BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the matter of the application of General Telephone Company of the Midwest, Columbus, Nebraska, for authority to adjust its rates and charges for telephone service.	)))))	Application No. C-562 GRANTED IN PART Entered: January 14, 1986

APPEARANCES: For the Applicant
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For the Commission Staff
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For the City of Genoa
Glenn A. Rodehorst, Attorney
Genoa, Nebraska

OPINION AND FINDING

BY THE COMMISSION:

By application filed December 28, 1984, General Telephone Company of the Midwest, Columbus, Nebraska seeks authority to adjust its rates and charges for telephone service furnished by it in the State of Nebraska.

Notice of the filing was published pursuant to the provisions of the Commission's Rules and Regulations. Letters of notification were sent to all mayors, community clubs and newspapers served by General Telephone Company of the Midwest advising that the application had been filed and that the increase requested was $2,518,557. A formal protest to the application was filed by the City of Genoa and at least 100 other letters and petitions protesting the application were received.

In accordance with the policies adopted by this Commission in 1974, an Assistant Attorney General was assigned to prepare and present the Staff case at the hearings. This was done to insure that the Commission would receive all relevant and material evidence on the record, where it would be subject to cross-examination testing its truthfulness. The assigned attorney was isolated from the decision-making process and placed in the same status as other participants of record. He, as well as the Applicant, presented evidence through witnesses on the record and cross-examined other witnesses.

Pursuant to notice required by law, public hearings were held on the application in Kearney, Nebraska, on October 16, 1985; Genoa, Nebraska on October 17, 1985; and Columbus, Nebraska on October 18, 1985.

Upon consideration of the application, the evidence adduced at the hearings and being fully advised, the Commission is of the opinion and finds that:

1. The Applicant is a corporation organized under the laws of the State of Missouri, with its principal executive office in the city of Grinnell, Iowa. It is a common carrier furnishing telephone service in Nebraska, Iowa, Missouri, Minnesota, and Kansas, and as such, is subject to the jurisdiction of this Commission.

2. Applicant furnishes local and long distance service at 37 telephone exchanges in Nebraska serving approximately 43,100 exchange access lines.

3. The rates and charges of the applicant now in effect were approved by the Commission in its order entered May 25, 1982, in Application No. C-136.

4. Applicant alleges that its earnings are inadequate and that its authorized rate of return is unreasonably low to provide a fair and reasonable rate of return on its property devoted to Nebraska intrastate business. Applicant seeks to increase rates in an amount to produce additional revenue of $2,518,557.

5. For the purpose of determining the results of operations, both applicant and staff have used a test year ending August 31, 1984, and an end of period rate base.

RATE BASE

6. Applicant's exhibits reflect its adjusted rate base as of August 31, 1984, to be $25,229,260, consisting of the following:

Telephone Plant in Service		$47,307,730
Unamortized IDC		63,716
Short-Term Construction		2,366,834
Materials and Supplies		280,335
CPE Depreciation Reserve		2,486,366
CPE Deferred Income Taxes		285,154
		$52,790,135
Less:	Depreciation Reserve	20,662,037
	Deferred Income Taxes	2,795,041
	Unamortized ITC-62	2,514
	Tax Normalization	148,548
	CPE Plant in Service	3,952,735
		$25,229,260

7. Staff has proposed several adjustments to this rate base. These adjustments are:

a.	To disallow unamortized interest on short-term construction.	(63,716)
b.	To disallow certain short-term construction projects not completed within 12 months.	(1,722,863)
c.	To disallow the proposal for deregulating embedded customer premise equipment.	2,362,430

The foregoing adjustments result in a rate base of $25,805,111.

8. The disallowance of the unamortized interest on plant under construction is proposed by the staff to recognize that the investors were aware of changes in accounting for plant under construction. A similar adjustment has been upheld by the Neb. Supreme Court in In re Application of Northwestern Bell Telephone Company, 218 Neb. 563, 357 N.W. 2d 443 (1984). The staff proposed to disallow certain short-term construction projects not completed within twelve months with an investment of $2,552,583. We agree with these adjustments, with the exception of the Kearney switch project which had a booked investment of $2,325,664 as a short-term construction project. We recognize that the staff's adjusment on this project was correct based on the filing of the applicant and F.C.C. Reg. 531.100:2, however we choose not to allow this adjustment for the following reason. The commission recognizes that this switch was placed into service on March 23, 1985, with an investment of $2,737,254. We further note that the revenues and expenditures associated with the operation of this switch are not part of the applicant's filing nor are they part of the record of this case. Nevertheless, this plant is providing service to the ratepayers of the applicant. While it might appear somewhat arbitrary, in the interest of equity and fairness, we find that the rate base should be adjusted to include the Kearney switch.

