BEFORE THE TENNESSEE REGULATORY AUTHORITY

AT NASHVILLE, TENNESSEE

April 30, 2002

IN RE:	)	
PETITION OF UNITED TELEPHONE COMPANY TO CHANGE AND INCREASE CERTAIN INTRASTATE RATES AND CHARGES SO AS TO PERMIT IT TO EARN A FAIR AND ADEQUATE RATE OF RETURN ON ITS PROPERTY USED AND USEFUL IN FURNISHING TELEPHONE SERVICE TO ITS CUSTOMERS IN TENNESSEE AND TO ADOPT NEW AND REALISTIC DEPRECIATION RATES FOR CENTRAL OFFICE EQUIPMENT	)	**DOCKET NO. 01-00451**

ORDER DENYING IN PART AND GRANTING IN PART PETITION OF UNITED TELEPHONE COMPANY TO CHANGE AND INCREASE RATES

This matter came before the Tennessee Regulatory Authority (the "Authority" or "TRA") at a regularly scheduled Authority Conference held on March 12, 2002 upon the *Petition* (the "*Petition*")[1] for a rate increase filed by United Telephone Company ("United" or the "Company").

PROCEDURAL HISTORY

United filed its *Petition* on May 22, 2001. With the *Petition*, United filed tariffs to become effective within thirty (30) days after the filing of the *Petition*, or June 22, 2001. In support of the requested rate relief, the *Petition* included the testimony of Mr. Herbert Bivens and Mr. Joe M. Enoch. On June 12, 2001, the Authority suspended the tariffs for 120 days until

[1] *Petition to Change and Increase Certain Intrastate Rates and Charges So As to Permit It to Earn a Fair and Adequate Rate of Return on its Property Used and Useful in Furnishing Telephone Service to Its Customers in Tennessee and to Adopt New and Realistic Depreciation Rates for Central Office Equipment,* May 22, 2001.

October 19, 2001. During the Authority Conference held on June 26, 2001, the Authority opened a contested case proceeding and appointed a Pre-Hearing Officer.[2]

On June 12, 2001, the Consumer Advocate and Protection Division of the Office of the Attorney General (the "Consumer Advocate" or "CAPD") filed a *Petition to Intervene* in this matter.[3] On June 21, 2001, AT&T Communications of the South Central States, Inc. ("AT&T") filed a *Petition for Intervention*,[4] and on July 2, 2001, United filed a response to AT&T's *Petition for Intervention*.[5] On July 13, 2001, the Consumer Advocate filed a response to AT&T's *Petition for Intervention*.[6] On July 23, 2001, AT&T filed a withdrawal of its *Petition for Intervention*.[7]

The Pre-Hearing Officer issued a *Notice of Procedural Schedule* on July 16, 2001. On August 30, 2001, the parties in this matter, United, the Consumer Advocate, and members of the Authority staff acting as a party (the "Staff"), filed an *Agreed Motion* to amend the procedural schedule by twenty-eight (28) days and extend any statutory deadlines associated with this filing.[8] The Pre-Hearing Officer granted the *Agreed Motion* in an Order issued on September 7, 2001.[9] During the October 9, 2001 Authority Conference, the Authority suspended United's tariff for the remaining statutory time until March 22, 2002.

On September 12, 2001, United filed a *Supplemental Petition*, along with the

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[2] *See Order Suspending Tariff for One Hundred and Twenty (120) Days*, Docket No. 01-00451 (October 11, 2001); *Order Convening a Contested Case Proceeding and Granting Intervention to the Consumer Advocate and Protection Division and Appointing Hearing Officer* (October 11, 2001).
[3] *Petition to Intervene*, June 12, 2001.
[4] *Petition for Intervention of AT&T Communications of the South Central States, Inc.*, June 21, 2001.
[5] *Response of United Telephone Company in Opposition to the Petition for Intervention of AT&T Communications of the South Central States, Inc.*, July 2, 2001.
[6] *Response in Opposition to AT&T's Petition for Intervention*, July 13, 2001.
[7] *Petition of AT&T Communications of the South Central States, Inc. to Withdraw Intervention Without Prejudice*, July 23, 2001.
[8] *Agreed Motion*, August 30, 2001. *See* Tenn. Code Ann. § 65-5-203(a), which states with respect to a request for a rate change that the Authority "shall decide the matter as speedily as possible, and in any event not later than nine (9) months after filing of the increase, change or alteration."
[9] *Order Granting Agreed Motion and Amending Procedural Schedule*, September 7, 2001.

Supplemental Testimony of Joe M. Enoch. On October 3, 2001, the Consumer Advocate filed the Direct Testimony of Robert T. Buckner, and the Staff filed the Direct Testimony of Joe Shirley.

Pursuant to a *Notice of Hearing* issued on December 19, 2001, a Hearing was held in this matter on January 14 and 15, 2002.[10] In attendance at the Hearing were the following parties:

United Telephone Company – **T.G. Pappas, Esq. and R. Dale Grimes, Esq.**; Bass, Berry & Sims, PLC, 315 Deaderick Street, Suite 2700, Nashville, Tennessee 37238

Consumer Advocate and Protection Division, Office of the Attorney General – **Vance L. Broemel, Esq**.; 425 Fifth Avenue North, Nashville, Tennessee 37243

Tennessee Regulatory Authority Staff – **Gary Hotvedt, Esq.**; 460 James Robertson Parkway, Nashville, Tennessee 37243

At the Hearing, Mr. Herbert Bivens and Mr. Joe M. Enoch testified on behalf of United and were cross-examined by counsel for the Consumer Advocate and the Staff. Mr. Robert T. Buckner testified on behalf of the Consumer Advocate and was cross-examined by counsel for United and the Staff. Mr. Joe Shirley testified on behalf of the Staff and was cross-examined by counsel for United. These witnesses also responded to questions from members of the Authority Staff acting as advisors to the Authority's Directors.

UNITED'S *PETITION* AND RELATED FILINGS

United's *Petition*

In its *Petition*, United states that costs of facility upgrades during the period from 1996 to 2000 exceeded a $23,000,000 Rural Utilities Service ("RUS") loan approved by the Authority in 1996. The *Petition* states that the Company had applied for an additional loan of $26,000,000 to finance its upcoming five (5) year construction plan.[11] The *Petition* further states that United's

[10] This docket was opened for public comment on January 14, 2002, but no testimony was presented on that date. All testimony was presented on January 15, 2002.
[11] *Petition*, May 22, 2001, pp. 2-4.

present rates are not adequate to allow the Company to earn a fair rate of return, attract reasonable terms on required additional capital needed to expand and improve current facilities, maintain its credit rating and maintain existing service levels.[12]

In the *Petition*, United requests that it be allowed to reduce the depreciable life of central office equipment from twenty-five (25) years to twelve-and-one-half (12.5) years.[13] Additionally, United filed tariffs to remove the current $1.00 residential, $1.50 business touch-tone rates; remove the temporary $2.00 residential, $4.00 business credit; and increase most of its residential rates by $1.00 per month and the business rates by $4.00 per month.[14] United states that "the total additional annual revenue to the Company during the test year, if the requested rates are approved, would amount to [$]456,914 and of that amount $138,142 would come from the lifting of the credits and $138,142 would come from the $1.00 a per [sic] month increase for residential rates and the $4.00 per month for increase in commercial rates. The balance of $180,630 would come from the increase in service charge revenues . . ."[15] This proposal includes a 2002 rate base of approximately $38,500,000, producing an overall earned rate of return of 4.85%, which is less than the 6.74% fair rate of return the Company requested be approved.[16] United maintains that the lower rate of return is acceptable because the Company cannot raise customer rates any higher than those proposed, and lower rates are needed in light of changing market conditions.[17]

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[12] *Id.*, p. 4.
[13] *Id.*, p. 5.
[14] *Id.*
[15] *Id.*, pp. 6-7.
[16] See *id.*, p. 7. The *Petition* states that under the company's proposal its rate base would be $37,800,000. *Id.*, p. 7. Exhibit 1 attached to the *Petition* reflects a rate base of $38,500,000 and a fair rate of return of 6.74%..
[17] *Id.*, p. 8.

