



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

November 18, 1993

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In Re: Pennsylvania Public Utility Commission v.
Commonwealth Telephone Company
Docket No. I-00920020

Dear Sir or Madam:

Enclosed is a copy of the Interim Order Denying Approval Of Joint Petition For Settlement Of Investigation in the above-captioned matter, issued this day and mailed to all parties of record.

If you do not agree with this Order you may file a Petition for Interlocutory Review with the Commission.

Very truly yours,

George M. Kashi
Judge, Admin. Law

GMK/ad

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :
v. : I-00920020
Commonwealth Telephone Company :

DOCKETED

INTERIM ORDER
DENYING APPROVAL OF JOINT PETITION NOV 29 1993
FOR SETTLEMENT OF INVESTIGATION

On April 2, 1992 the Commission initiated an investigation, at Docket No. I-00920020, into the current earnings of Commonwealth Telephone Company ("Respondent"/"CTCO"/"Company") i.e., "Commonwealth Telephone Company may have posited an inaccurate earnings position . . ." ". . . to gather additional information relative to a comprehensive calculation of return on common equity capital." Thereafter, by Commission Order entered July 9, 1992 ("Order") this earnings investigation was expanded and continued for the purposes of examining ". . . the appropriateness of Commonwealth's affiliated transactions, in particular the Parent Corporation Management Service Fees" and all related affiliated interest charges. See Order at 2.

On July 9, 1992, AT&T Communications of Pennsylvania, Inc. ("AT&T") filed a Complaint at Docket No. I-00920020 against the intrastate carrier access charges of Commonwealth. Also on

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July 9, 1992, the Office of Consumer Advocate ("OCA") filed a Notice of Intervention.

On July 23, 1992 the matter was assigned to this administrative law judge and a prehearing conference was scheduled for and held before the undersigned on August 6, 1992.

On July 29, 1992 CTCO filed an Answer to the Complaint of AT&T ("Answer") wherein it substantially denied the allegations of the Complaint. CTCO, pursuant to this Commission's Rules of Administrative Practice and Procedures, 52 Pa. Code §5.101(a), filed a Motion to Strike or Dismiss, with prejudice, the Complaint of AT&T ("Motion"). In its motion CTCO alleged that the AT&T Complaint should be stricken or dismissed because, inter alia, the subject matter of the Complaint and the relief requested is beyond the scope of this investigation proceeding.

On August 6, 1992, as directed by the July 9, 1992 Order, the Office of Trial Staff ("OTS") noticed its appearance in the proceeding. At the August 6, 1992 prehearing conference, CTCO attorneys argued that the I-920020 docket is an investigation directed at a particular type of affiliate fee, namely the Parent Corporation Management Service Fees and that any review of CTCO's earnings are only to be undertaken after a review of affiliated transactions and, only if the review of these affiliated transactions reveal irregularities. Therefore,

argues CTCO, earnings may not even be an issue in this proceeding and there is no incentive whatsoever of restructuring CTCO's rates or any notice to the parties that the Commission is considering revising CTCO's rates.

The parties presented written memoranda and by Order dated December 18, 1992, we denied the Motion of Commonwealth Telephone Company, together with its construction of the Commission's July 9, 1992 Order; noticed Commonwealth that the Commission may revise the rates of the company if it was determined that the present rates are unjust and unreasonable; directed Commonwealth to participate in discovery as with any rate case; and consolidated the AT&T Complaint.

In our December 18, 1992 Order we noted:

The Order clearly provides that CTCO's earnings are to be analyzed in this proceeding:

4. That the parties should investigate the Parent Corporation Management Service Fee expense and all related affiliated interest charges, and following that analysis, Commonwealth's earnings should be analyzed.

In fact, Ordering paragraph 5 directs that we make specific findings of fact concerning CTCO's affiliated interest charges and overall earnings.

5. That the presiding ALJ be, and hereby is, directed to make specific findings of fact concerning Commonwealth's

affiliated interest charges and overall earnings; and

Also, as noted above, the Commission specifically states that "[r]atemaking principles resist examining an isolated expense item without considering other relevant adjustments that may impact earnings." Thus, the Commission clearly does not want affiliated charges to be examined "in a vacuum" to determine whether such charges are reasonable. (Emphasis added)

No appeal was taken from our December 18, 1992 Order nor was there any request made to certify a material question.

A further prehearing conference was held on December 29, 1992 at which various procedural matters were resolved and a hearing schedule agreed to by the parties which was scheduled to begin May 26, 1993 and conclude September 21, 1993. See Notice of January 5, 1993. At the prehearing conference we requested the Company to provide the docket number of its Application of Commonwealth Telephone Company for Approval of the Transfer of Stock by Its Parent Company to an Affiliated Interest. We were notified that it was docketed to A-31800F500.

