COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

A REVIEW OF THE RATES AND CHARGES AND INCENTIVE REGULATION PLAN OF SOUTH CENTRAL BELL TELEPHONE COMPANY) CASE NO. 90-256

O R D E R

IT IS ORDERED that South Central Bell Telephone Company ("South Central Bell") and Theodore Barry & Associates ("TB&A") shall file the original and 15 copies of the following information with the Commission, with a copy to all parties of record, by December 17, 1990. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible. Where information requested herein has been previously provided reference may be made to the specific location of said information in responding to this information request. When applicable, the information requested herein should be provided for total Kentucky operations and Kentucky jurisdictional operations, separately.

Questions for South Central Bell

1. In its Motion to Adopt a Revised Incentive Regulation Plan and to Defer Rate Design, filed October 1, 1990, South Central Bell asks that rate design issues be deferred. In the event that it is decided to reflect the decrease in the amortization of inside wire and the represcription of depreciation in January 1991 prior to the conclusion of this proceeding, is it your opinion that the existing schedules in the current incentive plan or some other schedule should be used? If so, provide a suggested schedule.

2. At page 10 of the October 1, 1990 motion, South Central Bell states that if the rate of return changes within the duration of the plan, South Central Bell rates should be adjusted to maintain the relative position in the new range. Provide an explanation and an example using actual June 30, 1990 earnings given the current range and a new range using South Central Bell's suggested neutral range of 50 basis points above and below the new midpoint.

3. Provide a further explanation of how South Central Bell perceives the implementation of the true-up mechanism discussed on page 11, of the October 1, 1990 motion. At what point will these true-ups be implemented? Provide an example showing this process.

4. At page 12 of the October 1, 1990 motion, South Central Bell states that "Prior-test-period adjustments would defer any other rate changes related to those remaining "savings" or "costs" for two years, when they would be included with other then current

financial results." Explain how South Central Bell perceives that this mechanism will work. Provide an example showing how the results of the first point-of-test will impact subsequent points-of-test. Carry this example out over 6 periods. How does South Central Bell's proposal differ from the TB&A proposal?

5. In Item No. C Rate Base 1, sheet 1 of 2, of Cochran's reply to the October 25, 1990 data request, the statement is made that South Central Bell Kentucky's portion of South Central Bell's investment in BellSouth Services should not be removed from rate base and capital. Explain why Kentucky ratepayers should be required to pay a return on nonregulated investments, especially when a return component is included in the expenses paid to BellSouth Services which are included in the cost of service South Central Bell Kentucky uses to determine a revenue requirement.

6. The following questions relate to Cochran's Direct Testimony:

a. On page 4 in the first full answer on that page, second sentence, explain how South Central Bell Kentucky's portion of South Central Bell's investment in BellSouth Services is "investment in properties used and useful in providing telephone service."

b. On Exhibit 2, the Kentucky Company Basis Intrastate column includes an item labeled "Non-operating Plant" in the amount of $647,000. What does this amount represent? Disaggregate if necessary.

c. Disaggregate "Telephone Plant Under Construction" shown on Exhibit 1, into long-term and short-term.

d. How much of the "Cash" shown on line 6 of Exhibit 1 is actually in Kentucky banks as compensating or minimum cash balances needed to avoid service charges? List the banks and corresponding amounts.

e. It appears that all of the Job Development Investment Credit on Exhibit 2 is associated with intrastate investment. Explain.

f. Disaggregate the following amounts shown on Exhibit 3:

1.	Other Income - Net	$2,862,000
2.	Interstate Contribution	296,000
3.	Non-operating Income/Expense	2,115,000

7. The following questions relate to Mr. Pappanastos' Direct Testimony:

a. Explain in detail how comparable risk is determined in view of the fact that a substantial portion of South Central Bell Kentucky's revenues are not subject to competition and are therefore not at risk.

b. How many telephone companies have gone "belly up" in the last ten years?

c. What percentage of the revenues of each of the companies chosen for your analysis are not subject to competition?

d. How much of South Central Bell's cash requirements are generated internally?

e. What is the difference between the total debt shown on JSP Exhibit E, page 1 of 1, in the amount of $2,941,400 and that shown on Cochran Exhibit 2 in the amount of $3,006,568?

f. Provide a worksheet showing the development of the debt/equity ratio at page 17.

g. Is the "Average Cost" of short-term debt shown on JSP Exhibit "E" the average for the first 6 months of the year or the composite cost at the end of the period? If an average, why wasn't an end-of-period composite used?

h. What do the following amounts found on JSP Exhibit "D" represent:

1.	Unamortized Premium	$ 2,067
2.	Unamortized Discount	(13,817)
3.	Unamortized Issue Expense	(63,172)

Do any of these amounts represent transactions occurring for the purpose of refinancing, i.e., call premiums, unamortized discount, and expenses of retired debt issues.

