

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF RATES OF LESLIE)
COUNTY TELEPHONE COMPANY, INC.) CASE NO. 9430

ORDER FOR REHEARING

On June 2, 1986, the Commission entered an Order granting Leslie County Telephone Company, Inc., ("Leslie County") \$43,328 in increased operating revenues. On June 23, 1986, Leslie County filed a petition for rehearing, disputing the Commission's treatment of the following issues:

- (a) Right-of-Way Clearing Expense
- (b) Maintenance Expense
- (c) Embedded Customer Premises Equipment ("CPE")
- (d) Interest During Construction ("IDC")
- (e) Company Automobile
- (f) Rate Case Expense
- (g) Investment Tax Credit ("ITC")
- (h) Times Interest Earned Ratio ("TIER")

On the same day the Consumer Protection Division of the Attorney General's Office ("AG") filed its request for the Commission's reconsideration of the following issues:

- (a) Rate Base
- (b) Toll Revenues
- (c) Local Revenues
- (d) Miscellaneous Revenues
- (e) Depreciation Expense

DISCUSSION

Leslie County requested rehearing on right-of-way clearing expense asking that the Commission adopt Leslie County's proposed 3.667 year averaging of right-of-way expense on the grounds that

it was in conformity with the methodology used in Case 9002.¹ Leslie County cited cases in support of its position that right-of-way clearing expenses should be gauged by comparing the charges made by Clear Path with the charges of other firms. Those cases are not dispositive of the issue presented herein, since no directly comparable quotations are contained in the record.

Despite Leslie County's preferred approach, Leslie County acknowledged that the approach adopted by the Commission has support in the case law from several jurisdictions. The Commission has previously determined that the services performed by Clear Path, Inc., Leslie County's affiliate, could have been performed by Leslie County itself. Therefore, the profits of Clear Path, Inc., should appropriately be eliminated, once any additional expense to Leslie County of doing the right-of-way maintenance itself has been identified. Leslie County added that if the Commission decided to base its decision on the profitability of Clear Path, Inc., the Commission should also consider all of the operating expenses including payroll taxes and other overheads in its calculation.

The Commission concurs in that overheads should be considered in determining the normal recurring level of right-of-way expense. However, at the time the Commission issued its Order the proper test period financial data needed to determine these overheads was not made available. In its petition Leslie County has filed

¹ The Application of Leslie County Telephone Company, Inc., for Order Authorizing Adjustment of Rates and Charges, Order dated January 3, 1985.

additional financial information for Clear Path, Inc., which is helpful; however Leslie County has yet to file the proper financial data for the test period. The financial data required by the Commission to calculate the appropriate overhead costs is:

- 1) Clear Path's operating expenses for the period March 30, 1985, through August 28, 1985.
- 2) Clear Path's 1985 federal and state tax returns.
- 3) Identification, by invoice, of the right-of-way clearing which Leslie County chose to capitalize during 1985.

Therefore, the Commission grants rehearing on the proper level of right-of-way clearing expense, subject to the condition that Leslie County file the necessary information requested herein.

Leslie County requested rehearing on the issue of maintenance expense, dividing it into the three sub-issues of:

- (1) Rearrangement of cable, aerial wire, drop wire and pole lines.
- (2) Cost of installation, testing and routing used central office equipment ("COE").
- (3) Maintenance expense associated with embedded CPE.

Leslie County requested rehearing of the first two sub-issues based upon Leslie County's interpretation of the expense account description contained in the Federal Communications Commission Uniform System of Accounts ("USoA"). While Leslie County's interpretations of the USoA may be correct under other circumstances, during the test period Leslie County was in the midst of a

major construction program² and therefore, the USoA (Sec. 31-100:2) instructs that all construction costs be recorded in utility plant under construction before being transferred to the proper utility plant accounts.

Leslie County has failed to provide any new information to the Commission which necessitates a deviation from its original decision. Therefore, the Commission will not allow rehearing on the issues of rearrangement of cable, aerial wire, etc., and cost of installation, testing and routining used COE.