United's Supplemental Petition

In its *Supplemental Petition*, United states that, in preparing responses to data requests, the Company "discovered a few errors in the testimony and exhibits and that some of the information that was used has changed since the filing of the petition."[18] The *Supplemental Petition* states that the requested depreciation increase and rate changes in the initial filing will increase the Company's rate base to approximately $41,000,000, with an overall earned rate of return of 5.915%, instead of the 4.85% as stated in the *Petition*.[19]

United's Rebuttal Testimony

United filed the Rebuttal Testimony of Mr. Joe M. Enoch on October 12, 2001. On December 19, 2001, in response to an Authority data request, United submitted schedules reflecting the data and calculations presented in Mr. Enoch's Rebuttal Testimony. The exhibits in United's December 19, 2001 filing include financial positions labeled "CAPD, Company and Company using CAPD Method."[20] Using the CAPD method, United presents a rate base of approximately $40,700,000 for the year 2002, producing an overall 6.31% earned rate of return.[21] Additionally, this method adopts a fair rate of return of 7.87%.[22]

United's Revised Exhibit 1

On January 11, 2002, United filed Revised Exhibit 1 in support of the rebuttal testimony of Mr. Joe M. Enoch as a revision to the exhibits the Company filed on December 19, 2001.[23] United states that "it is willing to rely on the enclosed Exhibit as a basis for its increased revenue requirements in this case."[24] Revised Exhibit 1 has the same rate base as the December 19, 2001

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[18] *Supplemental Petition*, September 12, 2001, p. 1.
[19] *Id.*, p. 2.
[20] United Response to TRA Data Request, December 19, 2001, p. 4.
[21] *Id.*
[22] *Id.*
[23] Letter from R. Dale Grimes to K. David Waddell, January 11, 2002, p. 1.
[24] *Id.*

filing, approximately $40,700,000, and adopts a fair rate of return of 7.87%.[25] However, Revised Exhibit 1 states the overall earned rate of return for the year 2002 as 7.06% compared to the previous 6.31% filed on December 19, 2001.[26]

STANDARD OF REVIEW

The Authority reviews the rates of United, which is a rate-of-return regulated public utility, under its general rate-setting authority, particularly Tenn. Code Ann. §§ 65-5-201 and 65-5-203.[27] The Tennessee Supreme Court has expressed the Authority's general rate-setting powers as follows:

> The polestar of public utility rate establishment and regulation is the "just and reasonable" requirement . . . There is no statutory nor decisional law that specifies any particular approach that must be followed by the [Authority]. Fundamentally, the establishment of just and reasonable rates is a value judgment to be made by the [Authority] in the exercise of its sound regulatory judgment and discretion . . . The criteria by which the [Authority] should be guided have received only generalized comments in our reported decisions. This is proper because the courts are playing a limited role in reviewing actions which essentially are legislative in character. Rate making is not a judicial function and we accord the [Authority] great deference in reviewing its decisions. On fixing rates in general

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[25] Revised Exhibit 1, January 11, 2002, p. 4.
[26] *Id.*
[27] Tenn. Code Ann. § 65-5-201 provides:

> **Power to fix rates of public utilities.**
> The Tennessee regulatory authority has the power after hearing upon notice, by order in writing, to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof, as well as commutation, mileage, and other special rates which shall be imposed, observed, and followed thereafter by any public utility as defined in § 65-4-101, whenever the authority shall determine any existing individual rate, joint rate, toll, fare, charge, or schedule thereof or commutation, mileage, or other special rates to be unjust, unreasonable, excessive, insufficient, or unjustly discriminatory or preferential, howsoever the same may have heretofore been fixed or established. In fixing such rates, joint rates, tolls, fares, charges or schedules, or commutation, mileage or other special rates, the authority shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility.

Tenn. Code Ann. § 65-5-203 provides, in pertinent part:

> **Changes in utility rates, fares, schedules.**
> (a) When any public utility shall increase any existing individual rates, joint rates, tolls, fares, charges, or schedules thereof, or change or alter any existing classification, the authority shall have power either upon written complaint, or upon its own initiative, to hear and determine whether the increase, change or alteration is just and reasonable. The burden of proof to show that the increase, change, or alteration is just and reasonable shall be upon the public utility making the same. In determining whether such increase, change or alteration is just and reasonable, the authority shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility.

> the Court has spoken in terms of what is just and reasonable "under the proven circumstances," of "regard to all relevant facts" and to a rate "in the zone of reasonableness" . . . Thus, the [Authority] in rate making and design cases is not solely governed by the proof although, of course, there must be an adequate evidentiary predicate. The [Authority], however, is not hamstrung by the naked record. It may consider all relevant circumstances shown by the record, all recognized technical and scientific facts pertinent to the issue under consideration and may superimpose upon the entire transaction its own expertise, technical competence and specialized knowledge. Thus focusing upon the issues, the [Authority] decides that which is just and reasonable. This is the litmus test nothing more, nothing less.[28]

Although the "just and reasonable" standard by which the Authority generally sets rates is broad, it is nevertheless recognized that the Authority has no retroactive rate making power. As stated by the Tennessee Court of Appeals, the Authority's power to order refunds of rates is limited by statute:

> Upon a study of the applicable statutes, especially TCA § 65-5-203, this Court concludes that the Legislature never intended to extend retroactive rate-making power (ordering refunds) beyond that expressly stated in § 65-5-203. This is supported by the maxim of *Inclusio Unius est Exclusio Alterius*. The express inclusion of one (person or thing) (implies) the exclusion of all others. The cited statute provides for narrowly circumscribed power to grant tentative rates under bond for a limited time under emergency circumstances which were not found by the [Authority] and are not shown in this case. It must therefore be presumed that: (1) the Legislature considered that the [Authority] had no general or inherent power to set tentative rates subject to refund, else the special grant of power would have been unnecessary; (2) if the Legislature had intended that the [Authority] have broader powers than those conferred, the statute would have been composed in broader terms.[29]

While "[i]t is true that the [Authority] has no statutory authority to fix rates retroactively or to order refunds except in very limited circumstances,"[30] when setting rates prospectively the Authority "has the discretion to choose a historical test period, a forecast period, a combination of the two, or any other accepted method in rate making."[31] Thus, while monies for rates that

[28] *CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536, 542-543 (Tenn. 1980) (citations omitted).
[29] *South Cent. Bell Tel. Co. v. Tennessee Pub. Serv. Comm'n*, 675 S.W.2d 718, 719 (Tenn. App. 1984).
[30] *American Assoc. of Retired Persons v. Tennessee Pub. Serv. Comm'n*, 896 S.W.2d 127, 134 (Tenn. App. 1994).
[31] *Id.*, at 133.

have already been collected generally cannot be returned to customers as refunds in order to correct for a company's prior overearnings,[32] it is both acceptable and legal for the Authority to examine and consider such historical information when setting rates on a going-forward basis.