CTCO filed testimony in the above proceeding on May 3-5, 1993 concerning the following topics: affiliated relationships -- CTCO Statement No. 4 (P. Mazza); accounting issues -- CTCO Statement No. 3 (D. P. Cawly); rate of return-- CTCO Statement No. 7 (F. Hanley); depreciation expense and depreciation rates -- CTCO Statement No. 5 (E. M. Robinson); cash working capital -- CTCO Statement No. 6 (S. McDaniel);

jurisdictional separations and intrastate revenues -- CTCO Statement No. 2 (J. J. Laffey); and company policy, service standards and other matters -- CTCO Statement No. 1 (S. Burnside).

On May 13, 1993 the OCA filed a Motion to Require Supplemental Testimony Or, In the Alternative, Postpone the Evidentiary Procedural Schedule. OCA asked that the cross of CTCO now be moved to July. After a telephone conference with the parties, CTCO was directed to file supplemental testimony which was filed on May 21, 1993 as CTCO Statement No. 3-A regarding additional accounting issues addressed in OCA's Motion. Further documentation supplementing CTCO Statement No. 3-A was filed on May 25, 1993.

On May 27, 1993 a further prehearing conference was held and a new hearing schedule was established: cross of CTCO July 1 and 2; cross of other parties August 19, 20 and 23 and rebuttal on October 7 and 8.

Extensive discovery has been conducted by the parties and answered by CTCO. The OCA has propounded 16 Sets of discovery, consisting of a total of 486 interrogatories. The OTS has propounded 57 interrogatories, and AT&T has propounded 107 interrogatories. Additionally, the OTS and OCA conducted on-site document review and informal discovery at the Company's headquarters located in Dallas, Pennsylvania, for two (2) days,

June 21 and 22, 1993. Approximately twenty (20) data requests were also answered by CTCO.

On-the-record hearings were held on July 1 and 2, 1993, during which CTCO presented its witnesses and exhibits, all of which were subject to cross-examination.

While OCA & OTS prepared testimony for the second set of hearings, they requested that they be permitted not to publicly file it on the scheduled date because of settlement negotiations. We granted the request.

On October 18, 1993 OTS, OCA and CTCO ("Joint Petitioners") filed a Petition for Settlement of Investigation ("Joint Petition") attached as Appendix 1.¹

On November 5, 1993 AT&T filed its objections to the Joint Petition.

Terms and Conditions

The following are the terms and conditions agreed to by Joint Petitioners:

1. CTCO shall provide touch-tone service free of charge² to all residential subscribers effective for service rendered on and after January 1, 1994.
2. In the event that AT&T joins this Settlement Petition, then CTCO shall implement an access line cap of carrier

¹The Joint Petition is made Appendix 1, while all other attachments and filings are alphabetically listed A through H.

²The current monthly Residential touch tone charge is \$1.00.

common line ("CCL") charges of \$3.52 per month effective for service rendered on and after January 1, 1994.³ In the event that AT&T does not join in this settlement before adoption by the Commission Order approving this Settlement Petition, then CTCO shall flow back to ratepayers the same amount through some other change in rates. In such an event, the parties to this settlement will file, within 30 days of a final Commission Order, an additional joint petition to the PUC that will determine what other rate changes will occur to flow that money back to ratepayers.

3. CTCO shall implement Extended Area Service by December 31, 1994 to the 17 routes listed in Appendix "B" to the Joint Petition.⁴
4. CTCO shall record depreciation expense at the rates currently in use, which are listed in Appendix "C" to Joint Petition, at least until its next depreciation study is complete. The Joint Petitioners agree that the Appendix "C" depreciation rates expressly exclude any component for the prospective cost of removal.

CTCO shall not restate its depreciation reserve as a result of its historic practice of estimating salvage prospectively. However, CTCO retains the right to propose an adjustment to its depreciation reserve in any future proceeding to exclude those prospective salvage costs which the Company has historically booked. The Joint Petitioners reserve the right to oppose any such claim on any ground, except that the claim is untimely, because the issue has not been resolved in this proceeding.

5. Effective January 1, 1994 and continuing thereafter, CTCO shall flow through to income the state income tax impacts resulting from book and tax timing differences related to depreciation, unbilled revenues and cost of removal, and Commonwealth shall amortize the then outstanding balance of accumulated deferred state

³The proposed \$3.52/month/line/ charge is derived based upon 1993 CCL revenues and 1993 access lines.

⁴The Joint Petitioners agree that movement of exchanges within the Company's current rate bands and/or the creation of new rate bands shall not be prohibited by this Settlement.

income taxes using a thirty-six (36) month amortization schedule. The flow through accounting for state income tax expense and the amortization of the state deferred tax reserve, shall apply for both book accounting purposes and for ratemaking purposes.

