COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

DUO COUNTY'S AVOIDED COST METHODOLOGY AND STUDY	))	CASE NO. 99-376

O R D E R

BACKGROUND

On September 7, 1999, Duo County Telephone Cooperative Corporation, Inc. ("Duo County") filed with the Commission an avoided cost study in support of its proposed wholesale discount rate. The filing was made pursuant to the Commission's Order in Administrative Case No. 355.[1] The study consisted of workpapers showing the development of the wholesale discount rate and a narrative explaining the rationale supporting the methodology used in the development. On November 19, 1999, Duo County filed a revised study incorporating changes to bring the study in line with its annual report to the Commission. On January 11, 2000, an informal conference was held between the Commission Staff and representatives of Duo County to discuss certain issues that arise from the revised study and that are unique to small, rural, average schedule companies. On February 24, 2000, Duo County filed another avoided cost study incorporating recommendations discussed at the informal conference. On March 21, 2000, the Commission issued an Order requesting documentation of the cost study supporting the expense allocations. The information

[1] Administrative Case No. 355, An Inquiry Into Local Competition, Universal Service, and the Non-Traffic Sensitive Access Rate, page 14.

was filed on April 3, 2000. Duo County believes its methodology conforms to the guidelines prescribed by the Federal Communications Commission ("FCC") in its First Report and Order 96-325.[2] Duo County recognizes that a wholesale discount methodology must concur with rules prescribed by the FCC and the general rules established by the Commission in its Order in Administrative Case No. 355.

DISCUSSION

Duo County's Initially Proposed Method

Duo County's February 24, 2000 "Proposed Method" uses total operating expenses to determine the indirect expense percentage and for determining the avoidable discount. The proposed method also excludes Account 6722 – External Relations, Account 6725 – Legal, Account 6726 – Procurements, and Account 6728 – Research and Development from any calculation of the avoided cost rate. It is Duo County's position that in a resale environment these expenses could increase and not decrease, although there is no empirical evidence to support this position. Duo County also subtracted from its avoidable discount rate a factor for anticipated increased expenses that would be incurred in a resale environment. These increases were labeled "Cost Onsets." Finally, the "Proposed Method" treats uncollectible revenue as indirectly avoided. The "Proposed Method" produced a wholesale discount rate of 2.96 percent. Duo County recommended that the Commission adopt the proposed method

[2] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket No. 96-98) and Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers (CC Docket No. 96-185), First Report and Order, Released August 8, 1996.

because it is administratively efficient and does not require small local exchange carriers ("LECs") to prepare cost studies.

Adjusted Staff Method

At the informal conference, Duo County requested a copy of the methodology the Commission used in determining avoided cost from the large Kentucky telephone companies so that Duo County's inputs could be tested in that formula. The company made several adjustments to that study, both in its February 24, 2000 filing and in its April 3, 2000 filing. These adjustments included; (1) using costs related to local and intraLATA tolls as derived from the modified cost separation study; (2) inclusion of intrastate intraLATA and intrastate interLATA non-traffic sensitive revenues in the total retail revenue figure used as the denominator in the avoided cost calculation; (3) inclusion of uncollectible revenues as indirectly avoided; and (4) inclusion of cost onsets. The result was a 3.90 percent discount rate as reflected in the April 3, 2000 filing.

Commission's Position

In formulating its rules for resale, the FCC specifically recognized resale as an important entry strategy for new entrants into the local market and its strategic importance to the development of competition.[3] The Commission agrees with this assessment and considers the development of an accurate wholesale discount rate crucial to the development of competitive markets. Duo County's proposed method falls short, because it excludes certain accounts based on speculative changes, includes

[3] FCC Order No. 96-325, Paragraph 907.

revenues not subject to resale, and includes cost onsets. The Commission will continue to calculate the avoided cost discount rate in the same manner as it has in the past. The Commission's method is easy to administer and is consistent for all LECs.

