BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Application of United Telephone Company of the West, Scottsbluff, Nebraska, for authority to Increase its Rates and Charges.	)))))	Application No. C-574 GRANTED IN PART Entered: May 27, 1986

APPEARANCES:

For the applicant
J. Richard Smith, Attorney
6666 West 110th Street
Overland Park, Kansas 66211

For the City of Kimball
Darrel J. Huenergardt, Attorney
O'Brien, Huenergardt & Cook
Kimball, Nebraska

For the West Nebraska General Hospital
Paul W. Snyder, Attorney
Van Steenberg, Brower, Chaloupka, Mullen and Holyoke

For the City of Scottsbluff
Loren Olsson, Attorney
Scottsbluff, Nebraska

For the Commission Staff
John Boehm, Attorney
2115 State Capitol Building
Lincoln, Nebraska 68509

OPINION AND FINDINGS

BY THE COMMISSION:

By application filed March 1, 1985, United Telephone Company of the West seeks authority to increase its rates and charges for telephone service furnished by it in the State of Nebraska.

Notice of the filing was published in the daily record, Omaha, Nebraska on March 6, 1985, pursuant to the rules of the Commission. Letters of notification were mailed to the mayors, commercial clubs, and newspapers in the areas served by United. Formal protests to the application were filed by Lou Reeves, Scottsbluff; Norman McClure, Village Clerk, Village of Lyman; Willard Bott, Chairman, Board of Trustees, Village of Morrill; Marge Hillins, Kimball; Kenneth and Kathryn Merscheim; and Doreen Harmsen of Potter, Mrs. Mark Rogers of Potter; Ruth Latey of Kimball; Archie Huffman of Potter; Robert E. Yomell, Sr., B&J Phone Service of Kimball; Mr. and Mrs. Charles O. Beaver, A&E Tree Service, Kimball; Mr. and Mrs. Myron Woten, Potter; Jack Nerud, Mayor of Oshkosh; Mr. and Mrs. Beryl Carlson, Minatare; Mr. and Mrs. John Nelson, Kimball, Margret Nelson, Kimball, H. E. Burchfield, President, Lazy Three "J" Ranch, of Bayard, Frank U. Koehler, City Manager, City of Scottsbluff; R. E. "Bob" Richards, Attorney, City of Chappell; John W. Herdzina, Attorney, for Tracy Corporation II; Darrel Huenergardt, Attorney, City of Kimball; Richard A. Peterson, Attorney for AT&T Communications of the Midwest; and Randy L. Nielsen, Kimball, County Attorney. A number of other persons filed letters expressing their opposition to the increase.

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 received 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.

Notice of the hearings was sent to all parties on January 30, 1986 and public hearings were held on the application in Scottsbluff, Nebraska on March 5 and in Kimball, Nebraska on March 6, 1986.

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 Delaware, with its principal executive office in the city of Overland Park, Kansas and with its principal operating office in the city of Junction City, Kansas and with local operations conducted from the city of Scottsbluff, Nebraska. It is a common carrier furnishing telephone service in Nebraska and Wyoming and, as such, is subject to the jurisdiction of this Commission.

2. Applicant furnishes local and long distance service to approximately 24,000 customers in 13 exchanges in Nebraska.

3. The rates and charges for Applicant were last approved by this Commission on August 23, 1983, in Application No. C-335. On October 1, 1985, purusant to law, Applicant placed rates into effect on an interim basis pending hearing and Commission order.

4. Applicant alleged in its Application that the rates currently approved by the Commission do not generate sufficient revenues, after paying the operating expenses, interest and taxes and allowing for depreciation, for Applicant to earn an adequate return and in order to do so, Applicant would have to have increased revenues of $1,882,883. At the outset of the hearing Applicant amended its request, recognizing reduced capital costs since the date of filing, to about $1,400,000.

5. In order to determine the results of operations, both Applicant and Staff have used a test year ending March 31, 1985, and an end of period rate base. Applicant filed its testimony and exhibits on March 1, 1985, necessarily using one month's projections to arrive at a year end rate base and the results of operations for the test year. Applicant stated at the time it would furnish the actual results of operations as soon as they were available. Applicant did so in answer to a data request and they were included as a part of the Staff's case to which Applicant has agreed.

RATE BASE

6. The net intrastate rate base so arrived at appears on Schedule I to Exhibit 26 sponsored by John Burvainis and consists of the following components:

Gross telephone plant in service	$23,349,985
Depreciation Reserve	$(7,050,502)
Short term plant under construction	$ 234,953
Materials and Supplies	$ 2,168
Deferred income taxes	$(2,695,751
Pre-1971 unamortized investment tax credits	$ (4,612
Net Intrastate Rate Base	$14,044,244

No other party took issue with these amounts.