As for rate design issues, the Authority has broad discretionary powers to fashion the rates of a company to achieve its authorized, fair rate of return. When fixing "just and reasonable" rates, the Authority should give due "regard to all relevant facts" and establish rates that are within "the zone of reasonableness."[33] The Authority is not required to fix rates based on the cost of individual services:

> Specifically, there is no requirement in any rate case that the [Authority] receive and consider cost of service data, or that such data, if in the record, are to be accorded exclusivity. It is self-evident that cost of service is of great significance in the establishment of rates but is of lesser value in arriving at rate design. A fair rate of return to the regulated utility is one thing; the establishment of rates among various customer classes is quite another.[34]

Finally, if it is determined that a company's earnings are excessive, the Authority has broad discretion in determining how to best resolve the company's overearnings situation:

> The enabling statutes do not specifically delineate the [Authority's] powers when it projects that a telephone company will receive excess earnings if it continues providing the same services at its present rate. Tenn. Code Ann. §§ 65-4-104, -106 give the [Authority] broad power to regulate the services provided by the company and the rates the company charges for these services. Thus, when the [Authority] determines that a telephone company's earnings will be excessive if the company is permitted to continue to charge the same rate for the same services, the [Authority], exercising its regulatory discretion and expertise, may (1) reduce the rate prospectively, (2) order refunds in cases where the rates were put into effect under bond pursuant to Tenn. Code Ann. § 65-5-203 (Supp. 1991), or (3) require that the excess earnings be used to extend or improve the company's service.[35]

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[32] In this case, the term "overearnings" is used to refer to the amount or level of earnings in excess of that which is required to cover regulated expenses and to provide a fair rate of return on regulated rate base.
[33] *CF Indus.*, 599 S.W.2d at 542.
[34] *Id.*
[35] *Tennessee Cable Television Assoc. v. Tennessee Pub. Serv. Comm'n*, 844 S.W.2d 151, 160 (Tenn. App. 1992).

POSITIONS OF THE PARTIES

1. Revenue

United

United filed its *Petition* on May 22, 2001 with supporting testimony of Mr. Enoch and Mr. Bivens and exhibits. On September 12, 2001, United filed its *Supplemental Petition* with the supporting testimony of Mr. Enoch. Upon filing responses to an Authority data request on December 19, 2001, United filed updated exhibits revising its projected financial position. Finally, on January 11, 2002, United filed revised exhibits stating that these exhibits would be introduced during the Hearing.

Based on the position of United as set forth in its latest exhibits and during the Hearing on January 15, 2002, the Company's total projected revenues for the 2002 attrition year are $11,056,072.[36] The Company provided separate forecasts for local service, network access, long distance, and miscellaneous and uncollectible revenues.[37]

At the Hearing, Mr. Enoch stated that in responding to an October data request, the Company provided information through October.[38] Therefore, to use the latest available data, the Company revised its exhibits and position.[39] Additionally, to assist in comparability, United attempted to develop exhibits more in line with the Consumer Advocate's filings.[40] Using a total of 626 additional customers for the 2001 year and based on this most current data, United estimated the average growth rate in access lines to be 4.4%.[41] United calculated a 1.8% growth rate in average revenue per line based on 2001 actual revenues annualized.[42] This results in a

[36] Revised Exhibit 1, January 11, 2002, p. 3.
[37] *Id.*
[38] Transcript of Proceedings, Vol. II, January 15, 2002, pp. 103-04.
[39] *Id.*
[40] *Id.*, p. 107.
[41] *Id.*, p. 110.
[42] *Id.*, pp. 120-21.

projection of local revenues for the 2002 attrition year of $3,516,016.[43] Mr. Enoch admitted that United's 2002 projection anticipates that the 2001 economic downturn will continue throughout 2002.[44] He also admitted that the *Supplemental Petition* forecasted local revenues to be $2,052,372.[45] In response to the TRA data request, United updated that forecast to $3,353,993.[46] With the January 11, 2002 filing, United further revised the forecast to $3,516,016.[47] Mr. Enoch testified that he was not really sure why there is a significant difference between these filings.[48] He did state that in order to move the parties' positions closer together, United used the Staff's methodology.[49]

Mr. Bivens explained that the Company's application for an RUS loan was made in November and December of 2000.[50] At that time, the economy had not taken a downturn, and United had projected access line growth for 2001 of 846 lines and growth to 20,250 access lines by 2005.[51] Subsequently, based on actual data through October 2001, United added 626 lines in 2001 year-to-date.[52] According to Mr. Bivens, these figures demonstrate that growth is lower than forecasted in 2000, when the loan application was made.[53] As Mr. Bivens admitted, United has never denied that revenues are increasing, but the Company's position is that the rate of increase is not as high as projected by the Consumer Advocate and the Staff.[54]

According to Mr. Enoch, United concurs with the Consumer Advocate's projection of network access revenues of $7,040,401.[55] Mr. Enoch adopted Mr. Shirley's forecast for

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43 *Id.*, p. 110; *see also* Revised Exhibit 1, January 11, 2002, p. 3.
44 Transcript of Proceedings, Vol. II, January 15, 2002, p. 126.
45 *Id.*, p. 156.
46 *Id.*, p. 157.
47 *Id.*, pp. 157-58.
48 *Id.*, p. 158.
49 *Id.*
50 *Id.*, pp. 32-33.
51 *Id.*, p. 32; *see also* Direct Testimony of Herbert Bivens, May 22, 2001, p. 4.
52 Transcript of Proceedings, Vol. II, January 15, 2002, pp. 32-33.
53 *Id.*, p. 32.
54 *Id.*, p. 67.
55 *Id.*, p. 112.

miscellaneous revenues of $597,401.[56] The exhibits filed by Mr. Enoch on January 11, 2002 reflect the adoption of the Consumer Advocate's uncollectible expense of $97,746.[57]

Staff

Mr. Joe Shirley testified that the Company's total projected revenues for the 2002 attrition year are $11,407,117.[58] In support of his testimony, he provided separate forecasts for local service, network access, long distance, and miscellaneous and uncollectible revenues.[59] When forecasting local revenues, Mr. Shirley computes an average access line growth of 6.73% for the twelve (12) months ended April 30, 2000.[60] In applying this growth rate to the number of access lines, Mr. Shirley forecasts 15,995 access lines for the attrition year of 2002.[61] He computes the Company's local revenue per access line for the same period. Using the calculated local revenue per access line growth rate of 4.79%, Mr. Shirley forecasts $245.30 in revenue per line for the 2002 attrition year.[62] He derives the local revenue forecast by multiplying the number of access lines by the revenue per access line (15,995 x $245.30).[63] The result is $3,923,574 in local revenues for the 2002 attrition year.[64]

During the Hearing, Mr. Shirley stated that the effects of a 2001 tax law,[65] which effectively reduced the level at which public utility property is assessed, are designed to be revenue neutral; therefore, he made no adjustments to revenues to account for this law.[66] Mr. Shirley stated that he calculated access line growth rates using line count numbers through April

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56 *Id.*, p. 114; *see also* Revised Exhibit 1, January 11, 2002, p. 3.
57 Revised Exhibit 1, January 11, 2002, p. 3.
58 Direct Testimony of Joe Shirley, October 3, 2001, Exhibit C-01.
59 *Id.*
60 *Id.*, Exhibit C-03.
61 *Id.*, Exhibit C-02.
62 *Id.*
63 *Id.*
64 *Id.*
65 2001 Public Chapter No. 195, now codified at Tenn. Code Ann. §§ 67-6-221 and 67-6-222.
66 Transcript of Proceedings, Vol. II, January 15, 2002, p. 228.

