COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

SEPARATION OF COSTS OF REGULATED TELEPHONE SERVICE FROM COSTS OF NONREGULATED ACTIVITIES	)))	ADMINISTRATIVE CASE NO. 321

O R D E R

The Order which established this case was dated December 29, 1987 and was issued as a result of the Federal Communications Commission's ("FCC") action in CC Docket 86-111.[1] In the December 29, 1987 Order, the Commission propounded a list of questions which it directed the parties of record to respond to by February 1, 1988. On January 29, 1988, in response to numerous Motions for Extensions of Time, the Commission granted an Extension of Time until March 17, 1988 for all parties to respond to the Order dated December 29, 1987.

After reviewing the responses, the Commission, in an Order dated May 20, 1988, determined that the case should proceed in two phases. The Commission determined that phase one would include those companies which were required to file cost allocation manuals ("CAMS") with the FCC, generally referred to as Tier I

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1 Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities.

Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and Their Affiliates. 2 FCC Rcd. 1298 (1987).

LECs,[2] plus Continental Telephone Company of Kentucky (subsequently renamed Contel of Kentucky, Inc.), and Alltel Kentucky, Inc. Contel and Alltel were included in phase one because, in the opinion of the Commission, they had significant opportunity to engage in nonregulated lines of business.[3]

The second phase of the investigation would focus on those telephone utilities participating in the Independent Telephone Group ("ITG").[4] At the time of the May 20, 1988 Order these companies were operating under the guidelines established in previous administrative cases[5] and the Commission was of the opinion that with the implementation of the new Uniform System of Accounts on January 1, 1988, these guidelines were probably outdated. Therefore, the Commission opined that, absent the

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2 Local Exchange Companies that earn more than $100 million in total regulated revenues on an annual basis.

3 Order dated December 29, 1987, page 8.

4 Ballard Rural Telephone Cooperative Corporation, Inc., Brandenburg Telephone Company, Inc., Duo County Telephone Cooperative Corporation, Inc., Foothills Rural Telephone Cooperative Corporation, Inc., Harold Telephone Company, Inc., Highland Telephone Cooperative, Inc., Leslie County Telephone Company, Inc., Lewisport Telephone Company, Inc., Logan Telephone Cooperative, Inc., Mountain Rural Telephone Cooperative Corporation, Inc., North Central Telephone Cooperative Inc., Peoples Rural Telephone Cooperative Corporation, Inc., Salem Telephone Company, South Central Rural Telephone Cooperative Corporation, Inc., Thacker-Grigsby Telephone Company, Inc., West Kentucky Rural Telephone Cooperative Corporation, Inc.

5 Administrative Case No. 257, The Detariffing of Customer Premises Equipment Purchased Subsequent to January 1, 1983 and Administrative Case No. 269, The Sale and Detariffing of Embedded Customer Premise Equipment.

requirement to file CAMS, the ITG companies should reestablish procedures to identify their nonregulated activities and their associated costs.

Further, the Commission concurred with the suggestion of the ITG that a task force be established to discuss the allocation procedures revisions. The task group was to be comprised of representative members of the ITG and the Commission Staff as appropriate.

Included as a part of the May 20, 1988 Order was a procedural schedule identified as Appendix A which was adopted for the ITG phase of the case. This procedural schedule was later amended by an Order dated July 20, 1988. In accordance with this revised schedule, the ITG submitted its proposed methodology for assigning nonregulated and regulated costs. Subsequently, an informal conference was held between the ITG representatives and the Commission Staff, at which time specific points regarding the plan were discussed.

The plan, as presented, allowed for the direct assignment of costs to either nonregulated or regulated activities whenever they could be readily identified. For instance, expenditures associated with nonregulated activities such as customer premises equipment or inside wire would be directly assignable to nonregulated accounts. Other costs (common costs) which could not be directly attributable to an activity were to be allocated between nonregulated and regulated accounts based on a "general allocator." In this case, the general allocator proposed by the ITG was derived by dividing the nonregulated revenues by the total company revenues. This methodology was chosen because, in the opinion of the ITG, it was easily verifiable in the event of an audit and also because it would, from their perspective, be the least costly to administer.

The Commission agrees with the ITG that the allocation of common costs based on a revenue ratio would be easily verifiable and administered. However, the Commission is of the opinion that this methodology is imperfect because of the fact that revenues do not measure the amount of resources used by an activity. The Commission believes that a common cost allocator (general allocator) based on the ratio of all expenses directly assigned or attributable to regulated and nonregulated activities would provide a more reasonable method for allocating common costs. We have decided to choose such an allocator. Our choice is consistent with the general allocator selected by the FCC in CC Docket 86-111.[6] Further, the Commission is of the opinion that because directly assigned costs will have to be determined as part of the accounting process, the ease of administration and verifiability of this methodology will be comparable to the methodology proposed by the ITG.

With regard to the remaining portions of the ITG's methodology, the Commission is in agreement with the plan as submitted.

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6 See 2 FCC Rcd. 1298 at paragraph 156.

FINDINGS AND ORDERS

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. The revenue-based general allocator proposed by the ITG should be rejected.

2. A general allocator based on directly assignable expenses should be adopted.

3. The plan as submitted by the ITG, with the exception of the revenue-based allocator, is an appropriate methodology to assign costs to either nonregulated and regulated activities.

4. The allocation plan should be implemented on January 1, 1989.

IT IS THEREFORE ORDERED that:

1. The revenue-based general allocator shall be rejected.

2. A general allocator based on directly assignable expenses shall be adopted.

3. The remaining portions of the plan as presented by the ITG shall be adopted.

4. Within 30 days of the date of this Order, the ITG shall file a revised allocation plan reflecting the general allocator prescribed in this Order.

5. The allocation plan shall be implemented on January 1, 1989.

Done at Frankfort, Kentucky, this 22nd day of December, 1988.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director