7. We find the appropriate rate base to be used in this case is $14,044,244.

RESULTS OF OPERATIONS

8. The results of operations as filed by Applicant adjusted to reflect the actual results of operations for the test period are shown in column one of Schedule II of Exhibit 26 sponsored by Mr. Burvainis. The net operating income for the test year per Applicant was $1,122,319. The Staff suggested sx (6) major and eight (8) miscellaneous adjustments to Applicant's case which resulted in the net operating income as adjusted by Staff for the test year of $1,259,902.

9. The Staff recommended the elimination of $15,971 from depreciation expense on the ground that it was attributable to short-term Plant Under Construction. Staff's reasoning is that since, by definition, Plant Under Construction was not in service at the end of the test year, it should not be depreciated. Applicant's position is that the short-term construction will in fact be in service by the time this proceeding is concluded and it is a simple matter to calculate the appropriate depreciation expense that will be incurred while the rates that are the subject of this proceeding will be in effect. Applicant's position is that it is a known and measurable change. While the amount of short term construction can be measured, the extent of retirements which the constructed plant will replace is not measurable. We find that it is reasonable to exclude depreciation expense on short term construction for rate-making purposes.

10. The Staff made four (4) adjustments to Applicant's filing, all of which are based on the same rationale. Adjustment 3, "Depreciation Year End Level", 5, "Directory Adjustment", 6, "Labor Adjustment" and Adjustment #5 in column 8, "Other Operating Taxes", all reverse previous adjustments made by Applicant to its "per book" levels. Applicant had increased commercial expense, labor expenses and property taxes to what Applicant believed to be a "year end level". Applicant's position is that the adjustments are required so that expenses will match the year end level of investment in the rate base. Staff disagrees on the ground that these are not known and measurable changes and thus, adjusted them out of the case. After considering the evidence, we find that Staff's adjustments are reasonable.

11. Applicant had proposed in this case that the previously authorized amortization period for embedded inside wire be reduced from 10 years to 3 years. Staff recommends that this adjustment not be made and has reduced the depreciation and amortization account by $109,907 which appears in adjustment number four. We find no compelling reason to depart from the uniform authoriztion period we have ordered for all telephone companies.

12. The Staff also reduced general office salaries and expenses by eliminating expenses the Applicant incurred during the year on account of benefits paid to employees who were determined to be in surplus positions. Staff's rationale is that this is a one-time payment and should not be used to calculate on-going rate levels. Applicant's position is that while these may be non-recurring payments, they are in fact legitimate expenses and need to be recovered through the rate-making process and do result in lower wage costs in the future so the ratepayer is receiving the benefit. The balance of the adjustment consists of lobbying costs which the Staff states provide no ratepayer benefits. We find the Staff adjustments reasonable.

13. We find the balance of adjustments proposed by Staff to be reasonable and hereby adopt them.

14. After reviewing all the evidence we find that Applicant's net operating income from the test period is $1,259,902.

RATE DESIGN

15. Applicant proposed that it reduce its rate groups from the present 7 to 2. Applicant's position is that its cost studies indicate that there is no significant difference between cost of providing service to a large number or small number of customers. Presently, only 3 of the Applicant's 7 rate groups are being utilized. Staff agrees that 7 are too many, but proposes that they be reduced to 3 instead of 2. We find the Staff proposal to be reasonable and direct that it be adopted.

16. Staff proposed that the Applicant set out a separate rate on the customer's bill for Extended Area Service. At the request of Staff, Applicant submitted a study supporting such an additive. We find the Staff proposal to be reasonable and direct that it be adopted.

17. Applicant filed a plan for charging for calls to directory assistance. The Commission at the time of the hearing had under consideration a plan submitted by the telephone industry in Nebraska which is substantially different from that proposed by Applicant in this case. Since the Commission has decided the question of how to charge for directory assistance calls for all the companies in Nebraska, it is not in the public interest to consider a different plan in this proceeding. Therefore, we order that Applicant's plan not be implemented but that Applicant implement the industry-wide plan.

18. In its Application, Applicant requested approval of a new mirrored access charge tariff for the State of Nebraska. Since its filing, Applicant joined with the other carriers in Nebraska in submitting a state-wide access charge plan to the Commission which is under consideration. At the outset of the hearings, Applicant withdrew its access charge filing and is not now seeking any change in access charges having stated its desire to adopt whatever plan is finally approved by this Commission for the entire industry.

