

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

CASE NO. TR-82-199

In the matter of the filing by
SOUTHWESTERN BELL TELEPHONE COMPANY
of new intrastate rates, tolls, and
charges applicable to intrastate
telecommunication services furnished
within the state of Missouri.

INITIAL BRIEF OF THE STAFF OF THE
PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

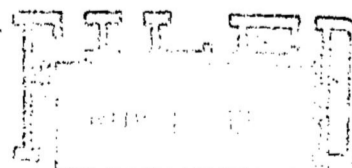
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PUBLIC SERVICE COMMISSION

TELEPHONE PLANT UNDER CONSTRUCTION

Company's Witness: T.R. Vrooman
Exhibit 14, pp. 16,19-25, 36;
Tr. 1456-1465

Staff's Witness: David G. Winter
Exhibit 60, p. 4; Exhibit 124;
Tr. 1465-1480

Public Counsel's
Witness: Tom Werdenhause
Exhibit 37, p. 17-19;
Tr. 1480-1486

INTRODUCTION

Company included telephone plant under construction in the amount of \$18,065,000 (the balance at the end of the test year) in rate base. The Staff and Public Counsel oppose inclusion of any telephone plant under construction in rate base, as it represents construction work in progress and not plant that is used and useful in providing service to the ratepayers. As a result of the agreement of the parties to the Hearing Memorandum to true up this item, the amount in controversy here is the balance in TPUC as of the true-up - September 30, 1982.

Company's Position

Company did not include in rate base those projects it refers to as long-term plant under construction, which by definition are scheduled to take in excess of one year to complete. The issue here deals with inclusion of the classification of telephone plant under construction (TPUC) which by definition is scheduled for completion in a period of one year or less. The amount for which Company is seeking rate base inclusion is the September 30, 1982 balance of short-term plant under construction. Company asserts that its approach "Most accurately balances the responsibility of our customers of supporting a construction program" and "would allow the Company to maintain its books and records for the State of Missouri in accordance with the Uniform System of Accounts prescribed by the FCC, without the need for records to support differences between the interstate and intrastate jurisdictions." (Exhibit 14, p. 20)

Company witness Vrooman testified that "based on 1981 average dollar turnover basis. . . this account turns over 3.2 times per year, or about every 3.8 months". (Supra at 22) He also asserts

that TPUC is "used and useful" to present customers.
Staff's Position

Staff's position is that short-term telephone plant under construction is, in essence, the same as construction work in progress (CWIP), and as such, it should not be included in Company's rate base until it is completed and used and useful in rendering service to the Company's ratepayers. In Staff's opinion, current ratepayers should not be required to pay rates based on the cost of projects still under construction. Staff proposes to exclude TPUC from rate base and allow capitalization of interest during construction (IDC) thereon. Capitalization of IDC will permit the Company to earn a return on this investment when construction is completed and transferred to plant in service. (Ex. 125, pp. 3-4)

Current ratepayers as defined by the Staff are those customers in existence and receiving service from the Company as of the end of the test year utilized in this proceeding. (Supra at 7) The significance of this point is that if Company's proposal is adopted, current ratepayers will be forced to pay a return on plant still being constructed which provides no corresponding benefit to them. (Supra at 8) Under Staff's methodology, future ratepayers will pay the return on the investment as they have the use of the plant.

Secondly, present ratepayers are already paying a return on plant which is currently in service but has more capacity than is needed by current ratepayers. (Supra at 10) Therefore, a portion of the existing plant in service is not utilized by current ratepayers and exists to serve new customers. However, current ratepayers are paying a return on this currently existing excess capacity. Excess capacity is common for utilities so that plant will have a reserve to meet new demand when called upon.

Company's plant is designed with planning margins for reserve capacity through engineering intervals. (Supra at 11) An engineering interval is a period of time between the planned in-service date of an equipment addition and the date when the next addition is required. (Id) For example, Company supplied documents show that building additions are engineered so as to have a capacity to meet anticipated growth and demand for a period of eight years;

buried cable and aerial cable are engineered to have a capacity to meet demand for a period of ten years. (Supra at 12) Therefore, existing plant is designed with an eye to the future to meet demands of future ratepayers as opposed to only meeting the demands of current ratepayers. Staff does not assert that this planning and construction method is improper, but it indicates that current ratepayers are already bearing plant costs in excess of plant necessary to serve them.

