

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 ON 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, both Leslie County and the Consumer Protection Division of the Attorney General's Office ("AG") filed petitions for rehearing on several issues. On July 11, 1986, the Commission issued its Order granting rehearing of the following issues:

- (a) Proper level of right-of-way clearing expense
- (b) Maintenance expense associated with embedded Customer Premises Equipment ("CPE")
- (c) Allocation of operating expenses to embedded CPE
- (d) Interest During Construction ("IDC")
- (e) Company provided automobile
- (f) Rate case amortization period
- (g) Proper level of Investment Tax Credit ("ITC")
- (h) Times Interest Earned Ratio ("TIER")
- (i) Additional regulated revenues
- (j) Pole attachment revenues from Cable TV

The rehearing was held in the Commission's offices in Frankfort, Kentucky, on October 8, 1986. Witnesses prefiling

testimony and/or appearing at the rehearing for Leslie County were: Donald Roark, Assistant Manager of Leslie County, and Richard Swanson, partner in the firm of Arthur Anderson and Company, Certified Public Accountants.

At the hearing the staff made a motion to strike from the record references made regarding the Commission's methodology concerning ITC¹ and the level of rate case expense² on the grounds that the Commission had disallowed both issues for rehearing. Leslie County argued that the discussion on ITC was in reference to the issue of TIER rather than ITC and that Leslie County was attempting to clarify a misconception it felt the Commission had in regard to the level of rate case expense.³ The Commission allowed the testimony to remain in the record but stated that Leslie County's arguments might have gone beyond the strict scope of the rehearing issues, and that the references in question would be given the appropriate weight, balanced with the issues as defined in the Rehearing Order of July 11, 1986.⁴

Leslie County informed the Commission through Richard Swanson's rehearing testimony that \$43,574 of maintenance expense had been mistakenly attributed to right-of-way clearing expense.

¹ Richard Swanson's prefiled rehearing testimony filed August 1, 1986, response to question 12, pages 6 and 7.

² Richard Swanson's prefiled rehearing testimony, response to question 20, pages 15 and 16.

³ Transcript of Evidence ("T.E."), October 8, 1986, pages 6 and 7.

⁴ T.E., page 9.

Swanson added that the mistake did not change the total test period maintenance expense but rather just the two components. This resulted in the Commission's adjusted maintenance expense being understated by \$43,574.

Both the Commission and the AG questioned Leslie County extensively on the issue of right-of-way clearing expense so that Leslie County had every reason to be totally familiar with the test period level. It is the Commission's opinion that Leslie County was given ample opportunity to note any discrepancy during the course of the case, which in this instance Leslie County failed to do. This issue was not subsequently included in the request for rehearing and, therefore, would not be considered in the scope of the issues granted for rehearing. Thus, the Commission will not consider Leslie County's request for reconsideration of this issue.

Right-of-Way

Leslie County proposed to increase test period right-of-way clearing expense of \$30,951, the amount found reasonable by the Commission, by \$31,318 in order to reflect certain cost overheads that Leslie County felt the Commission had neglected in its calculation. The Commission when calculating its original amount used the financial information that was available to it at that time; however upon rehearing Leslie County has filed detailed financial information that more clearly represents the actual cost of performing right-of-way clearing. After reviewing the costs proposed by Leslie County the Commission is of the opinion that if Leslie County had performed the right-of-way clearing itself,

certain overheads which Leslie County proposed to include would not have been incurred, such as income taxes and profit margin. Also depreciation expense would have remained at the amount originally calculated by the Commission. Therefore, Leslie County's proposed right-of-way clearing expense has been reduced by \$12,332 for an adjusted amount of \$49,937.

Customer Premises Equipment

Leslie County upon review of its CPE expense allocation methodology and actual maintenance expense records has proposed the following increases to the expenses the Commission found appropriate:

Commercial Expense	\$10,077
General Office Expense	18,263
Other Operating Expense	23,148
Payroll Tax Expense	3,892
Maintenance Expense	58,894

Originally, Leslie County's CPE expense allocation was based upon the ratio of deregulated CPE revenue to total local service revenue. The Commission expanded Leslie County's methodology to include PBX revenues originally neglected by Leslie County, resulting in 20.85 percent of operating expenses being allocated to CPE. Leslie County argued that an allocation of expenses of approximately 21 percent is unreasonable and that revenues alone do not explain the behavior of expense levels.⁵ The Commission concurs with Leslie County in its evaluation; however, it reemphasizes that "the alternate methodology of allocating these expenses, based on time studies, while more precise, may be