2000.[67] When questioned concerning a deterioration in the economy, Mr. Shirley maintained that:

> . . . although to the extent that there was a deterioration, my figures show that toward the end of 2001 that the revenue lines – that the trend is trending back upwards. And, for instance, for the first six months of 2001 the company added I think it's like 285 lines. Yes, it is 285 lines for January through June of 2001.
>
> But if you look at July through October, which is the latest available information that we have, or at least I have, the – they added 276 lines for just July through October. So they have almost added the same amount of lines for those months with still November and December yet to go. And so it looks like what I'm saying that the last half of 2001 is going to be better than the first half of 2001.[68]

Mr. Shirley stated that when using information through October 2001, his forecasted local revenues could be overstated by approximately $176,000 to $190,000.[69] He pointed out, however, that restating the revenues would result in restating expenses, since expenses are driven by the number of access lines.[70] This would result in expenses being overstated by approximately $93,000.[71] Mr. Shirley stated that he included non-revenue generating lines in his forecast.[72] He pointed out that his forecast is based on both access line counts and revenues per line.[73] Therefore, Mr. Shirley stated, "it simply doesn't matter whether you use revenue-producing lines or nonrevenue-producing lines."[74]

Mr. Shirley forecasts $6,992,759 in total network access revenues for the 2002 attrition year.[75] This amount encompasses revenue totals for interstate access ($3,834,266), intrastate-interLATA access ($1,091,573), intrastate intraLATA access ($1,835,671), intrastate special access ($229,045) and payphone access ($2,204).[76]

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[67] *Id.*, p. 244.
[68] *Id.*, p. 249.
[69] *Id.*, p. 252.
[70] *Id.*, pp. 252-53.
[71] *Id.*, p. 253.
[72] *Id.*, p. 258.
[73] *Id.*, p. 250.
[74] *Id.*
[75] Direct Testimony of Joe Shirley, October 3, 2001, p. 13; *see also* Exhibit C-05.
[76] *Id.*, Exhibit C-05.

Interstate access figures for the Company are based on monthly National Exchange Carrier Association ("NECA") AS3000 settlement statements.[77] Mr. Shirley uses these statements to arrive at projections for traffic sensitive, carrier common line, and end-user revenues for the attrition year.[78] In forecasting traffic sensitive revenue, Mr. Shirley uses one-half of the access line growth rate (6.73% x .5 = 3.365%) to project the revenue change for the years of 2001 and 2002.[79] In forecasting the carrier common line revenues, Mr. Shirley incorporates the latest carrier common line rates and return factors established by NECA.[80] He forecasts end-user revenues using the number of access lines calculated for 2002 multiplied by the average NECA end-user revenue per line for the year 2000.[81] This method holds revenue per line constant for years 2001 and 2002.[82]

Intrastate-interLATA revenues comprise intraLATA revenues handled primarily through the toll settlement process and interLATA revenues that are derived from carrier access billings. Using actual results from recent years, Mr. Shirley forecasts interLATA minutes of use for the attrition year of 2002.[83] Although actual results demonstrate that access revenues have grown in recent years, Mr. Shirley only grows the 2001 and 2002 years by one-half of the forecasted access line growth rate (3.365%).[84] Because of uncertainty surrounding the administration of the toll settlement process, Mr. Shirley forecasts intraLATA revenues at the 2000 levels.[85]

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[77] *Id.*, p. 14. Such statements are monthly reports the Company receives stating the amount of compensation it will receive from NECA.
[78] *Id.*
[79] *Id.*, Exhibit C-07.
[80] *Id.*, p. 15.
[81] *Id.*, p. 16.
[82] *Id.*
[83] *Id.*, p. 17.
[84] *Id.*
[85] *Id.*, p. 18. The toll settlement process is administered by BellSouth Telecommunications, Inc. ("BellSouth"). Uncertainty arises from BellSouth's intention eventually to withdraw from this administration.

When forecasting miscellaneous revenues, Mr. Shirley accepts United's forecast for directory revenues and uncollectible compensation.[86] Mr. Shirley proposes a different figure for billing and collection revenue.[87] He projects an overall decline in these revenues primarily due to the exclusion of interstate billing and collection revenue which has been de-tariffed by the Federal Communications Commission ("FCC").[88] As a result of the exclusion, Mr. Shirley removes approximately $60,000 of expense associated with these activities.[89] For the 2002 attrition year, Mr. Shirley forecasts $597,401 in miscellaneous revenue and negative $106,617 in uncollectibles.[90] During the Hearing, Mr. Shirley stated that his forecast of miscellaneous revenues could be understated by approximately $117,000.[91]

Mr. Shirley's testimony addressed the differences between his forecasts and United's original forecast submitted on September 12, 2001. The forecast of the Company, however, was updated on January 11, 2002. This update increases the total revenue forecast from $2,926,755 to $3,516,016. Therefore, the inconsistencies relating to United's forecast noted in Mr. Shirley's testimony no longer exist.

Consumer Advocate

Mr. Terry Buckner projects total revenues for the 2002 attrition year of $11,541,316,[92] based on separate forecasts for local service, network access, and miscellaneous and uncollectible revenues.[93] Mr. Buckner forecasts $3,909,858 in local service revenues for the 2002 attrition year.[94] His forecast is based upon an access line growth rate of 6.06% and growth

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[86] *Id.*, p. 20.
[87] *Id.*, p. 21.
[88] *Id.*
[89] *Id.*
[90] *Id.*, Exhibit C-01.
[91] Transcript of Proceedings, Vol. II, January 15, 2002, p. 256.
[92] Direct Testimony of Robert T. Buckner, October 3, 2001, Exhibit 1, Schedule 3.
[93] *Id.*, Exhibit 1, Schedule 4.
[94] *Id.*

of 5.27% in revenue per access line.[95] In calculating local service revenue, Mr. Buckner holds the growth rate constant from 2000 through the 2002 attrition year.[96] He also maintains that both growth rates are lower than the actual growth rates for 1999.[97] At the Hearing, Mr. Buckner acknowledged that the growth rates could be higher if there is an economic upturn in 2002.[98] He testified, however, that the lower growth experienced during 2001 was due to one-time anomalies; therefore, he believes the 6.06% growth rate is justified.[99] Mr. Buckner stated that his projection includes growth in integrated services digital network ("ISDN") services and digital subscriber lines ("DSL") based on the current subscription to these services.[100]

Mr. Buckner reduces expenses by approximately $100,000 to recognize the property tax decrease.[101] He maintained that a reduction in business rates is not necessary because "the taxes will make up for that in 2003."[102] Mr. Buckner admitted that if growth factors are overstated, the projected local revenues could be incorrect.[103] He countered this with the fact that his forecast results in $229,000 in overearnings, noting that forecasts are not guarantees but, rather, represent an opportunity for the Company to earn a fair and reasonable rate of return.[104] In forecasting local revenues, Mr. Buckner grows revenues at 11.65%.[105] When reminded that Mr. Enoch's calculations only show a 5.7% growth in revenues, Mr. Buckner noted that Mr. Enoch's percentage is based on ten (10) months of data, which would make the number lower than what should be projected.[106]

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95 *Id.*, p. 4.
96 *Id.*
97 *Id.*
98 Transcript of Proceedings, Vol. II, January 15, 2002, p. 199.
99 *Id.*.
100 *Id.*, pp. 180-81.
101 *Id.*, p. 196.
102 *Id.*
103 *Id.*, p. 201.
104 *Id.*
105 *Id.*, p. 204.
106 *Id.*, pp. 204-05.