ADJUSTMENTS

Avoided Cost Percentage

In determining the avoided cost percentage for Account 6621 – Call Completion, Account 6622 – Number Service, and Account 6623 – Customer Services, Duo County empirically evaluated each charge within these accounts. Such evaluation apparently determined the dollar cost of each activity in the accounts that would be avoided in a resale environment and divided those amounts by the total of the account, resulting in a 64.35 percent avoided cost percentage. For Account 6611 – Product Management, Account 6612 – Sales, and Account 6613 – Product Advertising, the company used a 90 percent avoided discount rate. The Commission agrees with these percentages.

Avoided Costs

In determining the avoided costs for these accounts, the company applied the factors determined above to the expenses associated with intrastate toll and local service activities. The Commission does not agree with this method. It is incorrect to apply an avoided cost percentage based upon an entire account to a mere portion of that account. If the company intended to develop an avoided cost percentage only for intraLATA toll and local, it should have included only those expense items in its determination of the avoided cost percentage. Therefore, the Commission will apply the avoided cost percentages described above to the total account. The Commission has consistently employed this method.

Retail Revenue

Duo County has proposed that intraLATA and interLATA non-traffic sensitive revenue be added to local and intraLATA toll revenue in the discount rate denominator. In support of this proposal, the company states that these revenues are designed to reduce local or retail rates and that, without these revenues, small LECs would necessarily see the residual revenue requirement increase in the local jurisdiction.

The Commission disagrees with the inclusion of these revenue streams in the calculation. These revenues are clearly access revenues, and access services are not subject to the FCC's resale requirements. The claim that the local revenue requirement would increase in the local jurisdiction for any one company in particular is speculative at best, since no small, rural company has come to the Commission since the early eighties for a review of its revenue requirement. Since new entrants into rural markets do not have these revenues streams to provide support to their rates, they could not possibly compete with incumbent carriers at a wholesale rate that included these revenues.

Uncollectible

The company proposes to include uncollectible revenues as indirectly avoidable. It claims the FCC recognizes that the LEC will continue to operate in a retail environment; consequently, uncollectible revenues will not be 100 percent avoidable.

Commission policy regarding treatment of uncollectible revenues was established in Case No. 96-482[4] in which it determined that it would be unreasonable to

[4] Case No. 96-482, The Interconnection Agreement Negotiations Between AT&T Communications of the South Central States, Inc. and BellSouth Telecommunications, Inc. Pursuant to 47 U.S.C.

classify as LEC costs uncollectible costs incurred by resellers pursuant to sale of services to end-users. Therefore, 100 percent of uncollectibles will be included in Duo County's study.

Cost Onsets

Duo County's study recognizes what it perceives to be recurring and nonrecurring costs incurred as a result of beginning operations as a wholesale provider company. The company characterizes the adjustment as consistent with FCC discussions in FCC Order No. 96-325. Although the company did not cite a paragraph in the FCC's Order, it appears that Paragraph 928 is the operative citation. In this paragraph, the FCC states that "some new expenses may be incurred in addressing the needs of resellers as customers." The discussion in this paragraph centers around percentages of costs in Account 6611 – Product Management, Account 6612 – Sales, Account 6613 - Product Advertising, and Account 6623 – Customer Services that are avoidable in a resale environment. The FCC concludes that 10 percent of the costs in these accounts would not be avoided. Nowhere in the discussion did the FCC indicate that the 10 percent did not take into consideration some new costs.

In Case No. 98-041,[5] the Commission denied GTE South Incorporated's ("GTE") proposal to include new costs that might be incurred by reselling its services, finding that GTE had failed to provide evidence supporting the alleged new costs. In this case, Duo County has provided dollar estimates of new costs that would be incurred as the result of wholesale activity. However, because of the lack of detail to support these

[5] Case No. 98-041, GTE South Incorporated Avoided Cost Study.

dollar estimates and the lack of information as to the number of competitors and lost customers that would be in Duo County's territory, the Commission rejects the inclusion of Onsets in the wholesale discount computation at this time. However, should competition become a reality in Duo County's service area, the company may petition the Commission for inclusion of known and measurable impacts on this rate.