⁵ Richard Swanson's prefiled rehearing testimony, page 9.

prohibitively expensive to small utilities."⁶ Donald Roark concurred that the cost of the time studies was a major prohibitive factor in performing them.⁷

The Commission is of the opinion that the original allocation process resulted in a relatively high proportion of costs allocated to deregulated CPE activities and might not have been reflective of the actual cost associated with CPE. The Commission is further of the opinion that the allocation methodology based upon time spent by outside plant employees working on CPE might be appropriate for allocating outside plant payroll expenses; however, it may not actually be reflective of the total cost associated with CPE. In the absence of actual time studies this is probably the closest representation Leslie County has proposed thus far. Therefore, the Commission accepts Leslie County's allocation methodology in this instance, but advises Leslie County to further review and attempt to find an allocation methodology more reflective of the actual cost of providing CPE service. One option open to Leslie County would be to spread the time studies over a few years in order to avoid the entire cost at one time. Another option would be a joint effort with other small telephone utilities sharing information and costs. This would assure that costs allocated to CPE would be more reflective of the actual cost incurred for providing that service. Leslie County's operating

⁶ Administrative Case No. 257, The Detariffing of Customer Premises Equipment Purchased Subsequent to January 1, 1983, dated May 13, 1983, page 2.

⁷ T.E., page 78.

expenses have been increased by a total of \$114,274 to reflect the new allocation methodology and revised maintenance expense records.

Interest During Construction

Leslie County requested that the Commission reconsider and accept Leslie County's original IDC estimate of \$2,500 rather than the amount calculated by the Commission. However, Leslie County has not provided any new information during the rehearing process that would persuade the Commission to change its original finding. At the hearing Donald Roark agreed that it would be a mismatch if the level of IDC was changed due to the placing of construction work in progress in service and not recognizing the effects this plant conversion would have upon revenues and expenses.⁸ In the original Order granting Leslie County rehearing on this issue Leslie County was requested to provide all effects the conversion to plant in service would have upon revenues and expenses.⁹ However Leslie County failed to provide such estimates.¹⁰ Based upon this failure to meet its burden of proof, the Commission affirms its original finding of its level of IDC.

Investment Tax Credit

When Leslie County was granted rehearing on the proper level of ITC the Commission requested that further financial information be filed. However, Leslie County has failed to file the requested

⁸ T.E., page 83.

⁹ Order for Rehearing, July 11, 1986, page 6.

¹⁰ T.E., pages 81 and 82.

information. Therefore, based upon Leslie County's failure to provide the requested information the Commission is of the opinion that the original finding should remain unchanged.

Times Interest Earned Ratio

Leslie County requested that the Commission reconsider its decision regarding TIER and grant Leslie County a TIER of 1.7, as originally requested. Leslie County's request for a TIER of 1.7 was based upon the following arguments: (1) actual interest expense has increased since the end of the test period, (2) the Commission's TIER methodology is not in conformance with the methodology of the Rural Electrification Administration ("REA"), especially in regard to deregulated activities, and (3) the Commission's ITC methodology for rate-making purposes was invalid.¹¹

The argument regarding increased interest expense based on the entire REA loan being drawn down is the same that Leslie County relied upon in the original proceeding. The Commission is of the opinion that if it granted Leslie County a higher TIER, because of the increased interest expense, then a mismatch would occur due to interest being recognized on plant which was not used and useful during the test period. The Commission therefore advises Leslie County that if it wishes coverage for the interest assumed after the test period then it should do so in a new proceeding where a later time period would avoid such a mismatch.

¹¹ Richard Swanson's prefiled rehearing testimony, pages 5 through 7.

The Commission is of the opinion that the formula provided by the REA to its lenders does not properly recognize rate-making treatment and is for reporting purposes only. This formula disregards deregulated operations while recognizing total debt. The Commission finds this inappropriate. Further, it is up to Leslie County and the marketplace, not the regulatory Commission, to determine the appropriate return for deregulated-competitive activities such as CPE. The Commission chose the ITC methodology which it deemed most appropriate under the circumstances. If a higher TIER were granted due to ITC, the Congressionally mandated sharing of the benefits derived from ITC between Leslie County's stockholders and its ratepayers would not result. Therefore, the Commission is of the opinion that Leslie County has failed to support a TIER higher than 1.5 and denies this request.