Mr. Buckner forecasts $7,040,401 in network access revenue for the 2002 attrition year.[107] This amount comprises $1,172,092 in interLATA revenue, $3,600,717 in interstate access revenue, $1,899,435 in intraLATA revenue, and $366,107 in special access revenue.[108] In calculating interLATA revenue, Mr. Buckner uses the access line growth rate calculated for local service revenues.[109] He calculates interstate revenue by using the actual 2001 revenues and adjusting for the change in NECA rates.[110] He calculates intraLATA revenues by using the growth rate for 2001 by annualizing seven months of actual data.[111] Mr. Buckner projects special access revenues based on Revised Exhibit 1 and United's responses to data requests from the Consumer Advocate.[112]

Mr. Buckner forecasts miscellaneous revenues for the attrition year of $688,803 and negative $97,746 in uncollectible revenues.[113] His miscellaneous revenue calculation uses the access line growth rate calculated for local service revenues after annualizing seven (7) months of actual data.[114] His forecast for miscellaneous revenue does not include interstate billing and collections.[115] Therefore, in Mr. Buckner's calculations, approximately $62,000 in customer operations expense is excluded from expenses associated with such billing.[116] For uncollectible revenues, Mr. Buckner adjusted the seven (7) months of actual revenues from United's TRA Form 3.01 filings to reflect twelve (12) months revenues for 2001.[117] He then applied the 2001 growth rate of 2.5% to arrive at the projections for the 2002 attrition year.[118]

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[107] Direct Testimony of Robert T. Buckner, October 3, 2001, Exhibit 1, Schedule 4.
[108] *Id.*, Exhibit 2, p. 8, 13, 16, 19.
[109] *Id.*, Exhibit 2, p. 13.
[110] *Id.*, Exhibit 2, p. 8.
[111] *Id.*, Exhibit 2, p. 16.
[112] *Id.*, Exhibit 2, p. 19.
[113] *Id.*, Exhibit 1, Schedule 4.
[114] *Id.*, Exhibit 2, p. 22.
[115] *Id.*
[116] *Id.*
[117] *Id.*, Exhibit 2, p. 24.
[118] *Id.*

2. Determination of Rate Base

United

In testimony filed with its *Petition*, United claims that it is currently faced with a $3,000,000 extraordinary retirement which it requests approval to amortize over ten (10) years.[119] While the Company originally included retired switching equipment in the rate base calculation in its *Petition*, the Company reversed its position by subsequently adopting the Consumer Advocate's rate base calculations.[120]

Staff

Mr. Shirley forecasts that the Company's rate base is valued at $41,505,795 for the 2002 attrition year.[121] Mr. Shirley objects to the inclusion of an unamortized extraordinary retirement of switching equipment in United's rate base, asserting that the value of such equipment should not be included in the rate base because it is no longer used or useful in providing phone service.[122]

Consumer Advocate

In agreement with Mr. Shirley, Mr. Buckner argues that it is improper to include the extraordinary retirement of switching equipment in the rate base as "ratepayers should not have to bear the cost of imprudent purchases."[123] Mr. Buckner allows the company to amortize this expense over a period of ten (10) years. As a result, Mr. Buckner forecasts a rate base valued at $40,671,865 for the attrition year.[124]

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[119] *See* Direct Testimony of Herbert Bivens, May 22, 2001, p. 2; *see also* Direct Testimony of Joe M. Enoch, May 22, 2001, p. 1.
[120] Transcript of Proceedings, January 15, 2002, Vol. II, pp. 111-12.
[121] Direct Testimony of Joe Shirley, October 3, 2001, p. 8; *see also* Exhibit B-01.
[122] *Id.*, pp. 8-9.
[123] Direct Testimony of Robert T. Buckner, October 3, 2001, p. 13.
[124] *Id.*, Exhibit 1, Schedule 2.

3. Expenses

a. Operations and Maintenance Expense

United

In its *Petition*, United presents its own forecast of operations and maintenance expenses. Mr. Enoch testified at the Hearing that the Company adopts the expense forecast of the Consumer Advocate, modified to account for non-regulated expense allocation resulting from the Company's management contract with UTC Long Distance ("UTCLD").[125] To account for its position that this management contract is the appropriate method to allocate costs to non-regulated operations, the Company adds $166,000 to the Consumer Advocate's attrition year operation and maintenance expense forecast.[126]

Staff

Mr. Shirley separates operations and maintenance expense into four (4) categories: plant specific, plant nonspecific, customer operations, and corporate operations.[127] Each of the categories can be further subdivided into four (4) classes of operating expenses: salaries and wages, benefits, rents, and other operating expenses.[128] Mr. Shirley explains that to determine operations and maintenance expenses he first generates a forecast for each class of operating expenses, then distributes these expenses into the four operations and maintenance expense categories by utilizing expense ratios calculated from the Company's 2000 annual report.[129] After calculating expenses for each operations and maintenance expense category, Mr. Shirley calculates the regulated operation and maintenance expenses by multiplying the relevant expense category by the non-regulated indirect expense factor.[130] Mr. Shirley adopts the Company's

[125] Transcript of Proceedings, Vol. II, January 15, 2002, pp. 108-09.
[126] Revised Exhibit 1, January 11, 2002, p. 5.
[127] Direct Testimony of Joe Shirley, October 3, 2001, p. 22.
[128] *Id.*
[129] *Id.*, pp. 22-23.
[130] *Id.*, p. 23.

approach to allocating costs between regulated and non-regulated activities.[131] That is, the non-regulated indirect expense factor is calculated by dividing non-regulated revenues by total corporate revenues.[132]

While he accepts the Company's methodology for calculating the non-regulated indirect expense ratio, Mr. Shirley treats the expenses associated with UTCLD in a manner distinct from the Company's expenses.[133] Mr. Shirley includes all non-regulated activities, including UTCLD, in his calculation of non-regulated indirect expense ratio.[134] United excludes the activities of UTCLD from its calculation of its non-regulated expenses allocation.[135] Instead, United maintains that it directly accounts for the costs of UTCLD by relying on the contract with UTCLD, under which the Company provides administrative and management services to the long distance affiliate at a fixed monthly rate.[136] Mr. Shirley contends that although UTCLD has been formally organized as a separate entity, its operational behavior with respect to administrative and management functions is similar to United's other non-regulated activities.[137] Given the similarity to other non-regulated activities, Mr. Shirley incorporates the revenues of UTCLD into his calculation of the non-regulated indirect expense factor.[138] The net effect of the inclusion of UTCLD's revenues is to shift more costs from regulated activities to non-regulated activities relative to the Company's forecast.[139]