Company divides its construction projects into four categories consisting of growth, modernization, plant replacement and customer movement. (Supra at 14) Growth concerns projects to expand and or increase revenues. Growth expenditures reflect projects which provide capacity for new customers and increased usage by existing customers. (Id) Accordingly, this type of construction project results in increased revenues. (Id) Modernization includes projects to introduce improved operational efficiency. (Supra at 15) This type of project improves service with corresponding increased productivity. It also makes available new services to customers which will also cause the Company to accrue additional revenues. (Id) Plant replacement consists of replacing worn or damaged equipment. This type of construction expenditures could result in reduced maintenance costs and thus less expense to the Company. (Id) Finally, customer movement classifications concerns the costs of meeting the day-to-day service requirement of existing customers. (Supra at 16) This particular category would not result in increased revenues to the Company except to the extent installation charges are incurred through the moving process. (Id)

The foregoing shows that if Company's proposal is adopted, Company will reap the benefits of an increased revenue requirement by increasing rate base without taking into consideration the related increased revenues and reduced maintenance expenses. (Supra at 19) If the current ratepayers are made to be responsible for financing TPUC as the Company suggests, then Staff is of the opinion that it is only proper and equitable that the same ratepayers be given the benefit of additional revenues and reduced expenses. (Supra at 21) While the Company is requesting rate base treatment of these

construction projects, it has not proposed the inclusion of related benefits which will result from this construction such as reduced maintenance costs and increased revenues therefrom. (Supra at p. 19)

In addition, Staff witness Winter examined the actual construction period for each of the construction projects during the test year which the Company classified as short-term construction projects and calculated the average length thereof. (Supra at 20) The result was an approximate six-month average, which would be a more precise measure of the average construction period for TPUC projects than the Company's average dollar turnover ratio. However, Staff does intend to true-up this item and therefore any projects which are actually completed as of the true-up audit will be included in rate base. (Id)

Essentially, the Staff's position is that short-term telephone plant under construction should not receive special treatment any different from any other construction work in progress before this Commission and that the used and useful, in-service test should be applied. Several additional reasons for excluding TPUC from rate base are stated above.

Public Counsel's Position

Public Counsel's position, as stated in the direct testimony of witness Werdenhouse is that telephone plant under construction should be excluded from rate base until such time as the plant is used to render service. (Exhibit 37, p.17) Public Counsel's position is also based on application of the "matching principle" which calls for matching of revenues with expenses.

Prior Missouri PSC Decisions

This Commission has consistently ruled that TPUC should not be included in rate base. In the most recent case involving this Company in which the TPUC issue was contested, the Commission held:

. . . In this context, the Commission concludes that it would be inappropriate to include short term TPUC in rate base without the presentation of an acceptable methodology by which the revenue and expense effects related to the inclusion of short term TPUC in rate base could be analyzed and offset, or unless it is demonstrated that there are no revenue or expense effects related to the particular short term construction involved. In Re: Southwestern Bell Tel. Co., Case No. TR-81-208, Report & Order pp. 47-48 (Nov. 27, 1981)

In Re: Southwestern Bell Telephone Company, Case No.

TR-79-213 (March 13, 1980) the Commission had the following to say regarding TPUC:

The Commission is not bound by the decisions of the Federal Communications Commission and there has been no evidence presented which would persuade us to depart from the customary practice of excluding the cost of all plant under construction from rate base. Undedicated plant under construction is not used and useful in rendering service and no return should be allowed on the amounts associated with the construction until it is dedicated to public service. In the Commission's opinion, the accrual of interest during construction to be capitalized at the time the plant goes into service provides the investor with an adequate opportunity to earn a return on those costs or the life of the plant. The Commission will continue to exercise its discretion in favor of excluding construction work in progress from rate base, and the Company's proposed inclusion is disallowed. (Report and Order at p. 14)

In Re: United Telephone Company of Missouri, Case No.

18,264 (October 10, 1975) the Commission provided some guidance on the factors concerning this issue:

The Commission is of the opinion that the controlling factors to be considered are: (1) The levels of CWIP in relation to total plant (If large, then to capitalize is to distort future rate base and present a false picture in actual dollars of revenue because of large amount of interest during construction being added to test year revenues though there are no actual dollars flowing in); (2) How far beyond the test year does the utility estimate the CWIP will be in actual service; (3) Is the CWIP good revenue-producing property or not, and if so, is it then necessary to adjust revenues and expenses as if CWIP were in service. (Report and Order at p. 4)

See also In Re: United Telephone Company: TR-80-235 (December 19, 1980).