Leslie County was requested to file test period breakdowns of the following maintenance expense accounts after the hearing:

| | |
|-------------------|-------------------------------|
| Account No. 605 | Embedded CPE |
| Account No. 605.2 | Station Equipment-Moves, Etc. |
| Account No. 605.4 | Repair of Telephone Sets. |

However, Leslie County did not provide the requested information until its filing for rehearing. Based upon this information, the Commission will grant Leslie County's request for rehearing on the issue of maintenance expense associated with embedded CPE and will consider this issue with the overall issue of CPE.

Leslie County requested rehearing on the deregulation of CPE stating that it agreed with the Commission's revenue adjustment, but considered the expense adjustment to be unreasonable. The methodology used by the Commission was proposed by Leslie County

² Transcript of Evidence ("T.E."), Hearing date April 8, 1986, pages 196, 201 and 202.

in Administrative Case No. 257³ and resulted in approximately 21 percent of operating expenses being allocated to deregulated CPE. Leslie County argued that the methodology used does not take into account all underlying revenues, such as toll and miscellaneous. In order to determine the appropriate revenue and expense adjustment the Commission requires Leslie County to file the following test period information:

- (1) A complete detailed breakdown of all items included in the revenue figure of \$188,361.
- (2) A complete detailed breakdown of maintenance expense accounts 605, 605.2 and 605.4.
- (3) Any expense allocation which Leslie County finds appropriate along with the supporting reasons for the allocation methodology chosen. (All expense items do not have to be allocated on the same basis.)

Therefore, the Commission grants rehearing on the issue of CPE on the express condition that Leslie County file the requested information.

Leslie County requested rehearing on the issue of IDC arguing that its projected level of \$50,000 was a more accurate measure of the future level of construction work in progress ("CWIP") and that it would be unreasonable to base IDC upon the CWIP level that existed in the middle of a multi-million dollar construction program. Leslie County added that if the Commission maintained

³ The Deteriffing of Customer Premises Equipment Purchased Subsequent to January 1, 1983 (Second Computer Inquiry FCC Docket 20828).

that IDC be computed using end of the test period CWIP, then IDC should be included in the state and federal tax calculations.

The Commission based IDC on the end of test period level of CWIP in order to properly match test period rate base with earnings. This maintained the actual end of test period levels and negated the need for the pro forma adjustments necessary to maintain proper matching. While the future level of CWIP may be somewhat lower than the actual end of test period level, Leslie County's projected \$50,000 level is based on only 2 prior years CWIP levels. It also does not meet the Commission's rate-making criteria of being either known or measurable. In order for Leslie County to support any other level of IDC, Leslie County must provide all adjustments to revenues and expenses which would result from the conversion of CWIP to plant in service in order to meet its burden of proof. Therefore, the Commission will grant rehearing on the issue of IDC.

Leslie County requested rehearing on the company provided automobile, stating that the amount proposed by the AG had no support or basis in the case other than DeWard's Supplemental Testimony.

Leslie County added that if the personal use of the automobile is to be disallowed then the lease value of the automobile should be the basis for the adjustment. The Commission is of the opinion that Leslie County's proposed adjustment should also contain the appropriate insurance cost and operational expenses (i.e., gas, etc). In order for the Commission to properly compute

the necessary adjustment Leslie County should file the following:

- (1) The continuous automobile records required by the Internal Revenue Code to substantiate between personal and business use.
- (2) A listing of Operating Expenses for the automobile for the test period.

Therefore, the Commission will grant rehearing on the issue of company automobile subject to the condition that Leslie County file the requested information.

Leslie County requested rehearing on the issue of rate case expense dividing it into the following two sub-issues:

- (1) The amount of rate case expense allowed for rate-making purposes.
- (2) The amortization period of the rate case expense.