Mr. Shirley projects operations and maintenance expenses of $3,711,414 for the 2002 attrition year.[140] His forecast uses a zero-based budgeting convention for the computation of the

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[131] *Id.*, p. 26.
[132] *Id.*
[133] *Id.*, pp. 26-27.
[134] *Id.*, p. 26.
[135] *Id.*
[136] *Id.*, pp. 26-27.
[137] *Id.*, p. 27.
[138] *Id.*
[139] *Id.*
[140] *Id.*, p. 28.

expense classes of salaries and wages, benefits, and rents based upon the Company's requirements during the attrition period.[141] Other expenses are forecasted by using a 5.64% inflation factor, which is based upon the inflation rate and growth projections of regulated operations.[142] Mr. Shirley opines that his approach is superior to the Company's approach of "growing the 2000 expenses by management growth factors, which resulted in an across-the-board annual growth rate of 7.96%."[143]

Consumer Advocate

When allocating non-regulated expense, Mr. Buckner utilizes the same methodology as Mr. Shirley, including the treatment of UTCLD. Mr. Buckner projects approximately $600,000 less in expenses associated with operations and maintenance than does the Company.[144] He attributes this difference to three factors. First, his treatment of UTCLD results in approximately $200,000 less in regulated operations and maintenance expenses.[145] Secondly, the zero-based forecasting method employed by Mr. Buckner results in approximately $300,000 less expense.[146] Finally, Mr. Buckner excludes an approximate $100,000 non-recurring expense for an out-of-period item which is included in the Company's forecast.[147]

b. Depreciation Rates

United

In its *Petition*, the Company requests a reduction in the present twenty-five (25) year depreciation rate for central office equipment to twelve-and-one-half (12.5) years, citing the necessity of three (3) extraordinary retirements since the installation of digital switching in

[141] *Id.*
[142] *Id.*
[143] *Id.*
[144] Direct Testimony of Robert T. Buckner, October 3, 2001, p. 6.
[145] *Id.*
[146] *Id.*
[147] *Id.*

1979.[148] This equates to an eight percent (8%) depreciation rate, as opposed to United's currently approved four percent (4%) rate.

Staff

Mr. Shirley states that he used the currently approved four percent (4%) depreciation rate in the preparation of his forecast, rather than eight percent (8%) as used by the Company.[149] As a result, Mr. Shirley forecasts depreciation expenses of $2,064,228, as opposed to the Company's forecast of $2,855,886, for the 2002 attrition year.[150]

Consumer Advocate

Mr. Buckner notes that United utilizes its proposed eight percent (8%) depreciation rate for central office equipment, as well as depreciation rates on other accounts, that differ from the TRA approved rates in the production of its forecast.[151] Mr. Buckner prepared his forecast of depreciation expense using a eight percent (8%) depreciation rate for central office equipment, which is identical to the rate set in TRA Docket No. 99-00995 (the "TEC Earnings Settlement"),[152] rather than the rates approved by the Tennessee Public Service Commission ("TPSC") and currently utilized by the company.[153]

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148 *Petition*, May 22, 2001, p. 5.
149 Direct Testimony of Joe Shirley, October 3, 2001, p. 29.
150 *Id.*, p. 29.
151 Direct Testimony of Robert T. Buckner, October 3, 2001, pp. 10-11.
152 In Re: Joint Petition of Crockett Telephone Company, Inc., Peoples Telephone Company, West Tennessee Telephone Company, Inc., and the Consumer Advocate Division of the Office of the Attorney General for the Approval and Implementation of Earnings Review Settlement, Docket No. 99-00995. At the Authority Conference held on January 8, 2002, the Authority approved the Settlement Agreement submitted in Docket No. 99-00995, including the accelerated depreciation and amortization expense amount specified in the Settlement Agreement. *See* Transcript of Authority Conference, January 8, 2002, pp. 8-9; *see also* Settlement Agreement, Docket No. 99-00995, December 30, 1999.
153 Direct Testimony of Robert T. Buckner, October 3, 2001, p. 11.

4. Fair Rate Of Return

United

In its *Petition*, United requests a 4.85% fair rate of return.[154] United revised its requested fair rate of return to 5.915% in its *Supplemental Petition*.[155] The calculations presented in the Rebuttal Testimony of Joe Enoch assume a fair rate of return of 7.87%, which is predicated on the Company's acceptance of the forecast results proposed by the Consumer Advocate.[156]

Staff

Mr. Shirley accepts the Company's fair rate of return calculation with one modification. He allows an 11.25% return on interstate investment and utilizes the FCC's seventy-five percent (75%) / twenty-five percent (25%) intrastate/interstate split to determine the interstate portion of the fair rate of return.[157] Based on those assumptions and the Company's debt structure, he proposes a fair rate of return of 7.86%.[158]

Consumer Advocate

Mr. Buckner allows an 11.25% return on interstate investment and utilizes a seventy-five percent (75%) / twenty-five percent (25%) intrastate/interstate separation factor in his calculation of a fair rate of return.[159] On this basis, Mr. Buckner proposes a 7.87% fair rate of return.[160]

5. Rate Design

United

In its *Petition*, based on a projected revenue deficiency of $528, 901 for the 2002 attrition year, United proposes the following rate design: elimination of the temporary credits ordered by

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[154] *Petition*, May 22, 2001, p. 7.
[155] *Supplemental Petition*, September 12, 2001, p. 2.
[156] Rebuttal Testimony of Joe M. Enoch, October 12, 2001, p. 10.
[157] Direct Testimony of Joe Shirley, October 3, 2001, p. 32.
[158] *Id.*
[159] Direct Testimony of Robert T. Buckner, October 3, 2001, pp. 13-14.
[160] *Id.*

the TPSC, elimination of touch-tone charges to residential and business customers, adjustment of the service order charges, rate rebalancing in the Nolensville exchange, and inclusion of approximately $3,000,000 in the rate base for the retirement of an obsolete digital switch.[161] This rate design is in addition to the depreciation increase from four percent (4%) to eight percent (8%) that is included in the 2002 forecast.[162] According to Mr. Enoch, the removal of the credits requires $375,000 in additional revenue, removal of touch-tone requires $200,000, the increase in the service order charges produces $180,000 in revenue, and the Nolensville rate re-balancing requires $40,000 in revenue from residential and $50,000 revenue from business customers.[163]

Mr. Bivens stated that the 2001 tax law,[164] along with the current $4.00 credit, will result in business rates being lower than residential rates.[165] Therefore, removal of the credit is necessary for rate equity.[166] Mr. Bivens testified that removal of the temporary credit, elimination of touch-tone, and the proposed rate changes in the Nolensville exchange will bring rates for all customers more in line with the calling scope of the Company's customers.[167] Mr. Bivens notes that service order charges have not changed since early 1990s; therefore, service order charges need to be adjusted to reflect current conditions.[168] Finally, United has included a depreciation increase to eight percent (8%) in its 2002 attrition year projection.[169] Mr. Bivens believes this is necessary because the life of digital switches has deteriorated since the 1950s and 1960s.[170]

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161 *Petition*, May 22, 2001, pp. 5-6.
162 *Id.*
163 Transcript of Proceedings, Vol. II, January 15, 2002, pp. 161-62.
164 2001 Public Chapter No. 195, now codified at Tenn. Code Ann. §§ 67-6-221 and 67-6-222.
165 Transcript of Proceedings, Vol. II, January 15, 2002, p. 33.
166 *Id.*, p. 34.
167 *Id.*, pp. 35-37.
168 *Id.*, pp. 37-38.
169 *Id.*, p. 37.
170 *Id.*

Mr. Bevins explained that the retirement of the digital switch was necessary because it could not be upgraded.[171] He stated that the manufacturer of the switch provided a letter to United stating that ISDN would be available on this switch, but recently the manufacturer announced that ISDN would not be made available on this switch.[172]

Mr. Enoch admitted that in Revised Exhibit 1, Net Operating Income was understated by $166,000.[173] Correction of this error reduces the revenue deficiency from $528,901 to $438,820.