Argument

In prior cases, Company has requested rate base treatment of TPUC, but did not include TPUC in rate base in its filing. In this case TPUC was included in Company's rate base calculation.

As previously stated, Company witness Vrooman asserted that he felt the Company's investment in TPUC was used and useful. In cross-examination, he defined those terms as follows:

By Ms. Garr:

Q. . . . Could you please define those terms used and useful?

By Mr. Vrooman:

A. Useful to me would mean that, for instance, you buy a pole, you just wouldn't take the money and pour it in a hole in the ground.

Used to me would mean that it is used now or in the future in the provision of continuous telephone service.

(Tr. 1458)

Staff and Public Counsel assert that TPUC is not currently used to render service. Staff asserts that TPUC is CWIP. Company witness Vrooman was led to a similar conclusion on cross-examination by Public Counsel:

By Mr. Pendergast:

Q. Sure. Now telephone plant under construction, could you just define that for me, short-term TPUC? What is your definition of that?

By Mr. Vrooman:

A. It's plant used in the continuous provision of telephone service, which is in the process of being constructed that takes up to one year versus being long-term, which takes more than a year. . .

Q. You say it is a telephone plant where the construction of it is in progress or in process?

A. That's correct.

Q. So it would be fair to say that it is construction work in progress?

A. That's not a term used in the telephone industry. Telephone plant under construction is from whence I came.

Q. But it is construction work, isn't it?

A. Yes, it is.

Q. And it is in progress, isn't it?

A. Generically, but I don't identify with that term.

(Tr. 1464-1465)

Regarding Company's assertion that inclusion of TPUC in rate base would be in accordance with the FCC ruling and would eliminate the need for side records, the Commission should keep in mind two items. First, Commission Rule 4 CSR 240-30.040.3 provides that the Missouri Commission is not bound by the FCC Uniform System of Accounts when it is engaged in ratemaking. Second, in its order regarding TPUC, the FCC made it clear that it was not dictating ratemaking treatment for state commissions. The FCC recognized that the majority of the states did not allow plant under construction in rate base and therefore, since varying treatments on the interstate and intrastate level would likely result, the keeping of separate records would be largely unavoidable. (Ex. 125 at 22-23) Staff would also point out that Company currently keeps these records and also keeps other

separate records for the Missouri jurisdiction and this would not be an extreme burden on the Company.

Company witness Vrooman conceded that at least a portion of TPUC could and/or would provide additional revenues to Company or reduce expenses and cost of service. (Tr. 1463-64) However, as was pointed out by the Staff and Public Counsel, Company did not propose any adjustment for additional revenues or reduced maintenance costs associated with this plant. (Ex. 125, p. 19 and Ex. 37, p. 17)

Staff would remind the Commission that all construction which is completed and in service by the true-up date, September 30, 1982, will be included in Company's rate base for purposes of this case. (Tr. 1488) The dollar amount in the TPUC account at September 30, 1982 will, by definition, include construction projects scheduled to be completed within 12 months; i.e. by no later than September 30, 1983. The issue before the Commission for determination is whether that September 30, 1982 TPUC amount should be included in rate base.

Staff's arguments described above have gone virtually uncontroverted by the Company. Staff's reasons for excluding TPUC from rate base are, once again:

- 1) TPUC is not used or useful in the rendition of service to current ratepayers.
- 2) Present ratepayers are already paying a return on plant completed and in service which has more capacity than is presently needed by current ratepayers.
- 3) Company's proposal fails to consider the related benefits associated with these capital projects which will be realized when they are completed.
- 4) Company's proposal on TPUC includes an amount of plant that will not be used and useful until after the end of the test period utilized by all parties of record in this docket, but it does not consider the additional revenues and reduced maintenance costs associated with this plant.

In Staff's opinion, the Commission should determine this issue based on the plant in service theory, and exclude TPUC as it does all plant under construction from rate base. However, in the event the Commission applies the criteria from TR-81-208 in this case, Staff would submit that Company has once again failed to bear its burden of proof on this issue. In fact, Company has not even attempted to do so.

Conclusion

For all the above reasons, Staff recommends that the Commission should continue to exclude Telephone Plant Under Construction from rate base.