COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of

NOTICE OF CONTINENTAL TELEPHONE)
COMPANY OF KENTUCKY OF AN)
ADJUSTMENT IN ITS INTRASTATE)
RATES)

CASE NO. 8428

ORDER DENYING REHEARING

On June 18, 1982, the Commission issued its Order in the above case granting Continental Telephone of Kentucky ("Continental") $912,746 in additional annual revenues. On July 8, 1982, Continental filed a petition for rehearing of this matter. The issues cited by Continental in its notice as a basis for its petition for a rehearing are toll settlement revenues, interest synchronization, salary increases and rate of return.

On July 14, 1982, the Consumer Protection Division of the Attorney General's Office, an intervenor in the above case, filed its response to Continental's petition for rehearing.

The Commission will address the issues of toll settlement revenues, interest synchronization and rate of return in this Order. In its discussion of salary increases, Continental presented no information or considerations not previously mentioned in the Commission's Order of June 18, 1982, and, therefore, the Commission denies Continental's petition for rehearing on this item.

Toll Settlement Revenues

Continental objected to the Commission's use of the 11.09 percent settlement ratio in determining toll revenues on the grounds that it was speculative, that the period of time it covered was too short to correct for abnormalities, that the Commission went outside the record in its use of the first quarter of 1982 to correct for these abnormalities and that South Central Bell ("SCB's") intrastate rate of return has been dropping for the last few months. Continental further stated that it is currently settling with SCB on an interim basis at 9.8 percent (the settlement ratio for the 12 months ended December 31, 1981).

As explained in greater detail in its June 18, 1982, Order, the Commission did not use SCB's earned 9.8 percent rate of return for the period ending December 31, 1981, as it is not representative of the expected 12-month period due to SCB's recent rate increase (Case No. 8150) which was not fully reflected in the period and the mismatching of revenue recovery and expensing of depreciation rates and station connection accounting changes.

The Commission is further of the opinion that proper rate-making standards include the use of annualized 3-month actual data when the data older than 3 months are unreliable, as in this case. The 3-month period used by the Commission to determine SCB's annualized intrastate rate of return does not fall outside the scope of the record as argued by Continental in its petition for rehearing. Continental was served with copies of these settlement ratios and made no objection at the hearing or otherwise to their use.

Therefore, Continental's objection is untimely and unfounded and is overruled.

Interest Synchronization

Continental further alleged that the Commission erred in its calculation of the tax effect of increased debt costs. The main thrust of Continental's argument is that the Commission violated 26 U.S.C. § 46(f) by allocating Continental's Job Development Investment Credits (JDIC) to its capital structure in the same ratio as the existing components of its capital structure and then calculating interest expense on the component of long-term debt including JDIC.

The method used by the Commission overstates Continental's actual interest expense and reduces its actual tax liability. This results in a lower cost of service and lower rates. However, it should be noted that the rates are not lower than they would be in the absence of JDIC. This regulatory treatment has received judicial approval. In Union Electric Co. v. FERC, 668 F.2d 389, page 395 (8th Cir. 1981), the Court ruled that this treatment is:

> . . . consistent with I.R.S. regulations; it allows a limited flowthrough to consumers, and allows the remaining benefits to the investors or taxpayers, without requiring that all the benefits be allocated to the investors.1/

Rate of Return

Continental argued that the 14.25 percent rate of return on common equity allowed by the Commission excluded an adjustment for financing costs. The Commission's method of determining a

1/ See also Public Service Co. v. FERC, 653 F.2d 681 (D.C. Cir. 1981).

range of returns applicable to Continental was clearly stated in its Order.

> CTC had four common stock issues from 1977 through the test year. In each case net proceeds per share exceeded current book value per share. CTC's achieved rates of return on average common equity for that period ranged from 12.97 percent to 14.64 percent. . . . Therefore, in determining a range of returns on equity applicable to Continental, the Commission has adjusted the 12.97 percent to 14.64 percent range achieved by CTC to reflect current market conditions and Continental's lower financial risk.2/ (Emphasis added.)

Net proceeds are, by definition, net of financing costs. As the achieved rates of return were adequate to allow net proceeds per share greater than book value per share, any further adjustment for financing costs would be inappropriate. Continental presented no information or arguments in its discussion of rate of return not previously mentioned in the Commission's Order of June 18, 1982. Therefore, the Commission denies Continental's petition for rehearing on this item.

Findings and Order

The Commission, after consideration of the evidence of record and being advised, finds that:

(1) Continental's petition for rehearing should be denied.

(2) Page 10 of the Commission's Order issued in this matter on June 18, 1982, should be replaced with page 10A attached hereto and made a part hereof.

2/ Order of June 18, 1982, page 20.

IT IS THEREFORE ORDERED that Continental's petition for a rehearing of the Commission Order issued in Case No. 8428 be and it hereby is denied.

IT IS FURTHER ORDERED that the Commission's Order in this matter is hereby amended by substituting page 10A, attached hereto, for page 10 of the original Order.

Done at Frankfort, Kentucky, this 28th day of July, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Volz
Chairman

Katherine Randall
Vice Chairman

[illegible] Carrigan
Commissioner

ATTEST:

Secretary

The salary committee which makes recommendations used by Continental in determining the amount of wage increases to be given meets in November or December.(14) Continental has no salary contracts with its employees.(15) Therefore, the Commission is of the opinion that the proposed 1983 11 percent wage increase presently appears unreasonably high, that the actual wage increases to be granted in 1983 are neither known nor measurable and that therefore they should be rejected for rate-making purposes in this proceeding. Thus, the Commission has reduced Continental's wage adjustment by $224,966.(16) This adjustment reduces Continental's intrastate maintenance expenses by $124,210, traffic expenses by $29,319, commercial expenses by $29,802, and increases its general office expense by $4,151.(17) This has the effect of increasing Continental's intrastate net operating income by $90,951. Moreover, the Commission puts Continental on notice that if in January 1983 Continental grants a wage increase which the Commission determines to be excessive, the Commission will take appropriate action to assure that the customers of Continental will not bear that portion of the wage increase found to be excessive.

Payroll Taxes

The Commission has adjusted Continental's pro forma payroll taxes to reflect the effect of the Commission's rejection of

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(14) Testimony of Mr. Dardon at May 6, 1982, hearing.
(15) Staff Request No. 1, Item 33.
(16) $569,533 X 39.5% = $224,966. Hearing Data Request, Witness No. 2, Item 3.
(17) These amounts were determined by Continental's allocation of this item to its expense accounts, times the applicable separation factors.