Staff

Based on computed excess revenues of $941,788 for the 2002 attrition year, Mr. Shirley recommends that the "temporary" credits in effect for residential and business customers be made permanent immediately, touch-tone charges for residential and business customers be eliminated starting in 2002, the depreciation rate for digital electronic switching equipment be increased from the current four percent (4%) to seven percent (7%) starting in 2001, and United be allowed to recover the cost of its extraordinary retirement of digital electronic switching equipment starting in 2001.[174] Mr. Shirley's forecast does not include any rate design proposals.

Mr. Shirley contends that no revenue requirement is necessary when making the temporary credits permanent because these credits are built into the existing revenues upon which projections are based.[175] He states that the elimination of touch-tone charges is needed in light of the growing trend in the industry to include touch-tone with basic local service.[176] He also maintains that this elimination would affect nearly every residential and business customer in United's service territory.[177] Based on a comparison with other rate-of-return regulated

[171] *Id.*, pp. 55-56.
[172] *Id.*, p. 55.
[173] *Id.*, pp. 123-24.
[174] Direct Testimony of Joe Shirley, October 3, 2001, pp. 33-36; *see also* Exhibit A-01.
[175] *Id.*, pp. 33-34.
[176] *Id.*, p. 34.
[177] *Id.*

companies, Mr. Shirley contends that the depreciation rate for digital electronic switching equipment should be increased to seven percent (7%).[178] Finally, Mr. Shirley contends that the early retirement of digital electronic switching equipment, which the Company purchased in 1992 but has since determined cannot be upgraded, should be recovered over a ten (10) year period.[179]

Consumer Advocate

Based on a finding of overearnings of $229,110 for the 2002 attrition year, Mr. Buckner recommends that the $2.00 residential and $4.00 business temporary credit be kept in place and reflected in the local exchange rates.[180] According to Mr. Buckner, United does not need further rate relief at this time.[181] He does, however, suggest that the overearnings he calculated would be sufficient to eliminate touch-tone charges for all customers.[182] It should be noted that the overearnings calculated by Mr. Buckner include the proposed depreciation expense adjustment from four percent (4%) to eight percent (8%).[183] Mr. Buckner also adopts the amortization of the retired switching equipment of approximately $321,000.[184] At the Hearing, Mr. Buckner agreed that no depreciation study was performed to arrive at the eight percent (8%) included in his 2002 projections.[185] He also agreed that seven percent (7%) would be a reasonable depreciation amount.[186]

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[178] *Id.*, p. 35.
[179] *Id.*
[180] Direct Testimony of Robert T. Buckner, October 3, 2001, p. 3.
[181] *Id.*
[182] *Id.*
[183] *Id.*
[184] *Id.*, p. 13.
[185] Transcript of Proceedings, Vol., II, January 15, 2002, p. 179
[186] *Id.*

FINDINGS AND CONCLUSIONS

Revenue

The Company used the latest eleven (11) months annualized to calculate access line growth.[187] Revenue per access line was based on the latest ten (10) months of historical data annualized.[188] From this the Company grew the number of access lines and revenue per access line for the years of 2001 and 2002.[189] The Consumer Advocate calculated access line and revenue per access line growth based on 1998, 1999 and 2000 historical data.[190] A reasonable alternative is to take a historical thirteen (13) month average for the preceding twenty-six (26) months to calculate access line growth and revenue per access line. Following logical methodology, the grown access lines are then multiplied by the grown revenue per access line.

Although there is no precise method, forecasting should be based on the latest data available and sufficient to predict trending of the data. Ignoring historical data when it is available, as proposed by the Company, does not seem reasonable. Nor is it reasonable to adopt a methodology that cannot be replicated from the exhibits submitted by the Company. Therefore, the Authority adopts Mr. Shirley's methodology to calculate local revenues. Further, the thirteen (13) month average shall be calculated based on the latest available data. This is consistent with Mr. Shirley's comment during the Hearing that his projection could be overstated by as much as $176,000.[191] Based on this recommendation, taking a thirteen (13) month average for October 1999 through October 2000 and October 2000 through October 2001 to calculate a historical growth rate for access lines, and calculating revenue per access line growth based on historical data for the latest three years, these growth rates result in local revenues for the 2002

[187] *Id.*, p. 32.
[188] *Id.*, p. 109.
[189] *Id.*, pp. 109-10.
[190] *Id.*, p. 182.
[191] *Id.*, p. 252.

attrition year of $3,784,704.

There is little difference in the network access revenue projected by each of the parties. This access revenue is driven in part by the access line growth rate calculated and used in projecting local revenues. Therefore, the Authority adopts a calculation of $6,964,376 for Network Access Revenue. This amount was arrived at using the access line growth rates for local revenues.

The methodology for calculating miscellaneous revenues is similar for all of the parties. Mr. Enoch stated during the Hearing that the Company adopted the Staff's miscellaneous revenue amount because it was developed in a manner that was understandable.[192] He did, however, qualify this by stating that based on current conditions the projection of the Staff may be too low.[193] While not changing his position, Mr. Shirley noted that miscellaneous revenues could be understated by approximately $117,000.[194] Therefore, the Authority adopts miscellaneous revenues of $688,803 as projected by the Consumer Advocate.[195] The recommended method more accurately reflects stabilization of billing and collection rates in 2001 and 2002 and does not incorporate any understatement of miscellaneous revenues as noted by Mr. Shirley and Mr. Enoch.

Uncollectible revenues were calculated based on historical data. The difference between the Staff and the Consumer Advocate is that the Staff calculated the percentage based on total revenues while the Consumer Advocate calculated the percentage based on local revenues. The Authority finds that uncollectible amounts arise from all sources. For this reason, the Authority adopts the Staff methodology. Using this methodology, the uncollectible revenue amount is $105,915. Accordingly, the Authority finds that the Company's total revenues are $11,331,969.

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[192] *Id.*, p. 106.
[193] *Id.*, p. 114.
[194] *Id.*, p. 256.
[195] Direct Testimony of Robert T. Buckner, October 3, 2001, Exhibit 1, Schedule 4.

Expenses

The Authority accepts the zero-based forecasting methodology proposed by Mr. Shirley and Mr. Buckner for the development of operating expenses.[196] The Authority disagrees only with Mr. Shirley and Buckner's calculations of other operations and maintenance expenses as such calculations are based on access line growth factors that the Authority has elsewhere rejected. Modifying Staff's calculations for other operations and maintenance expenses to account for the lower access line growth rate as calculated herein leads to an estimate of $1,815,016 for such expenses for the attrition year. This calculation, in turn, leads to forecasted 2002 attrition year operations and maintenance expenses of $3,672,674, which is expectedly lower than Mr. Shirley's proposal of $3,711,413 and Mr. Buckner's proposal of $3,684,012. The resulting projection, while comparable to both the Staff's and the Consumer Advocate's forecasts, is somewhat lower, reflecting the decreased expenses incurred with lower projected access line growth.