Additional Regulated Revenues

The AG requested rehearing on the issue that deregulated CPE revenues contained charges that remained regulated. Leslie County supplied the Commission with ample substantiating evidence to prove that the revenues classified below the line were totally for deregulated activities. The Commission is of the opinion that its original finding should remain unchanged.

Other Issues

The following are increases to operating expenses or revenues proposed by Leslie County and the AG:

Automobile Expense	\$12,833
Rate Case Expense	1,826
Cable TV Revenues	5,171

After reviewing the information provided, the Commission is of the opinion that the proposed adjustments are correct and has therefore allowed the adjustments to operating expense of \$14,659 and has increased miscellaneous revenues by \$5,171.

Income Taxes

The Commission has computed income taxes using Commission adjusted operating revenues and expenses from both the original Order and those found reasonable herein for an adjusted level of negative state and federal taxes of \$41,367 and \$2,147, respectively, resulting in a total decrease of \$71,279 to operating expenses.

Therefore, the adjusted operations of Leslie County are stated as follows:

	Leslie County Rehearing Adjusted	Commission Rehearing Adjustments	Commission Rehearing Adjusted
Operating Revenues	\$1,968,422	50,015	\$2,018,437
Operating Expenses	1,573,660	<83,611>	1,490,049
Net Operating Income	<u>\$ 394,762</u>	<u>133,626</u>	<u>\$ 528,388</u>

REVENUE REQUIREMENTS

Leslie County's adjusted net operating income of \$528,388 results in a TIER of 1.32. The Commission is of the opinion that this is unfair, unjust and unreasonable. The Commission has determined that Leslie County would require a net operating income of \$599,858 to achieve a TIER of 1.5, which the Commission believes is fair, just and reasonable. This will provide Leslie County with adequate revenues to cover operating expenses, loan payments, and provide the owners with an adequate return on

investment. Therefore, the Commission has determined that Leslie County is entitled to an increase in local service revenue in the amount of \$144,095.

FINDINGS AND ORDERS

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

1. The rates and charges in Appendix A are the fair, just and reasonable rates and charges for Leslie County to charge its customers for telephone service and will provide approximately \$841,714 of local service revenues.

2. All provisions of the Commission's Order of June 2, 1986, in this proceeding not specifically adjusted herein should remain in full force and effect.

IT IS THEREFORE ORDERED that:

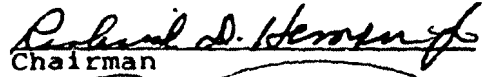
1. The rates and charges in Appendix A are the fair, just and reasonable rates and charges to be charged by Leslie County for telephone service rendered on and after the date of this Order.

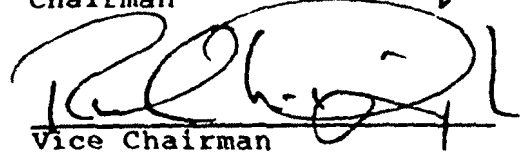
2. All provisions of the Commission's Order in this proceeding issued June 2, 1986, not specifically amended herein shall remain in full force and effect.

3. Within 30 days from the date of this Order, Leslie County shall file with this Commission its revised tariff sheets setting out the rates approved herein.

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

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9430 DATED 12/11/86

The following rates and charges are prescribed for the customers in the area served by Leslie County Telephone Company, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Local Exchange Tariffs

For The Service Areas of:

Hyden Exchange
Stinnett Exchange
Buckhorn Exchange

Wooton Exchange
Bledsoe Exchange
Canoe Exchange

Residential 1-Party Service:

Line Access Charge \$10.20

Residential 4-Party Service:

Line Access Charge \$ 8.25

Business 1-Party Service:

Line Access Charge \$14.95

Business 4-Party Service:

Line Access Charge \$13.00

Zone Charges

Zone 1	\$ 1.90
Zone 2	\$ 3.80
Zone 3	\$ 5.75
Zone 4	\$ 7.65
Zone 5	\$ 9.55

PABX

Regular	\$17.17
Trunkhunt	\$25.75

Key

Regular	\$17.17
Trunkhunt	\$25.75

For The Service Area of:

Dwarf Exchange

Residential 1-Party Service

Line Access Charge	\$10.80
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Business 1-Party Service

Line Access Charge	\$15.90
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PABX

Regular	\$18.15
Trunkhunt	\$27.20

Key

Regular	\$18.15
Trunkhunt	\$27.20