6. CTCO shall implement the following Modernization Goals:
 - a. 100% conversion of central offices to digital technology by December 31, 1993;
 - b. 100% deployment of fiber-optic cable on interoffice trunks by December 31, 1994; and
 - c. Full deployment of Signalling System-7 ("SS-7") by December 31, 1998.

7. CTCO shall file, within three (3) months of entry of an Order approving this Settlement Petition, the following with this Commission:
 - a. A request for clarification and/or amendment of the existing CCI/CTCO Affiliated Interest Agreement, Docket No. G-00920315, to establish the level of CCI profit;

 - b. A request for modification of the current C-TEC/CTCO Affiliated Interest Agreement, Docket No. G-890183, to exclude intangible assets from the 3-factor formula calculation. With this filing, CTCO shall clarify the C-TEC/CTCO Affiliated Interest Agreement to require the true-up of budgeted figures with actual figures in finalizing the 3-factor formula calculation for the allocation of C-TEC residual costs (also known as "Management Fees"). A trued-up 3 factor allocation formula will be used in determining CTCO's "Management Fees" to be included in its calendar year earning reports submitted to the PUC⁵; and

⁵Quarterly reports filed by CTCO under 52 Pa. Code §71.1, et seq., will contain a footnote indicating that the 3-factor formula is unreconciled for an identified portion of the reporting period.

- c. A request for clarification and/or amendment of the Tec-Air/CTCO Affiliated Interest Agreement, Docket No. G-900214, relative to indirect costs related to Tec-Air activities permitted.

CTCO will serve a copy of such filing directly upon both the OCA and OTS. The OCA and OTS reserve the right to oppose any such filings made by CTCO on any ground, strictly provided, however, that the Joint Petitioners may not recommend or seek a change in the revenues or rates existing upon the implementation of this Settlement Petition. See, ¶ 8, *infra*. Joint petitioners shall be permitted to use portions of the record in this case and the stipulated facts attached hereto as Appendix "G" in those affiliated interest agreement proceedings. The parties have incorporated their respective positions on these various affiliated issues in reaching the proper revenue requirement for CTCO reflected in this Settlement.

8. CTCO agrees not to file a rate increase that would constitute a general rate increase under 66 Pa.C.S. §1308(d) prior to January 1, 1997. The Joint Petitioners agree not to initiate or recommend the initiation of, individually or jointly, prior to January 1, 1997, a complaint or investigation which proposes a reduction in CTCO's rates or revenues. However, the foregoing limitations upon the Joint Petitioners contained in this sub-paragraph shall not prohibit any future proceeding which may be initiated by the Petitioners in order to make changes in rates related solely to mandatory rate changes resulting from legislative, regulatory, tax, or accounting changes which fundamentally affect CTCO and are not already implemented as of the date of the filing of this Petition (hereinafter "Fundamental Event"). Such a Fundamental Event includes, but is not limited to, the conversion by CTCO to a cost-based method of settlement before the Federal Communications Commission. In the event that CTCO seeks an increase in basic service revenues that would constitute a general rate increase under 66 Pa.C.S. §1308 as a result of such a Fundamental Event, then the OCA and OTS are fully relieved of their obligations under this sub-paragraph.
9. If the Commission initiates a proceeding prior to January 1, 1997, directed at CTCO to investigate and/or affect the rates and/or revenues existing upon

implementation of this settlement, then the OCA agrees not to take any position in such proceeding which recommends, advocates, or would support revenues or rates different from those existing upon the implementation of this Settlement Petition. See, ¶ 8, supra.

10. The rates established under this settlement shall be deemed just and reasonable rates pursuant to 66 Pa.C.S. §§1301 and 1309(a), upon entry of an Order approving such rates by the Commission.

Discussion

The joint petitioners argue that the rates embodied in the settlement are in the public interest for the following reasons:

1. The settlement results in a decrease of approximately \$2,634,000 in CTCO's on-going, annual jurisdictional net operating revenues, composed of the following: (a) elimination of residential touch tone charge, \$1,600,000 million; (b) acceleration of extended area service, \$699,000; and (c) capping of CCL charge or other rate reduction in the amount of \$335,000.
2. The on-going modernization of CTCO's network is assured.
3. The affiliate issues are identified and defined by this Settlement Petition, which further provides for the presentation of these issues for Commission review within three (3) months. However, under the terms of this settlement, the resolution of affiliate issues does not delay the implementation of the rate reduction contemplated herein.
4. CTCO has agreed not to propose an increase in rates which would constitute a general rate increase for a three (3) year period.
5. This Settlement avoids protracted litigation and the related expense to the parties, the Commission and CTCO's ratepayers.