Underlying the calculation of operations and maintenance expenses is the allocation of expenses to the non-regulated operations of United. United contends that costs should be allocated to its long distance affiliate in accordance with a management contract between United and UTCLD.[197] The Authority adopts the opposing view presented by Mr. Shirley and Mr. Buckner that the management contract should not be used to directly allocate expenses to the non-regulated operation. Under the contract, United provides UTCLD with all administrative and management functions for $1,200 per month. While United witness Bivens testified that employees of United spend very little time conducting the business of UTCLD, the Authority finds that it is unreasonable to believe that an approximately $1,000,000 dollar a year business

[196] United stipulates to using the CAPD's methodology and subsequent calculations with the exception of Mr. Buckner's development of the non-regulated indirect expense ratio. Transcript of Proceedings, Vol. II, January 15, 2002, p. 108.
[197] *Id.*, pp. 115-16.

has annual overhead costs of only $14,400.[198] It is doubtful that UTCLD could procure the services that it is receiving from United on the open market for $1,200 a month. Further, the Authority concludes that the standard for determining the reasonability of the management contract is whether UTCLD would have such low overhead costs if it were a stand-alone entity. Obviously, the answer to this question is no. Therefore, the Authority adopts the convention for allocating non-regulated indirect expenses proposed by Mr. Shirley and Mr. Buckner in the preparation of the operations and maintenance expense calculation described above.

The Authority adopts the depreciation expense methodology presented by Mr. Shirley. Mr. Shirley presents the only forecast of the depreciation expenses for the attrition year that is based on the Company's existing depreciation schedules. While the Authority finds Mr. Shirley's calculations clear and correct, more importantly, his forecast is the only one before the Authority which is useful in determining the Company's financial position without relief. The only other depreciation forecast before the Authority is presented by Mr. Buckner and accepted by the Company. This forecast, although numerically correct, is predicated on the assumption that the Authority has provided the Company its requested central office equipment depreciation relief. This, however, removes any diagnostic benefit the forecast may provide the Authority, effectively prescribing the remedy before it has been ascertained if a problem exists. On this ground, the Authority rejects the forecasted results of Mr. Buckner in favor of the depreciation forecast method of Mr. Shirley.

Expenses associated with taxation are driven by the forecasted level of revenues. There is no dissonance in the parties' voices concerning the proper manner in which to calculate the various taxes incurred by United. It is reasonable, therefore, to forecast taxes using the agreed upon rates used by the parties.

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[198] *See id.*, p. 87.

Fair Rate of Return

There is little disagreement over the rate of return the Company should be allowed on its regulated investment. The projections of Mr. Shirley and Mr. Buckner differ only to the extent that rounding leads to a marginal difference. Mr. Shirley proposes a 7.86% fair rate of return while Mr. Buckner proposes a 7.87% rate of return.[199] The Authority opts to use the 7.87% percent rate of return to calculate the Company's earning position.

Rate Base/Over (Under) Earnings

Based upon the forecasting method adopted above, United is projected to have excess earnings of $517,292 in the 2002 attrition year. Such overearnings result in $841,590 in excess revenues for the 2002 attrition year. The adopted forecast reveals that the Company is projected to earn a 9.12% return on its regulated investment in 2002.

Rate Design

The forecasted overearnings of $517,292 is based on United's current rates, which include the $2.00 residential and $4.00 business credit to customers. Therefore, the Authority concludes that these credits shall be made permanent and United shall file tariffs to reflect the proper rates. Thereafter, to effect the changes necessary to bring United's earning position in line with the adopted rate of return, the Authority grants the Company its proposed depreciation rate of eight percent (8%) for central office equipment and allows the amortization of the extraordinary retirement of central office equipment over a period of ten (10) years starting in 2001. Based upon the adopted attrition year forecast, implementation of the recommended rate design will permit the Company a return of 7.90% on its rate base investment. This figure is not

[199] Direct Testimony of Joe Shirley, October 3, 2001, p. 32; Direct Testimony of Robert T. Buckner, October 3, 2001, pp. 13-14.

significantly larger than the 7.87% fair rate of return, leaving the Company with only $21,098 in excess earnings for the 2002 attrition year.

This rate design removes the Company's excess earnings in a manner that does not affect the Company's flow of revenues, and it does not adversely impact the Company's revenue while removing excess earnings in a reasonable fashion. Consequently, the Authority denies United's pending tariff.

The overall effect of rate rebalancing for customers was stated by Mr. Enoch to produce $10,000 additional revenue.[200] The only reason set forth by the Company for increasing service order charges was that these charges have not changed since the 1990s. Since United is not underearning, the Authority finds no merit in rebalancing rates or increasing service order charges to produce increased revenues.

Elimination of touch-tone was suggested by the Company and the Staff. The Consumer Advocate also suggested that excess earnings could be used to eliminate these charges. The Authority concludes that excess earnings shall be used to increase the depreciation rates and the Company shall amortize the retired equipment. This conclusion potentially leaves the Company with excess revenues of $21,098. This amount is insufficient to support the approximate $200,000 needed to eliminate touch-tone charges.

<u>Consideration of United Petition at the March 12, 2002 Authority Conference</u>

At the March 12, 2002 Authority Conference, upon careful review of United's *Petition*, as amended, the testimony presented at the January 14-15, 2002 Hearing, and the entire record in this matter, the Directors of the Authority unanimously determined the following: (1) a 7.87% rate of return is just and reasonable; (2) using existing rates and credits, United will overearn by

[200] Transcript of Proceedings, Vol. II, January 15, 2002, p. 118.

$517,292, which would result in excess revenues of $841,590; (3) United's proposed tariff is denied; (4) United's existing $2.00 residential and $4.00 business credit shall be made permanent; (5) United shall use its excess revenues to increase central office equipment depreciation rates from four percent (4%) to eight percent (8%); (6) United is allowed to amortize the extraordinary retirement of central office equipment over a period of ten (10) years beginning in 2001; and (7) United shall file a tariff to reflect this action within thirty (30) days of the date of this Order.

Based upon the foregoing findings,

IT IS THEREFORE ORDERED THAT:

1. United's *Petition* is denied in part and granted in part.

2. United's proposed tariff is denied.

3. United's existing $2.00 residential and $4.00 business credit shall be made permanent.

4. United shall use its excess revenues to increase central office equipment depreciation rates from four percent (4%) to eight percent (8%).

5. United shall be allowed to amortize the extraordinary retirement of central office equipment over a period of ten (10) years beginning in 2001.

6. United shall file a tariff to reflect the action set forth in this Order within thirty (30) days of the date of this Order.

7. Any party aggrieved with the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within fifteen (15) days from the date of this Order.

8. Any party aggrieved with the Authority's decision in this matter has the right of judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty (60) days from the date of this Order.

Sara Kyle, Chairman

H. Lynn Greer, Jr., Director

Melvin J. Malone, Director

ATTEST:

K. David Waddell, Executive Secretary