As quoted by Leslie County, Richard Swanson, partner in the firm of Arthur Anderson and Company, Certified Public Accountants, testified as follows: "I wasn't directly involved in the audit, but I understand that the audit went reasonably well."⁴ Therefore, Mr. Swanson's opinion on the condition of Leslie County's financial records is not based upon first hand knowledge, but rather what someone else had told him. Leslie County appears to have gone from one end of the spectrum in Case No. 9002 where it attempted to file its own case at lower costs, to the opposite side of the spectrum in this case. The Commission reiterates its

⁴ T.E., page 279.

opinion that Leslie County's financial records are poorly maintained and documented and in further support of this opinion notes Leslie County's inability to file the appropriate information requested at the hearing regarding the maintenance expense accounts. Leslie County has failed to file any new information which would persuade the Commission to deviate from its position and, therefore, denies rehearing on this issue of rate case expense.

Leslie County requested rehearing on the issue of the amortization period for rate case expense. Leslie County requested that the amortization period be changed from 3 to 2 years and provided supporting evidence for its position. Therefore, the Commission grants rehearing on the issue of rate case amortization period.

Leslie County requested rehearing on the issue of ITC arguing that the Commission's approach jeopardizes Leslie County's future ability to use its ITC because (1) the method is not in accordance with the general rule of the Internal Revenue Code, and (2) the Commission's calculation was based on ITC that Leslie County had never used. Leslie County provided a short history of ITC in defense of its argument.

Had Leslie County's revenue requirements been determined using a Return on Net Investment then Leslie County's approach to ITC would have been appropriate. However, since Leslie County's revenue requirement was calculated using a TIER, then Leslie County's ratepayers would have received no direct benefit under Leslie County's proposed ITC methodology. The Commission's

concern for this topic was made apparent through the extensive cross-examination of Richard Swanson.⁵ The Commission refers to footnote 5 of Leslie County's 1985 audited financial statements which shows that Leslie County has approximately \$728,000 of unused ITC that can be carried forward to the years 1994 through 2000. The Commission is of the opinion that this is an adequate time span in which Leslie County can use its ITC carry forward; however, if for any viable reason Leslie County is unable to use all of its ITC then it will be able to reclaim the unused amount already amortized in the future.

The Commission used the financial data for the years 1971 through 1984; however, due to the information filed by Leslie County regarding the history of ITC it was made apparent that ITC may have been claimed by Leslie County as early as 1971. Therefore, the Commission denies rehearing on the methodology of ITC, but grants rehearing on the financial data, subject to the condition that Leslie County file the 1971 through 1981 federal tax returns.

The last rehearing request made by Leslie County was on the issue of TIER, basing its argument that a TIER of 1.5X is the minimum coverage requirement of its loan and that the additional coverage requested is necessary due to the additional debt Leslie County would incur. The Commission grants rehearing on the issue of TIER, but reminds Leslie County that it has the burden of proof to support a deviation from the TIER of 1.5X.

⁵ T.E., pages 267-278.

The AG requested rehearing on rate base stating that the Commission failed to reduce rate base by \$19,132 of unrecognized contributions. After completing a review of the transcripts, the Commission has determined that it was not adequately proven whether this amount was contributions or deposits for construction. However, the proposed adjustment is de minimus in this case since its deduction or inclusion in rate base has no impact upon required net operating revenues. TIER was used rather than return on net investment, making this adjustment irrelevant. The Commission therefore, denies rehearing on the issue of rate base.

The AG requested rehearing of toll revenues arguing that the negative NECA true-up adjustment was pure guess work upon Leslie County's part and, therefore, should be eliminated. The Commission found this adjustment reasonable and the AG failed to provide new evidence to support its contention. Therefore, the Commission denies rehearing on the issue of toll revenue.

The AG requested rehearing on the issue of local revenue dividing it into the two sub-issues of:

- (1) End-user charge.
- (2) Additional regulated revenues.

The AG argues that since the end-user charge increased from \$1 to \$2 on June 1, 1986, test period revenues should be adjusted to reflect this change. Although the adjustment proposed by the AG meets the criteria of being known and measurable, the change in rates occurred the day before the Final Order was issued, which in the Commission's opinion is too far outside of the test period.