Wholesale Discount Rate

The Commission has determined that certain adjustments as discussed herein should be made to the Staff methodology as proposed by Duo County. The resulting wholesale discount rate is 8.56 percent (Appendix 1). This discount will be offered to any competitor reselling Duo County tariffed services.

IT IS THEREFORE ORDERED that the appropriate wholesale discount rate for Duo County's retail services shall be 8.56 percent. This determination is, however, subject to Duo County's receipt of a bona fide request for interconnection and subsequent Commission action on such request.

Done at Frankfort, Kentucky, this 25th day of May, 2000.

By the Commission

ATTEST:

Executive Director

1998 Duo County

	Account #	Regulated Amount	Direct Costs by Account	Direct Avoid %	Direct Avoid Cost	Indirect Costs by Account	Indirect Avoid %	Indirect Avoid Cost
Basic Local Service	520	2,656,991						
LD Network Services	525	777,964						
Revenues Subject to Resale		3,434,955						
Uncollectibles	5301	5,423				5,423	100.00%	5,423
Uncollectibles - Other	5302	0				0	0.00%	0
Uncollectible Revenue		5,423				5,423		5,423
Network Support	6110	4,746	4,746	0.00%	0			
Land & Building	6121	115,570				115,570	4.45%	5,147
Furniture & Artworks	6122	2,543				2,543	4.45%	113
Office Equipment	6123	28,510				28,510	4.45%	1,270
Gen. Purpose Computer	6124	24,706				24,706	4.45%	1,100
General Support	6120	171,329				171,329	4.45%	7,630
Central Office Switch	6210	337,498	337,498	0.00%	0			
Operator Systems	6220	2,073	2,073	0.00%	0			
Central Office Trans.	6230	10,433	10,433	0.00%	0			
Information O/T	6310	0	0	0.00%	0			
Cable & Wire	6410	828,677	828,677	0.00%	0			
Other PP&E	6510	0	0	0.00%	0			
Power	6531	0	0	0.00%	0			
Network Adm.	6532	670,606	670,606	0.00%	0			
Testing	6533	0	0	0.00%	0			
Plant Operations Admin.	6534	0	0	0.00%	0			
Engineering	6535	0	0	0.00%	0			
Network Oper.	6530	670,606	670,606	0.00%	0			
Access	6540	0	0	0.00%	0			
Depr. / Amort.	6560	3,068,893	3,068,893	0.00%	0			
Product Management	6611	0	0	0.00%	0			
Sales	6612	0	0	0.00%	0			
Product Advertising	6613	14,455	14,455	90.00%	13,010			
Marketing	6610	14,455	14,455	90.00%	13,010			
Call Completion	6621	0	0	0.00%	0			
Number Services	6622	62,881	62,881	0.00%	0			
Customer Service	6623	350,032	350,032	64.35%	225,248			
Service Expense	6620	412,913	412,913	54.55%	225,248			
Executive	6711	261,452				261,452	4.45%	11,643
Planning	6712	0				0	4.45%	0
Exec. & Planning	6710	261,452				261,452	4.45%	11,643
Accounting & Finance	6721	162,019				162,019	4.45%	7,215
External Relations	6722	174,650				174,650	4.45%	7,777
Human Resources	6723	16,836				16,836	4.45%	750
Information Management	6724	162,458				162,458	4.45%	7,235
Legal	6725	18,448				18,448	4.45%	822
Procurement	6726	12,836				12,836	4.45%	572
Research & Development	6727	0				0	4.45%	0

Other General & Administrative	6728	147,123				147,123	4.45%	6,552	
General & Administrative	6720	694,370				694,370	4.45%	30,922	
Prov. Uncollect. Notes	6790	0				0	4.45%	0	
Total Expenses		6,477,445	5,350,294	4.45%	238,258	1,132,574	4.91%	55,617	293,875
									8.56%