The Joint Petitioners have also prepared and attached to the Joint Petition, as Appendices "D" (CTCO), "E" (OTS), and "F" (OCA), respectively, Statements of Position setting forth the bases upon which they believe the Settlement, including the rates contained in Appendix "A" are in the public interest.

On November 5, 1993 AT&T filed Objections to the Joint Settlement Petition recommending that the Joint Settlement Petition be rejected because (1) the settlement proposes to reduce local rates while leaving access charges virtually unchanged and (2) the settlement proposes to defer to three future proceeding issues which we were directed to resolve in this case. (AT&T Objection p. 1, attached hereto as Appendix H)

We are not exactly sure what happened on the way to the forum with this case, but to our mind the matter went awry. The investigation, as we read it, had its focus and genesis in the Commission's concerns about Commonwealth's affiliated transactions expenses.

The Opinion and Order states:

Upon the circumstances, we believe that a further investigation into the appropriateness of Commonwealth's affiliated transactions, in particular the Parent Corporation Management Service Fees, is warranted consonant with Section 331(a) of the Public Utility Code, 66 Pa.C.S. §331(a). Therefore, we conclude that it is necessary for us to obtain additional detailed information about this increase as well as the total annual payment of Management

Service Fees by Commonwealth to its parent corporation.

Ratemaking principles resist examining an isolated expense item without considering other relevant adjustments that may impact earnings. The parties should focus initially on the affiliated transactions expenses incurred by Commonwealth, and the ALJ should make specific findings regarding the appropriate level of the affiliate expenses incurred by Commonwealth. Then the parties should explore all relevant earnings information to determine whether Commonwealth's return (incorporating pro forma adjustments consistent with ratemaking principles) is reasonable in light of existing market conditions, or whether an adjustment is appropriate. This means that Commonwealth as well as other parties will be able to present all relevant adjustments that impact earnings (in addition to any potential affiliates expense adjustment).

Order at 2 (Emphasis added)

The Company initially took the position that the entire investigation was only a review of the affiliated transactions and unless and until there were irregularities shown in said transactions the Company's earnings were not at issue. The Company also took the position that it had no notice that the Commission was considering revising its rates and that the investigation begun under Section 331(a) of the Public Utility Code, 66 Pa.C.S. §331(a) was not a legally permissible vehicle by which to revise Commonwealth rates. The Company's position has always been that this investigation is about affiliates and affiliated transactions.

In our December 18, 1992 Order we specifically noted that the Commission in citing Section 331 sought to examine the appropriateness of Commonwealth affiliated transactions as well as the cost of those transactions. (December 18 Order p. 5)

Thus, in our mind the investigation was always two-fold: (1) affiliated transactions; and (2) earnings in light of appropriate transactions and existing market conditions.

The Joint Petitioners now present us with a document that says let's forget about all that. Let us consider this to be similar to a company-filed rate case in which we will settle for some reduced local rates if you approve our depreciation and amortization (i.e., no further rate adjustments) and let's side step the affiliate issues in the case and put them into a "paper shuffle" "G" docket.

Record evidence indicates that there are many questions open regarding the affiliate issues and the parent company C-TEC; TEC-AIR; CCI and project margins built into affiliate contracts which may exceed 31% or in some cases 45%; lack of record and timekeeping by affiliates making charges to the company (N.T. 352-374). Appendix G may or may not address all relevant affiliate issues.

The joint petitioners argue that providing the proposed rate relief sooner should be our paramount consideration. (OTS Appendix E at 6)

To terminate this proceeding without being able to support the settlement with findings regarding the affiliate transactions and level of payments is not, in our mind, in the public interest, nor is it responsive to the Commission investigation.

The proposed rate reduction does not look at the company earnings or growth in revenues. The decrease related only to the following: (1) elimination of residential touch tone charge, \$1,600,000 million; (2) acceleration/modernization of extended area service, \$699,000; and (3) capping of CCL charge or other rate reduction in the amount of \$335,000.

As noted by AT&T in its objections, the cap is something the Commission has consistently required LECS to do every time the issue has been addressed. See Footnote 10, page 2, AT&T Objections. The cap is something Commonwealth would be required to do anyway.

Based on the state of the record we cannot conclude or make any findings that Commonwealth's affiliate interest agreements are appropriate and in the public interest; nor can we determine whether Commonwealth is overearning. To terminate at the point to bring a \$2.39 million decrease to fruition sooner is not in the public interest.


THEREFORE, IT IS ORDERED:

1. That the Joint Petition For Settlement of Investigation be and is hereby denied.

2. That the OTS and OCA publicly file the testimony already prepared for filing.

3. That a further prehearing conference be scheduled to establish the remaining procedural schedule for this investigation.

Date: Nov, 18, 1993



GEORGE M. KASHI
Administrative Law Judge