹² See KRS 278.544(4), which provides that non-basic services are exempt from Commission review or action.

¹³ See North Central's Response to the Commission Staff's First Data Request, Item Nos. 4, 6, and 8. The revenue increase was derived from those responses.

¹⁴ Prefiled testimony of Thomas Strait at 8.

¹⁵ Transcript of Evidence at 26-27.

be diligent in ensuring the proper allocation of costs for all aspects of its non-regulated operations. North Central should carefully account for the costs associated with the non-regulated operations and properly allocate those costs to jurisdictional and non-jurisdictional services, respectively.¹⁶

CONCLUSION

Having reviewed the record, testimony, pleadings, applicable law, and other sufficient advice, the Commission hereby finds that North Central's request to increase the basic local service rates for residential and business customers should be granted.

IT IS THEREFORE ORDERED that:

1. North Central's request to increase its basic local exchange service rates for residential and business customers is granted.
2. North Central is hereby authorized to place into effect the rates and charges, as outlined within this Order, effective no sooner than April 25, 2008.
3. Within 20 days of the date of this Order, North Central shall file revised tariff sheets setting out the rates approved herein.
4. The Executive Director shall serve a copy of this Order upon the Attorney General, through his Office of Rate Intervention.

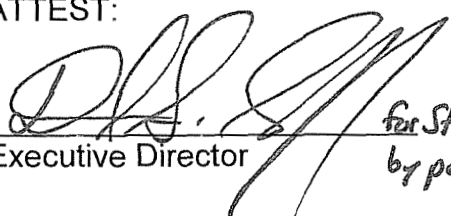
¹⁶ The Commission retains the authority to review the reasonableness of such accounting procedures when considering adjustments of rates for basic local exchange service.

Done at Frankfort, Kentucky, this 24th day of April, 2008.

By the Commission

Commissioner Clark Abstains.

ATTEST:


Executive Director *for Stephanie Stumbo*
by permission

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