19. We find the balance of rate design as submitted by Applicant to be reasonable and direct that it be adopted.

RATE OF RETURN

20. The Applicant presented Randy Farrar, Mr. Farrar suggested the use of the capital structure of United Telephone System rather than that of United Telephone Company of the West. Mr. Farrar testified that since United Telephone Company of the West is a wholly owned subsidiary of United Telecommunications, Inc., an analysis of its appropriate rate of return is not possible and suggested the use of the cost of capital of United Telecommunications, Inc. as a surrogate. He recommended a return on equity in the range of 15.83 to 15.14 resulting in an overall rate of return in the range of 12.93 to 13.10.

21. The Staff presented Mrs. Bobette Murtaugh. Mrs. Murtaugh recommended the use of the capital structure of Applicant instead of that of United Telephone System. She testified to a return on paid in capital of 14.67% and a return on retained earnings 14.36% resulting in an overall rate of return for Applicant of 11.67%. Both witnesses utilized a discounted cash flow methodology to determine the appropriate return on equity. Mr. Farrar used a risk-premium methodology as a check on the reasonableness of his discounted cash flow results and Mrs. Murtaugh used a capital asset pricing model approach as a similar check. Mr. Farrar relied entirely on United Telecommunications, Inc. as a surrogate for Applicant while Mrs. Murtaugh utilized a list of comparable telephone companies for her analysis.

22. After reviewing all of the evidence, we find that the capital structure utilized by United Telephone Company of the West for its operations as of the end of test year is the appropriate capital structure for use in this case. We also find that an appropriate overall rate of return for Applicant is 11.67%.

Type Capital	Percent	Cost	Weighted Cost
Long Term Debt	46.37%	8.47%	3.93%
Common Equity	41.30%	14.36%	5.93%
Retained Earnings	12.33%	14.67%	1.81%
			11.67%

SERVICE

23. Mr. Gene Hand of the Commission Staff testified that he had reviewed the customer trouble reports for each of Applicant's 13 exchanges for the years 1984 and 1985. He found that 4 exchanges Morrill, Minatare, Lyman and Potter failed to meet Commission standards during those years. He reported that they were the same exchanges that failed to meet Commission standards in Applicant's last rate case. Mr. John Bowser, Vice President of Applicant, testified at length concerning the service improvement steps Applicant had taken and specifically those targeted for the 4 exchanges. He reported that the trouble reports in those 4 exchanges were cyclical and that, while he felt the steps he had taken should bring the 4 exchanges within Commission standard, he would not be satisfied of that until he had observed the results through the spring months. Since the hearings Applicant has filed its service improvement plans in writing with this Commission. Such plans appear to be well thought out and

designed to cure the problems. In addition, Applicant has filed its quarterly service report on April 11th which clearly indicates improved service levels in these 4 exchanges. The results showed that all 4 exchanges were below the 8% trouble report level at which corrective action is required but not yet at the 6% objective. We feel this is satisfactory progress on the part of Applicant.

24. At the hearings, a number of customers of Applicant appeared and testified as to various and miscellaneous service problems they were having. Applicant has followed up on each of the service complaints brought up at the hearing and has filed with the Commission its responses and the action that has been taken to satisfy those complaints. While applicant has responded to service complaints voiced at the hearing, we are concerned about service problems at Kimball which appear to be caused by faulty cable. Applicant should be ordered to review its outside plant at Kimball and present to the Commission within 90 days a plan for service improvements in its Kimball exchange.

RATES

25. The revenue increase required to produce 11.67% return on a rate base of $14,044,235 is a sum of $746,403.

Rate Base	$14,044,235
Rate of Return	11.67%
Required NOI	$ 1,638,962
Test Year NOI	$ 1,259,902
NOI Deficiency	$ 379,060
Revenue Factor	1.969089
Revenue Dificiency	$ 746,403

26. Applicant should ordered to file a schedule of rates and charges which will produce additional annual revenue of $746,403 for our review and approval. Such schedule of rates and charges should comply with the directions herein made.

ORDER

IT IS THEREFORE ORDERED by the Nebraska Public Service Commission that application No. C-574 be and it is hereby granted in part and the United Telephone Company of the West be and it is hereby authorized to increase its rates and charges to produce additional annual revenue of $746,403.

IT IS FURTHER ORDERED that applicant file for approval of rates and charges which will produce additional annual revenue of $746,403 as set forth in the Opinion and Findings herein.

IT IS FURTHER ORDERED that applicant file with the Commission within 90 days from the date hereof a plan for service improvements in its Kimball, Nebraska exchange.

MADE AND ENTERED at Lincoln, Nebraska, this 27th day of May, 1986.

NEBRASKA PUBLIC SERVICE COMMISSION

Bob Brayton
Chairman

ATTEST:

Donald Adams
Executive Secretary

COMMISSIONERS CONCURRING:

Duane D. Gay

Duane D. Gay
Bob Brayton
James F. Munnelly
Eric Rasmussen
Harold D. Simpson