Questions for TB&A

1. What specific evidence supports the conclusion on page VI-24 that "The organizational movement toward consolidation of services is in the best interest of the Kentucky ratepayers," other than the general statement on page VI-25 that "economies appear to be accruing, although no formal studies have yet been performed."

2. Given the statement on page VI-24 that "BellSouth Corporation has not identified, and we have not observed, any change in corporate policies and procedures regarding affiliated interests that were triggered by incentive regulation," is it TB&A's opinion that the introduction of incentive regulation in Kentucky and other South Central Bell state entities has not had a

measurable impact on the organizational structure, staffing levels, and management of BellSouth Services and BellSouth Corporation? If it has had an impact on BellSouth Services and BellSouth Corporation, provide examples of such.

3. In TB&A's 1985 management audit of South Central Bell Kentucky, the chapter devoted to affiliated interests discusses the monitoring and control of affiliated charges at South Central Bell Headquarters, rather than at the South Central Bell Kentucky level. Page VIII-59 of that report states in part:

> Delegating a portion of the responsibility for development and control of these numbers to the state level would provide additional assurances of the efficient and effective allocation of funds. If proper value was not being received through a service rendering, and this fact was recognized at the operating level, pressure would certainly be brought to bear on either the service provider or the budgeted allocation for the following year.
>
> This additional control on value received at the state level is quite important to maximum efficiency of operation.

TB&A in that report at page VIII-63 recommended that "Affiliated Interests and SCB Headquarters Costs" charged to South Central Bell Kentucky be clearly communicated, so that "SCBK will be better able to control costs and assist in evaluations of the services performed by the affiliated interests".

Given TB&A's emphasis on improved state-level review and control of affiliated costs in the 1985 audit, why was the conclusion reached in the Incentive Plan audit at page VI-26 that "The <u>SCB</u> role of reviewing, evaluating, and controlling affiliated charges on behalf of Kentucky is appropriate"? (Emphasis added.)

Does TB&A's position as expressed in the 1990 audit, which supports regional review and control, represent a change in philosophy from the 1985 audit? Explain.

4. Explain the statement on page X-12 in the last paragraph, that "SCBK's strategic goal is to link all of the national or regional subsidiaries to the parent through the South Central Bell and particularly the SCBK network." Specifically, clarify how South Central Bell Kentucky, as a local exchange carrier prohibited from offering interLATA service, can link all national subsidiaries to the parent through the South Central Bell Kentucky network.

5. a. At page III-6 of the September 4, 1990 report, TB&A states that if the limits of the neutral range are changed, South Central Bell's present earnings should simultaneously be adjusted to leave South Central Bell's present return in the same relative relationship in the new range. Provide an explanation and an example using actual June 30, 1990 earnings given the current range and a new range with a midpoint of 30 basis points in either direction of the current midpoint and a neutral range of 50 basis points in either direction of the new midpoint. Provide the same using a new midpoint of 60 basis points in either direction.

b. Should this simultaneous adjustment occur with the adoption of the continuation of the proposed revised incentive plan and all subsequent modifications to the neutral range and midpoint, or should this mechanism only be implemented with all subsequent modifications?

6. At page III-7, TB&A recommends retroactively truing-up any variances in the 3 months used for forecasting and applying any trued-up adjustment within that point-of-test after actual results are known. Provide an explanation and an example of this proposed mechanism. Be specific with regard to the dates of all adjustments.

7. a. At the top of page III-8, TB&A discusses its recommendation of prior test period adjustments. In its analysis, TB&A states it is not in agreement with the current prior period adjustment mechanism. Provide your perception of the current mechanism and a full discussion of your reasoning for disagreement.

b. In its recommendation TB&A states that "prior test period adjustments be modified such that the <u>rapidity</u> in which the adjustment mechanism recaptures previous SCBK point of test savings be <u>lessened</u> in the first two subsequent points of test and the full SCBK savings from earnings above the range be recaptured through price reduction within two years . . . ." (Emphasis added.) Provide a full discussion of the recommendation and detailed examples over 6 points of test.

c. Do you agree with South Central Bell's October 1, 1990 proposal? How do you differ? Elaborate fully.

Done at Frankfort, Kentucky, this 3rd day of December, 1990.

PUBLIC SERVICE COMMISSION

For the Commission

ATTEST:

Executive Director