9. We find the other staff adjustments to be reasonable and further find that the appropriate rate base to be used in this case is $28,542,365.

RESULTS OF OPERATIONS

10. Applicant's exhibits show adjusted intrastate operating income for the year ended August 31, 1984, in the amount of $2,012,934. Adjustments include the deregulation of embedded customer premise equipment, (CPE) official company toll, out of period expenses, annualized depreciation at the year-end level, proposed new depreciation rates, and an end-of-period revenue adjustment. Also included are adjustments for end-of-period and pro forma labor costs and benefits, rate case expenses, toll compensation, and income taxes.

11. The staff recommends adjustments that would result in adjusted net operating income of $2,813,692. The previous staff income tax calculation was based on the premise that the federal tax rate furnished by the company did not reflect the deductibility of state income tax for federal tax liability. The company has informed the staff that the rate furnished did allow for the state income tax deduction. Restating the financial results with the corrected tax rate results in adjusted net operating income of $2,760,916.

12. Staff proposes two adjustments to revenues, (1) to correct a toll recovery adjustment, and (2) to reflect local service revenues booked during the test period. These adjustments total $90,617 and increase net telephone earnings by $47,619. We find these adjustments reasonable.

13. The Staff proposes, and we concur in an adjustment to exclude the sum of $12,177 which is the amount of amortized interest on short-term construction projects. This adjustment increases net telephone earnings by $6,399.

14. Staff proposes to exclude from General Service and License expenses, $85,806 of research projects conducted at GTE labs. To be included as rate-making expenses, the expenditures should:

(1) Be made at the discretion of the Company;

(2) Be of known amount for each good or service;

(3) Be used and useful for providing service in Nebraska; and

(4) Be from an accounting view, an expense.

The Staff contends, that the Company has not demonstrated that these criteria have been met. We find the evidence supporting these projects to be reasonable and the staff adjustment should not be allowed.

15. The Company is proposing special depreciation treatment of the Manual Switching account. Their proposal would recover the net book cost over a 12 month period estimated to start January 1, 1985.

Staff recommends the Commission, deny the request for special treatment, thus mandating that the current depreciation rate remain in effect until the plant is fully retired. At that time, any negative reserve balance should be amortized over a period not to exceed 3 years. We find this treatment to be appropriate and concur with the staff position.

16. Applicant proposed new depreciation rates to the COE-Electro-Mechanical account and to the aerial cable account. In Application No. 33118 the Commission set forth guidelines for maximum depreciation rates. The following rates were approved under the Commission's order:

Aerial Cable	18 %
COE - Step-by-Step	12.5%
COE - Common Control Non-Electronic	7 %

We find these rates proper.

17. Staff proposes to exclude from depreciation expense an amount of $495,716 which represents two depreciation adjustments which the staff maintains are not measureable. This adjustment increases net telephone earnings by $260,498. We find these adjustments reasonable.

18. The staff proposes to continue to treat embedded customer premise equipment (CPE) on a regulated basis. Pursuant to the Third Report and order issued by the F.C.C. in CC Docket No. 81-893, this Commission filed a plan to deregulate embedded CPE on or before December 31, 1987. Staff contends that during the test period for this case, revenues from CPE exceeded expenses and contributed $493,000 toward net operating income to help ease upward pressure on local service rates. We find that applicant's proposal does not meet the requirements of the plan adopted by the Commission and further find no compelling reason to deregulate embedded CPE under these circumstances, and find the staff adjustment reasonable.

19. The staff proposes to exclude from Applicant's expenses, an amount of $71,932 representing various expenses which the staff contends provide no ratepayer benefit, are non-recurring, or should be corrected as to the amount charged during the test year. These costs consist of national advertising expenses, lobbying costs, early termination and incentive plan expenses, and rate case expenses. This adjustment increases net telephone earnings by $37,800. We find these adjustments to be reasonable.

20. As a result of these adjustments, and the correction of the income tax calculation, the Applicant's intrastate net operating income is $2,738,373.

21. We find after all of the adjustments, the toll recovery, and the resulting tax effect, that Applicant's net operating income for the test period is $2,738,373.

22. Applicant should be required to file monthly for six months from January 31, 1986 a financial statement showing its intrastate rate base, revenues and expense for the preceeding twelve months, in a format similar to information filed in response to Staff Interrogatory No. 1.

RATE OF RETURN

23. Applicant's witness, John C. Dunn, testified that applicant required a rate of return of 12.99% on its rate base and 17.00% on its common equity. Mr. Dunn's analysis was based on the use of three techniques: the discounted cashflow model, an analysis of earnings price ratios, and a review of book returns on common equity. All three methodologies were applied to an industry analysis of telecommunications companies primarily involved in delivering local telephone service.

24. Staff witness, Bobette Murtaugh, testified that an overall return of 11.16% based on a return on common equity of 13.07% would adequately reward the shareholders of General Telephone Company of the Midwest. Her recommendation was based on the use of two techniques: discounted cashflow analysis (DCF) and comparative analysis. The Comparative Analysis involved six of the smallest telephone companies that are traded on the New York Stock Exchange. The results of the Comparative Analysis verified and substantiated the results of the DCF technique.

25. We find that the returns of 11.16% on rate base and 13.07% on common equity are fair and reasonable and will allow applicant to continue to attract capital.

SERVICE

26. Testimony was presented by Commission Engineer M. G. Hand on the results of central office service tests conducted in twelve of the applicant's exchanges. The results from the EAS tests revealed that the Hildreth and Riverdale exchanges failed to meet the 97% objective while the Duncan and Genoa exchanges failed to meet the 95% objective for toll tests. In his opinion the installation of new toll equipment in the Columbus office and the rerouting of operator handled calls should improve the toll service to Duncan and Genoa.

27. Trouble report information supplied by the company revealed that Edison, Lindsay, Pleasanton, Platte Center, Madison, Heartwell, Palmer and Monroe failed to meet the Commission objective for at least one 6 month period during 1984. During the first 8 months of 1985, Edison, Lindsay, Pleasanton, Platte Center, Amherst, Riverdale, Madison, Heartwell and Naponee failed to meet the objective. The company should file quarterly trouble indicies for the cited exchanges until July 1, 1987 or further order of the Commission.

28. During 1984, 28 of the company's 37 exchanges averaged more than 15 percent regarding repeated trouble reports. Of these 28 exchanges, 12 had repeated trouble report percentages exceeding 20 percent. For the first 8 months of 1985, 7 of the company's exchanges had repeated report rates exceeding 20 percent. The company should investigate the conditions in these exchanges where the repeated report percentages exceed 20 percent and make whatever adjustments are required to reduce the repeated reports.

29. Twenty-nine public witnesses presented testimony at the three hearings on this application. Testimony given at the hearing in Genoa related problems subscribers were encountering placing local and long distance calls. A letter was submitted by Sally Jaixen signed by Jane L. Kaup, (Exhibit 22) Genoa City Clerk-Treasurer which documented service trouble from May 1 through October 8, 1985. Mrs. Jaixen testified she has had problems placing long distance calls.

30. On March 13, 1985 the Commission received a motion from Glenn A. Rodehorst, Attorney requesting that the signatures of over 225 of the subscribers of the Genoa exchange be allowed into evidence as proof of poor service being provided in the Genoa Exchange, (Exhibit 23).

31. Several subscribers of the Genoa exchange provided testimony that they were experiencing trouble placing toll calls. Mr. Bauman, State Vice President for General Telephone Company of the Midwest testified that the toll service to Genoa was rerouted on September 25, 1985 and that AT&T now provides the operator services. The Commission staff will investigate further to insure toll service is adequate in the Genoa exchange.

RATES

32. The revenue increase required to produce an 11.16% return on a rate base of $28,542,365 is the sum of $890,334.

33. Applicant should be required to submit for Commission review and approval a schedule of rates and charges which will produce additional annual revenue of $890,334.

34. As modified above, the application is fair and reasonable, is in the public interest and should be granted in part.

ORDER

IT THEREFORE ORDERED by the Nebraska Public Service Commission that application No. C-562 be and it is hereby granted in part and General Telephone Company of the Midwest be and it is hereby authorized to revise its rates to produce additional annual revenue of $890,334.

IT IS FURTHER ORDERED that applicant submit for Commission approval a schedule of rates designed to produce additional annual revenue of $890,334.

IT IS FURTHER ORDERED that applicant file quarterly trouble indices for the eleven exchanges set forth in the Opinion and Findings until July 1, 1987 or further order of the Commission.

IT IS FURTHER ORDERED that applicant file monthly for six months from January 31, 1986 a financial statement showing its intrastate rate base, revenues and expense for the preceeding twelve months, in a format similar to information filed in response to Staff Interrogatory No. 1.

MADE AND ENTERED at Lincoln, Nebraska this 14th day of January, 1986.

NEBRASKA PUBLIC SERVICE COMMISSION

Harold D. Simpson

Chairman

ATTEST:

Donald Adams

Executive Secretary

COMMISSIONERS CONCURRING:
Bob Brayton
James F. Munnelly
Eric Rasmussen
Harold D. Simpson

COMMISSIONER DISSENTING:

Duane D. Gay