Further, Case No. 8838⁶ is now examining the impact this will have upon local service revenues. The Commission therefore denies rehearing on the issue of end-user charge.

The issue of additional regulated revenues was based on the argument that the Commission's embedded CPE revenue adjustment was inclusive of revenues not connected with deregulated CPE. Therefore, since rehearing has been granted on embedded CPE, the Commission grants rehearing on the issue of additional regulated revenues.

The AG requested rehearing on miscellaneous revenue, dividing it into the two sub-issues of:

- (1) Cable TV revenues
- (2) The premature removal of CWIP and placing it into plant in service.

The AG provided support from the hearing that substantiated its claim that test period cable TV revenues were understated. Therefore, the Commission grants rehearing on the issue of cable TV revenues. The AG could provide no new support that CWIP transferred to plant in service was not used and useful at or near the end of test period. Therefore, the Commission, denies rehearing on the issue of premature transfer of CWIP.

The last request for rehearing made by the AG was for the issue of depreciation expense based upon the transfer of CWIP into

⁶ An Investigation of Toll and Access Charge Pricing and Toll Settlement Agreements for Telephone Utilities Pursuant to Changes to be Effective January 1, 1985.

plant in service. As in miscellaneous revenues the AG has provided no new evidence on which to base its claim. The Commission therefore denies rehearing on the issue of depreciation expense.

IT IS THEREFORE ORDERED that:

1. Leslie County's request for rehearing on the issue of right-of-way clearing expense be and it hereby is granted on the condition that Leslie County file the necessary information requested herein.

2. Leslie County's request for rehearing on the issues of rearrangement of cable, aerial wire, etc., and cost of installation, testing and routining used COE be and it hereby is denied.

3. Leslie County's request for rehearing on the issue of maintenance expense associated with embedded CPE be and it hereby is granted.

4. Leslie County's request for rehearing on the issue of embedded CPE be and it hereby is granted on the condition that Leslie County file the necessary information requested herein.

5. Leslie County's request for rehearing on the issue of IDC be and it hereby is granted on the condition that Leslie County file the necessary information requested herein.

6. Leslie County's request for rehearing on the issue of company automobile be and it hereby is granted on the condition that Leslie County file the necessary information requested herein.

7. Leslie County's request for rehearing on the issue of rate case expense amount be and it hereby is denied.

8. Leslie County's request for rehearing on the issue of rate case expense amortization period be and it hereby is granted.

9. Leslie County's request for rehearing on the issue of ITC be and it hereby is denied on the issue of methodology but granted on the issue of reviewing past financial data.

10. Leslie County's request for rehearing on the issue of TIER be and it hereby is granted.

11. The AG's request for rehearing on the issue of Rate Base be and it hereby is denied.

12. The AG's request for rehearing on the issue of Toll Revenue be and it hereby is denied.

13. The AG's request for rehearing on the issue of end user charge be and it hereby is denied.

14. The AG's request for rehearing on the issue of additional regulated revenue be and it hereby is granted.

15. The AG's request for rehearing on the issue of cable TV revenues be and it hereby is granted.

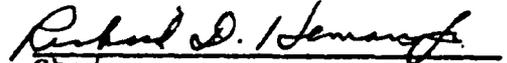
16. The AG's request for rehearing on the issue of CWIP transferred to utility plant in service be and it hereby is denied.

17. The AG's request for rehearing on the issue of depreciation expense be and it hereby is denied.

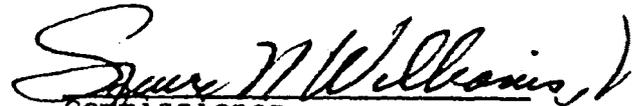
18. The information requested herein and prefiled testimony by Leslie County and/or the AG shall be filed within 3 weeks of the date of this Order.

Done at Frankfort, Kentucky, this 11th day of July, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary