BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of United Telephone Company of Missouri's tariff sheets designed to increase rates for telephone service to customers in the Missouri service area.	)	Case No. TR-93-181
In the matter of the local exchange telecommunications companies' modernization of plans pursuant to 4 CSR 240-32.100.	)	Case No. TO-93-309

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HEARING EXAMINER: Joseph A. Derque III

REPORT AND ORDER

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Procedural History

On December 7, 1992, United Telephone Company of Missouri (UTM) initiated this rate case by submitting to the Commission tariffs designed to increase the revenue of UTM by approximately $9.2 million, exclusive of gross receipts and franchise taxes. The Commission issued a Suspension Order and Notice of Proceedings on December 30, 1992, suspending the proposed tariffs until November 7, 1993.

On February 16, 1993, the Commission issued an order granting intervention to (in alphabetical order): AT&T, the Cities of Jefferson City, Lotawana, and Maryville, Missouri, Competitive Telecom Association of Missouri, GTE Midwest, Inc., MCI Telecom Corp., Midwest Independent Coin Payphone Association, the Office of Administration of the State of Missouri (by the Attorney General of the State of Missouri), Southwestern Bell Telephone Company, and the United States Department of Defense and Executive Agencies. The Commission allowed as a participant without intervention, the City of Mound City, Missouri.

On August 25, 1993, the Commission issued an order consolidating the revenue request from UTM's modernization plan, Case No. TO-93-309, with this case, said order having resulted from a motion filed by the Staff, Office of Public Counsel (OPC), and UTM. Case No. TO-93-309 is UTM's filing of its proposed modernization plan pursuant to Rule 4 CSR 240-32.100. As argued by UTM, the implementation of proposals for funding of various aspects of that plan can be taken together with this general rate case, and therefore, the consolidation of Case No. TO-93-309 is appropriate.

On May 14, 1993, the Commission issued its order adopting the historical test year as the twelve month period ending December 31, 1992. No adjustments were requested of this test year period.

Four public hearings were held in this matter. The evidentiary hearing was held August 30 through September 3, 1993, in the Commission offices in Jefferson City, Missouri. A briefing schedule was agreed to by all parties, and this matter was finally submitted to the Commission on October 8, 1993.

Motions and Exhibits

Exhibit No. 1, the Hearing Memorandum, was offered at the evidentiary hearing and admitted pending the signature of representatives of all parties and intervenors. The signature page was later filed with the Commission. Exhibit No. 1 will, therefore, be admitted into evidence.

At the evidentiary hearing a motion was made and agreed to by UTM and the Staff to extend the page limit for initial briefs to 125 pages, from the Commission standard of 100. Due to the length and volume of material in this litigation and the agreement of the parties that this would be acceptable, the motion is granted and the page limit on initial briefs is extended to 125 pages.

Subsequently, on September 24, 1993, UTM filed a motion to file its initial brief which exceeds the 125 page limit. UTM states that the Staff and OPC do not object to this motion. UTM states that it was unable to accurately determine the exact length of the brief when it was being composed. After editing, the brief exceeded the page limit by seven pages. As this was apparently unavoidable and no party objects, the motion is granted.

The Staff and intervenor Mound City, Missouri, have both moved to file briefs late. Both late filings were, for various reasons, unavoidable, and therefore, both requests are granted.

Findings of Fact

The Missouri Public Service Commission, having considered all competent and substantial evidence, upon the whole record, makes the following findings of fact.

The Commission has reviewed and considered all of the evidence and argument presented by the various parties and intervenors in this case. Due to the volume of material presented to the Commission, some evidence and positions on certain issues may not be addressed by the Commission. The failure of the Commission to mention a piece of evidence or the position of a party indicates that, while the evidence or position was considered, it was not found to be relevant or necessary to the resolution of the issue.

The issues in this case, for purposes of organization and ease of understanding, will be addressed in the order that the dollar amounts representing the issues appear on the Summary of Revenue Issues, to be found at the end of this Report and Order. The issues will be addressed beginning with rate base issues, followed by issues concerning the calculation of the appropriate rate of return, issues representing revenue and expense items, UTM's proposed modernization plan, other miscellaneous issues, rate design issues, and settled issues. Several issues, depending on their outcome, include entries in both the rate base and revenue or expense portions of the reconciliation. These issues will be dealt with as part of the appropriate revenue or expense item.

UTM is a wholly-owned subsidiary of Sprint Corporation, an unregulated competitive company, and is one of sixteen local telephone companies owned by Sprint. UTM and six other telephone companies are part of another Sprint operating company, that being United Telephone-Midwest. In addition, UTM also does business in the State of Kansas as United Telephone Company of Southeastern Kansas. United Telephone-Midwest performs centralized operational and support functions, such as customer billing, payroll, accounting, and data processing for UTM and six other LEC companies located in Kansas, Minnesota, Texas, Nebraska, and Wyoming. Sprint is the sole shareholder of common equity in UTM, acquired by Sprint in 1985. The common stock of UTM is not publicly traded; however, the bonded indebtedness of the Company is sold in the market.

UTM currently serves approximately 198,000 access lines in 79 exchanges in the State of Missouri. During the test year, UTM had gross revenues over $100,000,000, and is requesting an increase of annual revenue in this case of $9.2 million.

I. Rate Base

A. Depreciation Reserve for Operators

In September, 1991, as the result of a cost study done by UTM, UTM's Warrensburg operator center was closed and the services performed by that center contracted to be performed by United North Central. According to the testimony of Company witness Whinery, this resulted in a substantial savings during the test year. The associated net equipment investment and removal costs totalled $731,301 as the result of the closing of the Warrensburg center.

UTM has requested a three year amortization of the Missouri jurisdictional amount of $531,024, which is, according to Staff witness Richey, $177,008 per year. In addition, UTM has allowed a depreciation reserve to remain in the rate base in the amount of $531,024, taking the position that a return should also be earned on that money, as closing the operator center saved both the Company and the ratepayer money.

It is the position of both the Staff and OPC that the depreciation reserve should be removed from the rate base, since the equipment for which the expense was incurred is no longer in service, and therefore, not used and useful to the ratepayer. The Staff proposes to adjust the rate base by deducting $531,024, claimed by UTM as a debit reduction deficiency.

In Telephone Authority Order (TAO) #984, ordered paragraph #3, the Commission reserved the right to consider this amount in UTM's next rate case, for ratemaking purposes.

The Commission finds that, while it is appropriate, per the Staff recommendation and TAO #984, to amortize the $531,024 amount over a three year period beginning in 1993, as suggested by UTM, it is not appropriate to also include the $531,024 in rate base. The Commission adopts the Staff's position that, even though UTM gained a savings in closing the center, the equipment involved is no longer in service. For purposes of calculating rates for current and future ratepayers, it is inappropriate to place the cost of items in the rate base which are no longer used and useful. The Commission has consistently taken this position in the recent past. The Commission holds that the $531,024 deduction from rate base, as proposed by the Staff, is appropriate and will be approved.

B. Cash Working Capital

Cash working capital (CWC) is the amount of cash necessary for the utility to pay the day-to-day expenses incurred in providing service to the ratepayer. A lead-lag study is used to determine the amount of cash a utility must provide in order to maintain service. The use of a lead-lag study has been approved by the Commission in numerous rate cases as an accurate and competent method for calculation of the cash working capital requirement.

When the utility must pay for an expense incurred to provide service before the ratepayer has paid for the service, cash must be provided to do so by the shareholder. The shareholder is then entitled to a return on that advance, generally as a part of the rate base. If the ratepayers have provided the capital to the utility before the utility has had to pay for the expenses of providing service, the negative cash working capital balance should be removed from rate base as the shareholder is not entitled to a return through rates on that amount.

The Staff's lead-lag study of UTM's CWC requirement was based on an initial lead-lag study done by UTM. After examination, the Staff determined that several changes were necessary in calculating an accurate CWC requirement. The Staff proposed two negative adjustments to rate base, those being $750,000 for "collection lag" and $1,233,000 for long and short-term interest expense inclusion. UTM has disagreed with those adjustments.

1. Collection lag

Revenue lag in general is defined as the amount of time between the provision of service by the utility and the receipt of payment for that service from the ratepayer. Collection lag specifically, as part of revenue lag, is defined as the period of time between the day the bill is placed in the mail by the utility and the day the Company receives payment from the ratepayer. This lag is determined through use of the above stated lead-lag study. The lead-lag calculation is expressed in number of days, either plus or minus.

The Staff maintains that, in its study, it calculated a composite weighted average for revenue lag based on three separate categories, those being usage, billing, and collection lag. UTM used an accounts receivable turnover method in calculations. UTM found a collection lag of 21.53 days. The Staff found a composite overall collection lag of 18.30 days. This resulted in a proposed deduction from rate base by the Staff of $750,000 as the result of the 3.23 day difference in lag times between UTM and Staff.

It should be noted that the essential difference between the two methods of calculation centers around the fact that UTM used a random sample of all customers for its calculations while the Staff used approximately 500 customer accounts of all types, and adjusted the average by respective percentage of local service revenue (thus the term "weighted" average) to gain its lag figure.

While the Commission notes that both methods are well-explained on the record, the Commission holds that the Staff method, and thus the Staff lag number is, by substantial and competent evidence, the more reliable of the two, since an actual cross-sample, as weighted for percentage of actual revenue, was used for the calculation and not just a random sample. UTM's argument that some classes of ratepayers are under-represented in the Staff samples is not persuasive, as the Staff checked its calculations with past studies and weighted the average obtained, principally for purposes of accuracy.

The Commission, therefore, holds that the Staff proposed reduction of $750,000 from rate base is proper and will be approved.

2. CWC Short-term Interest:

The record indicates that UTM pays interest on its long-term debt on a semi-annual basis. The Staff points out that, from the time UTM collects these funds from ratepayers until the time, semi-annually, it is required to service the debt, the Company has the use of the funds interest free. In layman's terms, this might be referred to as "float."

In addition to the CWC adjustment for lag, the Staff proposed a $1,233,000 reduction from rate base for short-term accrued interest.

The Staff takes the position that, while interest expense is an appropriate element of CWC, the ratepayers are entitled to the cash flow advantage from the delay in payment of interest expense by the Company, since the ratepayer must pay the company's interest expense through rates.

UTM maintains that interest expense is not an operating expense to be recovered from ratepayers. UTM maintains that interest expense should be reflected in the rate of return calculation as a capital cost component. The record indicates that UTM did not disagree with the actual amount of the "float" calculated by the Staff, merely the exclusion from rate base.

It has been pointed out, and the Commission reaffirms, that the Commission has traditionally included an accrued interest reduction from rate base as part of the CWC calculations. No convincing evidence of a substantial and competent nature has been offered to persuade the Commission to abandon this position. In addition, the Commission would distinguish between the determination, for purposes of rate base calculations, of the cost of long-term debt and the actual portion of revenue paid periodically by the ratepayer, in advance, for the service of that debt.

Therefore, the Commission finds that the $1,233,000 adjustment to rate base as proposed by the Staff is appropriate and is approved.

C. Short-Term TPUC

TPUC (telephone plant under construction), also referred to as "cost of work in progress," refers to those funds expended by the Company in the construction of a capital asset.

The Staff has proposed a $914,000 adjustment to rate base removing various costs associated with UTM plant under construction. It is the Staff's position that these costs should not be included for ratemaking purposes because the items included in these costs are not in service during the test year, or during a test year update period. No update of the test year was ordered in this case. The Staff adds that, even though it is alleged that most of the projects involved in this adjustment will be in service by the end of calendar year 1993, the appropriate relationship between costs and revenues will not be maintained. The Staff argues that it is inappropriate to include the cost of work in progress in the rate base but fail to include other major revenue or expense changes occurring after the test year.

UTM argues that the Commission, having recognized the benefits to be gained from aggressively promoting the modernization of telecommunications facilities should, in all fairness, change its policy regarding TPUC. It is UTM's chief contention that the Commission's current policy of allowing capitalization of AFUDC (allowance for funds used during construction) will eventually cost the ratepayers more than simply allowing TPUC in the rate base.

The Commission is not convinced that UTM has presented substantial evidence sufficient to cause the Commission to abruptly change its successful and long-standing policy. The Staff is correct in its position that the current policy of allowing the capitalization of AFUDC on TPUC provides the Company with the opportunity to recover construction related costs while not forcing the ratepayer to pay a return on investment which is not providing service to the ratepayer. In addition, it is the Commission's opinion that AFUDC and TPUC are mutually exclusive. Should the Commission adopt a policy of allowing TPUC in the rate base, AFUDC would then, of necessity, be eliminated.

For the above reasons, the Commission holds that its current policy is reasonable for both UTM and the ratepayer, and will continue. Substantial and competent evidence clearly appears on the record supporting the Staff adjustment and the basis for it. The Commission will, therefore, approve the Staff's proposed adjustment to rate base of $914,000 of TPUC.

D. Deferred Taxes - Alternative Minimum Tax

The Staff has proposed an adjustment to rate base of $252,000, thereby removing the alternative minimum tax (AMT) deferred asset.

The Staff explains in testimony that deferred taxes are created by timing differences between the point in time when an expense or revenue can be recognized in calculating the income tax expense for book purposes and the point in time when the expense or revenue can be used to calculate taxable income. In addition, deferred taxes can also be created by timing differences between recognition of the expense for regulatory purposes and for income tax purposes. The Staff takes the position that, due to the uncertain short-term timing of the alternative minimum tax, the Staff recommends that it not be included in rate base.

UTM maintains that, in accordance with Part 32 of the FCC rules, the alternative minimum tax (AMT) balance, kept by UTM as a running balance of the amount of tax paid in current and prior years, should remain in the rate base. UTM cites its compliance in this regard with FAS 109.

Much has been made by UTM of its compliance with Part 32 (Uniform System of Accounts) in regard to the treatment of the AMT. UTM cites Commission Case No. TC-89-14 (SWBT) as adopting Part 32 for telephone companies. The Commission points out the last two sentences of that portion of the decision, which state:

> "Other local exchange companies (LECs) may seek implementation of Part 32 for ratemaking purposes in future rate cases. The Commission will have to review those decisions individually in the context of each LEC's overall revenue requirement."

In addition, the Company, in its testimony, admits the uncertain nature of the AMT calculation and timing by stating "the Company expects to be subject to the AMT for the foreseeable future. Accordingly, the Company expects the AMT deferred tax asset to remain on the books at current or greater levels." The use of the term "expects," which is, at best, vague, together with a lack of substantial showing as to the accuracy of UTM's calculation of the AMT asset account, leads the Commission to favor the position of the Staff for purposes of ratemaking.

As stated above, the Commission retains the prerogative of reviewing treatment of various accounts, such as the AMT account, for ratemaking purposes. In this case, the Commission finds that, due to the uncertain nature of the AMT asset, and the difficulty in determining the actual timing differences inherent in the accrual and payment of the AMT, the Staff's position is reasonable and in the best interests of the ratepayer, and the asset will be removed from the rate base.

Therefore, the Commission finds that the Staff adjustment of $252,000, removing the alternative minimum tax deferred asset from the rate base, is reasonable and will be approved.

II. Rate of Return

The cost of capital is a weighted average of the costs of short-term debt, long-term debt, preferred stock, and equity capital. The costs of all factors save equity capital are fixed by contractual obligation, and in the case of short-term debt, variably indexed to a benchmark financial measure such as the prime interest rate. Analyses of the cost of equity, based on expert testimony, is generally a question of fact. When taken together, these factors result in the weighted cost of capital. Weighted cost of capital is the necessary ingredient in making a recommendation as to the rate of return to be applied to the Company.

A. Capital Structure.

Inherent in the accurate calculation of the cost of capital is the ratio for the capital structure itself. There is substantial variance in the capital structure proposed by the Staff and UTM. OPC is in agreement with the Staff. Those proposals are:

Staff:

36.52%	common equity
0.21%	preferred stock
58.46%	long-term debt
4.81%	short-term debt

UTM:

50.94%	common equity
0.29%	preferred stock
43.88%	long-term debt
4.89%	short-term debt

Both the Staff and UTM have used a double-leveraged method in their respective capital structure proposals, although the methods vary substantially in detail and application.

The Staff explains, in testimony, that the double leveraged method used by Staff, referred to as the "traditional" method, is designed to recognize Sprint's ability to finance its equity investment in UTM or any subsidiary with a combination of long-term debt, preferred stock, retained earnings, and common stock issuances. The Staff's capital structure proposal is derived by "overlaying" Sprint's parent-only capital structure on the equity portion of UTM's capital, thus implying that UTM has the 36% common equity figure as set out above.

The Staff has pointed out, and there is no denial of this fact on the record, that the cost of equity is higher than the cost of debt. Sprint is a company which is heavily leveraged, i.e., has a large portion of debt in its capital structure, as can be seen by the Staff's imputed long and short term debt ratio of 63.27%. The Staff maintains that its capital structure proposal represents, as closely as possible, the actual cost of capital for UTM.

UTM also uses a double leverage approach, but modifies that approach and refers to it as "normalized" double leverage. UTM maintains that this approach is preferable to the traditional approach because it recognizes the temporary nature of Sprint's heavy debt structure and eliminates the capital structure effects of Sprint Corporation's recent involvement in various acquisitions and enterprises not involving UTM. Apparently UTM is referring to the continuing support of Sprint Long Distance. UTM alleges that, as the various Sprint competitive enterprises become more profitable, the substantial long-term debt now extant will be paid and the equity portion of the capital structure will increase. UTM concludes by stating that the normalized capital structure proposed by UTM is representative of the "normal" capital structure of Sprint when it primarily owned local exchange companies in the past and prior to its long-distance communications ventures. UTM believes that this capital structure will also be representative of Sprint in the future, after absorbing the start-up cost of its long distance venture.

The Commission has, in the past, used a traditional double leverage approach, as offered by the Staff. It is clear that UTM and Sprint are partially attempting to maximize the value of UTM by using a method for the calculation of capital structure which includes as much equity, at greater cost, and as little debt, at lower cost, as possible - this in spite of the fact that Sprint is a heavily leveraged (heavy debt) company by regulated utility standards. In this case UTM went back to the corporate structure of several years ago, i.e., to "normalize," in an attempt to impute a capital structure on Sprint, and therefore UTM, as if the Company had made no acquisitions and was involved in no competitive ventures, but was still only a holding company for LECs. This was referred to by OPC as "back-to-the-future" ratemaking.

The decisive point in a rather lengthy and detailed series of testimony, however, is the fact, as stated by the Staff witness and not disputed by UTM, that the Staff's capital structure proposal will more clearly represent the actual current cost of capital of UTM. By contrast, it is also clear from the record that the calculations finally arrived at by the UTM witness were relatively unsupported by the evidence and based largely on theory, not reality.

The Commission finds that the traditional double leverage method has, over time, been one of proven accuracy, and has been consistently adopted by the Commission as the most reliable method of obtaining the correct cost of capital. Alternatively, in final analysis, the method proposed by UTM would force the ratepayers to pay rates based on a theoretical cost of capital more expensive than that actually incurred by UTM. The Commission, therefore, adopts the Staff proposal in regard to capital structure.

B. Return on Equity

The rate of return on common equity, necessary in the calculation of the overall rate of return, must accurately reflect an investor's required return on common equity sufficient to allow a company to be able to publicly trade its stock in the marketplace and thereby be able to raise sufficient equity capital.

In calculating the proper return on equity, the Staff presented the continuous growth form of the discounted cash flow model. Testimony indicates that this model is a market-based approach relying on the assumption that common stock prices are dependent upon expected cash flows and dividends received through gains or losses resulting from stock price fluctuations. This rate, which discounts the sum of the future expected cash flow to the current market price of the common stock, is the cost of equity. This is rendered in the Staff testimony as an algebraic formula. This formula is also adjusted to reflect the comparative risk involved in potential equity investment in the Company.

UTM also used the discounted cash flow model modified by use of another method, the risk premium model. Both models are forward-looking and market based.

The OPC also used the continuous growth DCF model, but obtained a slightly different outcome than the Staff.

UTM recommended a return on equity of 13.66% based on its use of the DCF model and risk premium analysis of a group of six market-traded companies comparable in risk to UTM, normalized, with imputed parent leverage.

The Staff recommended a mid-range return on equity of 12.00% with a range from 11.70 to 12.30%. In its analysis, Staff used the continuous growth DCF model and then performed a risk premium analysis and market-to-book value ratio analysis to check and validate the recommended prescribed return level. As a final test of reasonableness, the Staff also performed a pro-forma ratio analysis.

In considering the cost of equity, the Commission's decision regarding the modernization proposal of UTM should be noted. The Commission has allowed UTM to concurrently recover in rates certain modernization expenditures. This creates substantially less inherent risk for equity investment than would otherwise be the case.

The Commission will adopt the analysis and resultant cost of equity range as proposed by the Staff for the following reasons.

After review of the testimony of both the witnesses for the Staff and for UTM in regard to the details of the analytical methods used, the Commission finds the Staff analysis to be thorough, complete, accurately based on the current economic conditions and reasonably based on forward-looking market projections.

It has been the experience of the Commission over a substantial period of time that the continuous growth DCF model, as employed by the Staff, taken together with the various reasonableness and accuracy checks performed, has proven to be substantially more reliable than any other method or combination of methods presented in testimony. To accept the position of UTM, the Commission would need unimpeachable evidence that the proposed alternative method was more reliable, accurate, and far superior to the one used by Staff in this case. The testimony offered by UTM in this regard, which was at certain points substantially impeached on cross-examination, was not persuasive in the least. UTM failed to show, in its model, substantial reliability in its market-based assumptions used as a basis for the calculation of risk factors and growth potential. The accuracy of these two factors, and the assumptions upon which they are based, are critical elements in the calculation of the cost of equity. UTM was far from persuasive in its presentation of its proposal.

In short, UTM has failed to show, by substantial and competent standards, that its proposed method of calculating the cost of equity is as accurate, much less superior to, the Staff proposal.

Finally, as the risk inherent in the ordered modernization program has been largely removed as the result of the Commission decision in that regard, infra, the low range of the Staff proposal will be adopted as opposed to the mid-range figure.

Therefore, for the above reasons, the Staff proposal for determining the return on equity, and as the result of the modernization decision, the low-range figure of 11.70% for that return on equity, is approved.

C. Cost of Debt

An issue was presented by UTM in regard to the calculation of the cost of debt as it related to the call premiums and unamortized debt expense for one series of bonds, that being Series W. The Staff did not add these embedded costs in its calculations for the reason that UTM's balance sheet, according to Staff testimony, as of March 31, 1993, did not include an account which carried the balance of the call premiums and unamortized debt expense associated not only with Series W, but also with Series N and Series T. Testimony indicates, and the balance sheet accounts affirm, that all three series were refinanced and are correctly no longer part of UTM's books. The Staff included in its cost of debt calculation the costs associated with refinancing Series N and T, but not Series W.

UTM takes the position that the costs of all three series should be treated the same, and that the Series W costs should be included in the cost of debt calculation.

The Staff maintains that the Series N and T bonds were refinanced within the test period and, therefore, the associated costs were written off as legitimate expenses. The Staff normalized these items in its embedded cost of long-term debt calculations. The Series W bonds were redeemed prior to the test year, and the costs associated with that redemption have already been recovered by UTM prior to the test year.

The Commission holds that the Staff's position is reasonable, and that substantial and competent evidence exists to adopt that position. The Staff was correct in its disparate treatment of Series N and T and the Series W bonds as the expenses for the Series W bonds, refinanced prior to the test year, were already recovered by UTM. In addition, the inclusion of these annualized expenses associated with call premiums and unamortized debt expense for the Series W bond, which was called prior to the test year and not included on UTM's financial statement, could constitute a form of inappropriate retroactive ratemaking.

For the above reasons, the Commission adopts the Staff's proposed treatment of the embedded cost of long-term debt, and approves the Staff rate of 8.70% using the Staff calculations for cost of long-term debt, therefore, the overall weighted average is 5.41%.

D. Rate of Return

Using the capital structure, cost of equity, cost of debt, and the cost of service ratemaking method used by the Staff to develop a rate of return, the rate of return calculation made by the Staff presents a range of 9.70 to 9.91%. The Commission finds this rate of return to be reasonable and adequate to allow UTM the opportunity to earn the appropriate revenue and will approve the 9.70% rate for use in this case.

III. Revenue Items

A. Access Revenue - Linn to Jefferson City

As quoted in the Staff testimony, UTM, in response to a data request, stated that this one-time payment to Southwestern Bell Telephone Company was to purchase transport ownership from the Osage River to Jefferson City. The transaction represented a compromise between the two companies for a cost-effective method of upgrading carrier facilities owned by SWBT from the Linn exchange to Jefferson City. UTM purchased the right to a portion of all future transport revenues and a reduction in access expenses generated over the route.

The Staff has proposed removing $107,600 from the revenue requirement, based on the fact that the charge was non-recurring and not within the test year, the expense is non-recurring, and the payment was tendered in November, 1991, preceding the 1992 test year.

UTM agrees that the one-time payment was actually made in 1991. UTM maintains, however, that it did not purchase an asset, but rather a right to transport ownership over the route and has properly treated that right as an intangible asset, booking it as a contra-revenue. UTM states that the cost is properly amortized as a contra-revenue over the expected economic life of the intangible asset. The amortization will continue to 1995, at which time SWBT's obligation to use these facilities will expire.

UTM concludes that, if the expense is removed, then the accompanying incremental revenue and cost savings gained from the transaction should also be removed.

In this unique instance, the Commission holds that the proposed adjustment by the Staff is inappropriate. While the Commission has no intention of abandoning the historic test year concepts as they apply to one-time, non-recurring payments, the arguments presented by UTM hold merit. Although all agree that this is a one-time payment and was actually made prior to the test year, the Commission finds that, due to the fact that the payment can reasonably be considered made for an intangible asset with incremental revenues, the amount is correctly booked by UTM.

B. Toll Revenues

UTM is contesting the Staff's annualization of various toll revenues, including inward and outward WATS revenues and long distance private line toll revenues. Three adjustments, totalling $87,000 were made by the Staff based on the same single issue, that being the appropriate method of annualizing these revenues for test year purposes.

It is the position of UTM that the most appropriate and accurate means of calculating ongoing revenue such as the inward and outward WATS and long distance private network revenues is to multiply December 1992 revenues by twelve.

The Staff maintains that the annualized toll revenues as computed by UTM are not accurately reflective of ongoing levels. The Staff points out that UTM's calculations reflect a decrease in overall toll revenues below the 1992 test year level. The Staff states that this is caused by UTM's selection of specific isolated categories where revenues actually decreased to measure the overall revenue level. The Staff claims that the overall toll revenues have, in fact, increased from 1991 to the present with the exception of only two months. After a month-by-month analysis, the Staff found that there was a growth trend in overall toll revenues. The Staff concludes that the growth in toll revenues clearly demonstrates that UTM's proposed decreases to test year toll revenue should be disallowed.

The Commission notes that the Staff testimony is undisputed in regard to the fact that, in the year ending June 30, 1993, actual toll revenues were almost $1 million higher than either UTM's or the Staff's test year proposals. This clearly indicates that toll revenues have shown an overall increase, as alleged by the Staff. The Staff's total adjustment to revenue requirement is $87,000 and is calculated to offset UTM's selective adjustments in toll revenues. The Staff's method of calculation, using total unadjusted test year toll revenues is, in the opinion of the Commission, more accurate and effective than the UTM method, and reflects more reliable results in total toll revenue trends.

Therefore, for the above reasons, the Commission will approve the adjustments to revenue requirement, as proposed by Staff, totalling $87,000 and comprised of the toll-outward, toll-inward, and toll-p/l network entries on the reconciliation.

C. Miscellaneous Revenue

This issue arose as the result of the Staff's inclusion in annualized revenues of a one-time charge by UTM to an interexchange carrier, booked as a billing and collection program development charge. This charge was in the amount of $99,303.

UTM maintains that the revenue generated is a one-time charge and its inclusion in annualized revenue is not supported by historical trends or budgets.

The Staff restates its position regarding the overall increase in toll revenues and, therefore, believes that the $99,303 should be removed from the revenue requirement.

The Commission holds that, whereas in the previous issue the Staff was attempting to ascertain annualized revenue by using the total overall trend of toll revenues, this billing and collection charge must be distinguished on the grounds that it is simply a one-time, non-recurring charge which may have been inappropriately booked by UTM. As no support for this charge being other than a one-time occurrence can be found in either historic trends or budgets, the Staff adjustment of $99,303 will be disallowed.

D. Revenue Conversion Factor

The revenue conversion factor is a mechanism by which income can be converted to a revenue requirement by factoring in the effects of income tax. The result of the application of this factor is a calculation showing how much revenue it takes to generate $1.00 in net income. UTM's calculation shows a factor of $1.5751 to generate $1.00 of net income. The Staff's revenue conversion factor is somewhat lower, causing Staff to recommend a reduction in revenue requirement of $30,000. Both parties agree to the use of federal and state income taxes as part of the conversion factor. UTM, however, takes the position that uncollectibles should also be included, thus the $30,000 difference.

It is the position of the Staff that application of the revenue conversion factor to uncollectibles will have the effect of raising the level of uncollectibles in conjunction with an increase in revenues. The Staff, however, states that, unlike income taxes, there is no direct correlation between a net income increase and the level of uncollectibles. The Staff concludes that UTM incorrectly maintains that an increase in revenue will cause a proportionate increase in uncollectibles.

The Commission agrees with the Staff position. The purpose of the revenue conversion factor is to insure an appropriate amount of revenue is authorized to generate the necessary net income, after taxes. There is a direct correlation between income tax expense and revenue requirement levels. The Commission fails to see this direct correlation between revenue requirement and collectibles. The correlation, if any, is remote and speculative. Inclusion of collectibles in the revenue conversion factor is clearly inappropriate. The adjustment of $30,000 in the revenue conversion factor, as proposed by the Staff, is approved.

E. Sprint Publishing ("Yellow Pages")

Sprint Publishing, as part of the Sprint corporate family, is responsible for the publishing, marketing, manufacturing, and distribution of telephone directories, including the UTM directory. The UTM directory contains white and yellow page sections, and is generally published in the same market served by UTM. The distribution of directories is made to all, or nearly all, business and residential customers free of charge. Principally because of the business listings and universal distribution, yellow page directories are an attractive advertising medium and generate considerable revenue through the sales of yellow page advertising.

Sprint Publishing began to publish UTM's directory in 1986. Prior to that time, UTM contracted with a private company, L. M. Berry, for publication of the directory.

The Staff has made two adjustments; one addition to rate base of $1,941,000, which represents the amount of deferred costs relating to directories in process, published directories, and other prepaid directory costs for the test year 1992, and one addition to revenue, in the amount of $1,157,000, which represents the additional profit the Staff maintains should have been imputed to UTM from Sprint.

It is the Staff's position that these adjustments were made to reflect a contribution (from Sprint to UTM) which accurately represented the contribution level (profit) made to UTM from L. M. Berry prior to the purchase of UTM by Sprint. As all numbers relating to directory revenues are proprietary or highly confidential, none will appear in this order. However, the Staff testimony indicates that, while net revenues to Sprint as a result of the in-house publication of the directory have increased substantially from 1985 to 1992, the percentage of contribution to UTM has decreased and is now approximately 1/2 of the 1984 percentage level. The OPC also supports the adjustments made by the Staff.

UTM states that Sprint has maintained a contribution level consistent with the compensation formula that was established between Sprint and UTM in 1985. UTM maintains that, because of increased costs, competition, and resultant substantial improvements in the quality and features contained in the current directory, the contribution level made to UTM is reasonable and should be maintained. UTM takes the position that the current contribution level is a reasonable reflection of the market conditions in Missouri at this time.

After a thorough review of the testimony in this matter, the Commission finds the following. It is clear from the record that the business arrangement, initiated by Sprint, in placing the directory publication in-house is simply a wise and profitable business decision from the standpoint of an unregulated competitive corporation. This makes additional business sense in light of the fact that UTM is a regulated LEC. The desire of Sprint to obtain and shield as much revenue as possible from its regulated subsidiary is understandable.

It is the position of the Commission, however, that balance must be maintained from the perspective of not only the shareholder, but from that of the ratepayer. The Commission has long maintained that a standard of reasonableness applies to this type of contractual arrangement and that it is clearly inappropriate for the ratepayers to be forced to, in effect, subsidize a separate competitive enterprise through regulated rates and not obtain an appropriate benefit from payment of those rates. It is undeniable that the percentage of net revenue paid to UTM by Sprint has substantially declined since the execution of the contractual arrangement with Sprint. It is equally undeniable that this contractual arrangement was not an arms-length transaction, but one designed by the parent corporation to obtain the maximum benefit from a subsidiary. UTM has offered little, if any, evidence regarding the nature and disposition of the expenses attributed to the cost of publication of the UTM directories. The Commission is unable to ascertain the appropriateness of the costs of publication alleged by UTM without substantial and competent evidence in that regard. To simply testify that costs went up is patently insufficient.

The Commission has reviewed the evidence presented by UTM in regard to the nature and various amounts attributable to Sprint's increased cost of publication of the directory and finds no substantial evidence justifying the extreme decline in percentage of net revenue suffered by UTM.

Again, while the Commission does not find there was any wrongdoing on the part of Sprint in conceiving this arrangement, the Commission holds that, due to the nature of the contract and the resulting substantial and unaccounted for decline in percentage of net revenue to UTM, the contract is imprudent from the standpoint of UTM, taken separately from Sprint, and from the standpoint of the ratepayers, who are being asked to subsidize a separate competitive venture without adequate benefit or compensation.

The Commission holds that, for ratemaking purposes, the rate base and revenues will be adjusted, per the Staff's proposal. The amount of adjustment to rate base is substantiated on the record. The adjustment to revenues in the amount of $1,157,000 appears slightly low, particularly in conjunction with the effect of the offsetting amount added to rate base. This results in a net percentage profit to UTM several percentage points lower than that which the Commission would deem wholly adequate. However, with due regard to the expert testimony of the Staff witnesses on the record, the Commission will approve the imputed revenue amount offered by the Staff of $1,157,000.

IV. Expense Items

A. Interest Synchronization

Interest synchronization is the method whereby the interest charged to the ratepayers is matched, or "synchronized," with the interest used in the income tax calculation. This calculation is made routinely by the Staff in rate cases and adoption of an interest synchronization adjustment has long been the policy of the Commission.

UTM does not object to an interest synchronization adjustment, but wishes to use its proffered "normalized" double leverage capital structure for that calculation rather than the "traditional" double leverage approach used by the Staff.

As both of these methods of determining capital structure have been thoroughly discussed previously in this decision, no lengthy discussion is necessary here. The Commission holds that, as the Staff's capital structure has been adopted in this rate case, the interest synchronization adjustment proposed by the Staff will necessarily follow. Therefore, the Staff interest synchronization adjustment is approved.

B. Other Post-Retirement Employee Benefits (OPEBs)

OPEBs refer to certain benefits paid to retired employees that are non-pension related, primarily medical benefits. Almost all major utilities incur OPEB expense to some degree. Costs, if prudently incurred, have been generally granted rate recovery in Missouri and other states. Traditionally, such costs have been treated on a pay-as-you-go basis, both for financial reporting and ratemaking purposes. Currently, OPEB expense is booked at the time the utility pays out cash for these benefits to its retired employees.

In 1990, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standard No. 106 (FAS 106) concerning the accounting treatment and financial reporting of OPEB costs. FAS 106 states that the accrual method of accounting should be used for OPEB costs for financial reporting purposes for most entities, beginning January 1, 1993. In addition, and in supplementation of FAS 106, the emerging issues task force of the FASB created several standards interpreting FAS 106 and providing for its implementation. These standards, among other matters not relevant here, set out the appropriate amortization periods and provided that a transitional benefit obligation (TBO) would be incurred in converting from pay-as-you-go accounting to the accrual method. Simply put, this TBO is comprised of catch-up accrual costs for all current employees.

Initiation and use of the accrual method of accounting for OPEBs will cause utilities to estimate and charge to expense OPEBs earned by employees at the time they are "accrued," not at the time they are paid out. The FASB views post-retirement benefits as deferred compensation for current services rendered and believes that the obligation for that compensation is incurred as employees render the necessary service. Moving to the accrual method of accounting for

OPEBs will sharply increase the expense charged on the financial statement for most utilities. In this case, UTM is requesting an annual accrual for OPEB requirements including:

\$ 468,000	-- service cost
\$ 2,071,000	-- interest cost
\$ 1,334,000	-- TBO
\$ 3,873,000	annual accrual

The Staff has included the 1992 "pay-as-you-go" amount in the reconciliation, adjusting the reconciliation to deduct \$1,773,000 from expense, representing the accrual amount.

It is UTM's position, as supported by intervenors SWBT and GTE, that all FASB pronouncements are considered part of the generally accepted accounting principles (GAAP) currently in use by both the regulated utilities and the Commission. UTM is of the opinion that the Commission is obliged to accept FAS 106 as part and parcel of the GAAP standards. UTM proposes, as set out above and suggested by the EITF, a 20-year phase-in of prior costs, (TBO), and a full recovery of current costs.

UTM maintains that the use of GAAP standards are required by the Securities and Exchange Commission in conjunction with the external auditing of investor-owned companies. UTM states that failure to receive a "clean" external audit can result in a lowering of the companies' financial rating and, therefore, a loss of ability to raise both equity and debt capital.

In addition, UTM argues that accrual accounting for OPEBs properly matches the cost of providing service with the revenues received for that service. This is commonly referred to when discussing OPEB issues as "intergenerational equity." UTM feels this will match the "cost causer with the cost payer." In addition, as the result of the rising cost of medical care, UTM maintains that the accrual method will avoid extraordinary costs to ratepayers at some time in the future, when those costs are actually incurred. Finally, UTM states that, to avoid inaccurate estimates as the result of the inherent uncertainty regarding actuarial assessments, the accrual amount for OPEBs will be adjusted annually.

The Staff and OPC are opposed to any form of accrual accounting for OPEBs. The Staff takes the position that the Commission should maintain pay-as-you-go accounting for the expense level of non-pension benefits included in the revenue requirement determination. The Staff has a number of arguments supporting its position.

The Staff disagrees with UTM in its contention that the accrued amount under FAS 106 is known and measurable. The Staff points out that the ability to make an actuarial calculation for OPEBs does not make them known and measurable for ratemaking purposes. The Staff sets out in detail in its testimony its support for this proposition. The Staff states that the actuarial calculations themselves may be correctly done, but the costs and expenses are incapable of being measured. Assumptions must be made to make these actuarial calculations. The Staff points out that the assumptions necessary for the calculations may be grossly in error or not capable of being even remotely measurable.

After an in-depth review of the issues and testimony surrounding the proposed adoption of FAS 106, the Commission reaffirms its current position. For ratemaking purposes, the pay-as-you-go method will continue to be used for OPEBs, for the following reasons.

A brief review of the background regarding post-retirement type benefits, elicited from the witness stand, might be useful in understanding the Commission's position in this matter. Originally, and as an effort to obtain favorable tax treatment, benefits of this type were paid directly to employees. After various changes in the tax structure, it became more beneficial for both the employer and the employee for the company to furnish these benefits, which are mostly medical, to its employees. Finally, as the result of action by the FAS Board, which is associated with, but not a direct agency of the Securities Exchange Commission, an attempt is being made to force employers to account for accrued, rather than pay-as-you-go, OPEB benefits. It might be noted that the FAS Board does not act with the force of law, either at a federal or state level.

The Commission learned through testimony that, should the Commission fail to adopt the accrual method for OPEBs, it is the Company's present intent to "probably" write off the costs. Testimony was clear in regard to the fact that, beginning January 1, 1993, numerous investor-owned, non-regulated companies have simply written off the TBO costs to remain competitive. It was pointed out that this Commission serves as a surrogate for competition for the regulated monopolies in Missouri. The Commission can find no justification for forcing the local ratepayer, who is unable to choose an alternate source and has basically an inelastic demand, to pay the substantial increase in cost when, in the competitive market, the consumer has not been forced to do the same in many instances.

The Public Service Commission has been charged with the responsibility of regulating the various investor-owned utilities to achieve fairness and balance between the interests of the ratepayers and shareholders and to insure that safe, economical and efficient utility service is provided to the public. Inherent in that responsibility is the obligation to set rates at levels that reflect the cost of service and duly compensate the shareholders for their investment, but protect the ratepayer from the abuses of the natural monopoly. The Commission believes that allowing the FAS Board to dictate such a profound effect in rates, and in the balance maintained by the Commission between the ratepayer and the utility through the ratemaking process, without the benefit of the due process normally accorded both the company and the ratepayer in Missouri would usurp the powers and duties of the Commission and violate the clear mandate of the people of the state in giving this Commission its responsibility. The FAS Board is neither elected by nor representative of any constituency. It is the opinion of this Commission that, to allow such a body to simply dictate a rate outcome so far-reaching and expensive to the citizens of Missouri, could well be characterized as an abrogation by the Commission of the public trust placed in it. This is wholly unacceptable to this Commission.

It was pointed out on the record that Congress is currently considering a National Health Care Plan, which, if enacted, will most certainly have a profound effect on OPEBs. The Commission feels that an expensive and abrupt change in the method of accounting for OPEBs at this time is substantially premature considering the uncertainties created by the anticipated legislative proposal. Adoption of FAS 106 at this time will raise ratepayer costs but may, in the near future, all go for naught depending upon the type of National Health Care Plan enacted. While this accounting procedure may be adopted at any time in the future, substantially reversing the adoption of FAS 106 in the face of a conflicting federally mandated health care plan will be difficult, if not impossible, for this Commission to do without substantial cost having already been incurred by the ratepayer. The Commission acknowledges the difficulty UTM is apparently having with this matter; however, UTM must seek relief from accounting regulation rather than from the ratepayers at this time.

Evidence was offered in regard to the exact wording of the FAS 106 standard at various points in this litigation. The Commission is of the opinion that the salient fact in the FAS 106 text is that nowhere does the FAS Board refer to OPEB benefits as being vested in or owned by the employee, but consistently uses the term "accrued." In this regard, OPEBs can clearly be distinguished from pension and other related benefits in that employees typically have a vested interest, or "own," those benefits when earned. This is not the case with OPEBs. OPEBs may be altered or completely eliminated by the Company at any time, as was admitted in testimony by UTM. As will be discussed in the next section, there is a statutory requirement that pension plans be adequately funded, also giving employees certain legal rights in the administration of those funds. Again, this is clearly not the case with a discretionary benefit such as post-retirement medical benefits. The Commission, therefore, feels it is inappropriate to prematurely force the ratepayers to sponsor anticipated future costs for an employee benefit which can be substantially altered or even eliminated unilaterally by the Company at any time in the future. Until actual payment or transfer is made, these accrued costs should be shouldered by the Company and its stockholders, who have control over these benefits.

The Commission elicited testimony on the stand in regard to the possible effect of Commission action disapproving the accrual method for FAS 106. UTM raised the specter of possible damage to its financial rating as the result of regulatory incongruence with the FAS ruling. On the stand, however, when asked the question as to possible effect on the Company's rating should the Commission not adopt FAS 106, the frank answer of the Company witness was "I don't know." This leads the Commission to the conclusion that actual evidence is lacking as to the alleged profound financial effect on the Company as the result of disapproval of FAS 106.

The Commission has addressed the issue of OPEBs in five previous cases, those being: Case No. EO-92-179, *In re: Union Electric*, Case No. EO-93-35, *In re: Empire District Electric Company*, Case No. GO-93-201, *In re: Western Resources*, Case No. ER-93-37, *In re: Missouri Public Service*, and Case No. ER-93-41, *In re: St. Joseph Light and Power Company*.

In Case No. ER-93-41, the Commission made a clear distinction between granting an accounting authority order to book OPEB costs in Account #186, and the proposal submitted by Western Resources Incorporated (WRI), and approved by the Commission, to fund OPEB costs on an accrual basis by the use of external funding. In the cases in which no external funding was proposed, the Commission stated its intent to allow prudently incurred OPEB costs in rates in the future, and reserved such treatment for future rate cases. Absent an external funding source, however, the Commission, in the St. Joseph Light and Power case, supra, held:

> "The Commission finds that the cash basis accounting method is the appropriate method to determine OPEB expense for ratemaking purposes. In addition, the Commission will authorize SJLPC to continue to use the pay-as-you-go method for calculating the amounts charged to post-retirement benefits expenses other than pensions on its financial statements, based on actual payments to retirees. The difference between the expense amount calculated under FAS 106 and the pay-as-you-amount shall be booked to the Uniform System of Accounts No. 186, Miscellaneous Deferred Debt, as a regulatory asset."

Finally, the Commission would note its finding in Case No. GO-93-201, *In the matter of Western Resources' Application for an Accounting Authority Order*, issued March 30, 1993, in which the applicant proposed to use an external funding source to offset the OPEB expense resulting from FAS 106. The Commission states:

> "The Commission finds the WRI Plan and Staff's recommendation to be a reasonable and acceptable approach in dealing with the implementation of FAS 106 and the accompanying EITF pronouncements." . . . .
>
> "The Commission finds the WRI proposal to use its COLI program as an offset to the sharp increase in PBOP expense as a result of FAS 106, to be a reasonable and prudent mechanism for the avoidance of substantial detrimental impact for both the ratepayer and shareholder alike."

For the above reasons, the commission declines to adopt FAS 106 and the accrual method of accounting for OPEBs, and will approve the $1,773,000 adjustment proposed by Staff.

C. Pension Expense (FAS 87)

FAS 87 is an accounting methodology which recognizes current pension expense for financial reporting purposes. FAS 87 is an accounting standard which requires actuarial assumptions to be made in regard to projecting pension benefits earned by current employees (as explained in the previous section). This projected contribution is referred to as the projected benefit obligation (PBO).

Currently, the UTM plan is overfunded. As the result of altering actuarial assumptions, UTM takes the position that the Company contribution to the plan should be returned to the ratepayers as a credit to expense at this time and debit when the plan eventually needs funding.

The Staff disagrees and maintains that the federal law governing the establishment and funding of pension plans (ERISA) requires pension funds to be "adequately" funded. Since the UTM plan is currently overfunded, the Staff maintains that the correct and adequate amount of contribution required is zero.

The Commission has not previously adopted FAS 87 for ratemaking purposes for the reason, as pointed out by Staff, that adequate funding of pensions is governed by federal law. The Commission feels no obligation, nor has evidence been presented to convince the Commission to allow ratepayer sponsored funding over and above the federal requirements. In addition, the Commission would refer to the previous section in regard to its opinion and findings on accrual accounting and the lack of reliability and accuracy of anticipated costs.

For the above reasons, the Staff's adjustments regarding FAS 87, those being 1) a prepaid pension asset deduction from rate base of $4,879,000, 2) a deferred tax on pension credit to rate base of $1,954,000, and 3) a credit to expenses of $1,239,000, will be approved.

D. Generic Software

This issue involves the capitalization of certain software, purchased by UTM for a digital switch, referred to as the "Clinton Switch." Testimony indicates that software used in this type of switch is of two types, those being operating software and application software. Operating software is typically capitalized and depreciated, appearing as part of the rate base calculation. In this case, UTM, following what it maintains is proper accounting procedure, charged $187,000 as expenses for the application part of the software for the Clinton Switch. Operating software can be characterized as software which controls the computers' main processors. The DOS system is a common and typical example of operating software. Application software is software which allows the user to perform specific tasks with the computer. WordPerfect is a typical example of application software.

UTM maintains that it is following specific accounting guidelines in expensing the application portion of its software. UTM placed RAO letter #7, dated July 1, 1987, in evidence, citing this as authority for its treatment of the software. In addition, UTM maintains that application software is not appropriate for depreciation, and therefore, rate base treatment, since it becomes obsolete very rapidly and unpredictably. UTM adds that the current depreciation schedule for its operating software is 11 1/2 years. UTM states that the life of application software is considerably shorter than that.

The Staff maintains that UTM should capitalize the cost of first-time purchases of application software. The Staff states that, as a result of the expense and necessity of purchasing this software from the manufacturer of the switch, it is in the nature of a capital expenditure.

The Commission finds that UTM's treatment of the application software as an expense is appropriate in this case. RAO letter #7 gives the Company the option of accounting for application software at its discretion, so is nondeterminative of this issue. However, the operating and application software can be distinguished from one another. It is clear that UTM purchased the application software for the Clinton Switch in a form tailored to meet specific needs. In addition, evidence exists as to the generally short life-span of such software. Therefore, in this unique instance, the application software for the Clinton Switch is not in the nature of a capital investment and was appropriately expensed by UTM. For the above reasons, the Commission will disapprove the Staff adjustments regarding generic software.

V. Local Network Modernization

A. The Modernization Plan

The Commission has chosen to consolidate Case No. TO-93-309 with the rate case filing by UTM. A docket was opened in Case No. TO-93-309 as the result of the filing of UTM's modernization plan for Commission approval, as required by Rule 4 CSR 240-32.100, the complete text of which is attached to this Report and Order as Attachment B.

UTM's modernization plan, called "Teleprogress," proposes to upgrade UTM's plant to comply with the Commission's standards of basic local and interexchange telephone service in accordance with Rule 32.100. "Teleprogress," as proposed by UTM, is a seven year plan to provide the UTM service area with electronic switching, custom calling features, modern touch-tone service, equal access, and enhanced 911 service. The program will also provide one-party service for all customers and complete digital interexchange facilities.

The Staff recommends the implementation of the seven year plan with two reservations. UTM proposes the complete replacement of its analog loop carrier. UTM also proposes the replacement of three digital switches, Ft. Wood, Kearney, and Oak Grove, which UTM maintains are obsolete or require service which is increasingly unavailable and expensive. The Staff is of the opinion that these two proposals are unnecessary and not required by the rule, and therefore, the costs incurred in these two projects should not be included as modernization costs. The OPC takes a position in regard to the modernization plan similar to that of the Staff.

In conjunction with the seven year plan, UTM is requesting a two year, (Phase I), incremental revenue requirement over the costs currently incurred in its present method of operation, (PMO costs), to be reflected in rates. Classification of these costs as either modernization or PMO costs is the subject of substantial debate between the parties.

In its testimony, the Staff has proposed that the modernization costs, if not approved in advance by the Commission, should be considered in standard accounting authority proceedings, as needed by UTM, to properly book the costs, and then be taken up in the next rate proceeding to determine prudence of expenditures and amount of recovery in rates. An additional fact which must be considered is the clear intent of UTM to return to the Commission in two years for another rate proceeding. This is also apparently considered in the two-year phases contained in the modernization plan. The plan seems to anticipate a rate proceeding every two years for appropriate cost adjustments and/or recovery through rates.

The Commission, based on the recommendation of the Staff, testimony of UTM, and evidence presented in this case, will approve the UTM seven year modernization plan and find it in compliance with Rule 4 CSR 240-32.100. The Commission expresses substantial concern over the general state and condition of the UTM system in Missouri. This concern is supported by testimony taken at the four local public hearings. Most noticeable is the existence of well over 4000 party lines in the UTM system, located in all but two exchanges. The Commission will therefore order UTM to complete Phase I of its suggested plan as set out in Schedule 1 of the direct testimony of Catherine Jones, and incorporated herein as Exhibit 4 as if fully set out, within the specified two year period. Further, the Commission will order UTM to report the completion of each specified item listed as a Phase One project in Exhibit 4 and will cause Docket No. TO-93-309 to remain open for consideration of those reports.

In addition, the Commission will direct that, within the specified seven year time period, that the remaining two phases of the proposed modernization plan be completed by UTM. Phase Two and Phase Three of the proposed plan are set out in the direct testimony of UTM witness Richard G. Pfiefer and in the schedules attached to that testimony.

The Commission is aware that UTM considers some portions of the complete seven year plan to be "uneconomical." For this reason, and as a result of the Commission's concern not only for the state of the UTM system, but also for UTM's actual commitment to the prompt completion of this project, the Commission will return the $1,118,000 plant growth entry, deleted by the Staff, to the revenue requirement. The Commission expects the entire three-phase modernization plan to be completed promptly as proposed by UTM.

The remaining three deductions from the revenue requirement proposed by the Staff are approved by the Commission.

The Commission will not approve any further proposed increases to revenue requirement for implementation of the plan in this case. UTM is advised to file separate and timely requests for accounting authority orders to account for any capital expenditures UTM feels should be included as part of the modernization plan which have not been considered by the Commission in this decision. UTM is also advised that the PMO attribution of the costs of modernization may be taken up in future rate cases, subsequent to the item being placed in service.

VI. Miscellaneous Issues

A. Depreciation

OPC seeks an expense adjustment based on the belief that, under the current depreciation schedules, UTM will be overdepreciating three accounts, those being analog pair gain, digital switching equipment, and digital switching AMR.

UTM and the Staff take similar positions on this issue. They state that the depreciation rates included in this case are the currently approved rates as set out in Telephone Authority Order No. 984 (TAO 984), made on December 4, 1992, effective for depreciation rates beginning January 1, 1993. As the Commission adopted TAO 984 with the proviso that nothing in the order would be considered a finding as to the impact of the adopted rates for ratemaking purposes, the Staff and UTM are asking the Commission to approve TAO 984 in this case for ratemaking.

OPC has selected three schedules for equipment depreciation from a host of various schedules, all of which were carefully studied and approved by the Commission as a package. UTM is correct in pointing out that its composite basic service life and recovery rate are both lower than the industry average. To select individual items from TAO 984 for different treatment would upset the balance inherent in the overall schedule. The Commission agrees with the Staff, and UTM and will adopt the depreciation rates in total as set out in TAO 984 for ratemaking purposes. The rates are appended to this order as Attachment A and incorporated herein by reference.

B. Allocations from Sprint United Management Company (SUMC)

OPC proposes to deduct $836,000 from the revenue requirement which it maintains is a one-time expense for the customer access support and new billing system improperly allowed in the test year. The Staff and UTM take the position that, since the costs incurred in the development of the above access and billing systems do not represent a normal level of annual expense, the Staff has adjusted the costs to reflect an annualized expense. The Staff maintains that the cost included in the test year reflects annualized ongoing levels of expense based on historical data from a 29-month period in 1991, 1992, and 1993. The Staff reduced the amount of expense for these items booked during the test year by UTM in the amount of approximately $335,000, representing what the Staff maintains is the annualized ongoing expense.

The OPC takes the position that the costs are for items which are not yet in-service and are not used and useful to the ratepayer. Alternatively OPC argues that, even if the costs are accurate, there is no offset included in the Staff's calculations for the cost benefit of the systems in providing service.

The Commission finds substantial and competent evidence that the Staff's calculations of the annualized cost of the access and billing systems are accurate. Clearly, these costs are known and measurable to a reasonable degree. In fact, the Staff based its adjustment on actual historic expenditures rather than the budgeted amounts used by UTM.

In regard to OPC's argument that the systems are not in-service, and therefore not used and useful to the ratepayer, the Commission finds no evidence on the record that these are capital expenditures. The costs are clearly part of the cost of doing business and are properly expensed.

The question remains as to the inclusion in the test year adjustments of any offsetting revenue benefit from the expenditure of these funds on the development of the new systems, and if such a benefit calculation is necessary.

The Commission, after due consideration of the position of the OPC in this matter, finds that Staff's position is correct in adjusting the test year for the annualized expense of these systems. As this is a non-capital expenditure, the commission considers it appropriate to consider the expense as an ongoing cost of doing business and, therefore, does not find that the policy regarding used and useful should apply. Finally, the Commission can find no evidence that any benefit from the ongoing development of these systems has yet occurred and, therefore, cannot require the inclusion of benefit costs.

For the above reasons, the Staff's original adjustment to the test year is correct and will be approved.

C. United Telephone Long Distance Royalty Fee

The OPC requests the Commission reduce the revenue requirement by a sum of $75,000, to be considered an imputed royalty fee from UTLD to UTM for the purpose of compensating UTM for the benefits derived by UTLD from its association with UTM. As part of the benefits accruing to UTLD, OPC would include the use of various UTM resources including, but not limited to UTM's name, reputation and image, logo or trademark, proven methods of operation, and specific technical knowledge. In addition, OPC maintains that there is a direct relationship between the proposed royalty fee and the imputing of goodwill from UTM to UTLD.

UTM offers a number of reasons why the royalty fee should not be imputed; however, the Commission need only address two in this order. The Commission finds that the imputation of the fee is based on the valuation of an unrealized intangible asset, that being goodwill. This asset is incapable of being accurately measured for ratemaking purposes unless a sale has occurred and a value attached to the intangible. As this is not the case here, there is no known and measurable basis for the imputation of the fee. The Commission further finds that no competent and substantial evidence exists on the record for the amount of the fee itself. OPC maintains that fee was calculated based on a market share analyses, but the fact of the matter is that the fee is 5% of gross revenues. Evidence indicates that the basis for the 5% figure was the general practice in the franchise industry. The Commission can find no basis for the comparison between a hamburger franchise and a regulated public utility in applying this proposed standard.

Therefore, for the above-reasons, the proposed adjustment by the OPC is rejected.

VII. Revenue Summary

	Revenue Requirement
UNITED TELEPHONE COMPANY'S RECOMMENDATION	$9,239,000
ITEMS SETTLED	($11,000)
COMPANY'S REVISED RECOMMENDATION	$9,228,000
STAFF'S RECOMMENDATION	($200,000)

Issue	Decision	$Value	Revenue Effect
CAPITAL STRUCTURE:	Staff		($1,494,000)
RETURN ON EQUITY - 11.70%			($1,494,000)
OVERALL WEIGHTED AVERAGE COST OF DEBT	Staff		($ 97,000)
RATE OF RETURN			($3,346,000)
RATE BASE:			
Debit Depr. Res For Operators	Staff	($531,000)	($ 82,000)
Cash Working Capital	Staff	($750,000)	($ 115,000)
CWC-Long & Short Term Interest	Staff	($1,233,000)	($ 190,000)
Short Term TPUC	Staff	($914,000)	($ 141,000)
Prepaid Pension Asset	Staff	($4,879,000)	($ 750,000)
Deferred Taxes On Pensions	Staff	$1,954,000	$ 301,000
Generic Software Deleted from Expense	UTM	$ 0	$ 0
Deferred Tax on Alternate Minimum Tax	Staff	($ 252,000)	($ 39,000)
Sprint Publishing Investment	Staff	$1,941,000	$ 299,000
REVENUE & EXPENSE:			
Test Period Access Rev- Linn to Jeff City	UTM		$ 0
Test Period Long Dist Toll-Inward WATS	Staff		($ 29,000)
Test Period Long Dist Toll-Outward WATS	Staff		($ 5,000)
Test Period Long Dist Toll-P/L Network	Staff		($ 57,000)
Test Period Misc Rev-AT&T Programming	UTM		$ 0
Revenue Conversion Factor	Staff		($ 30,000)

Sprint Publishing - Income Stmt. Only	Staff	($1,157,000)
Interest Synchronization	Staff	($1,041,000)
OPEBs	Staff	($1,773,000)
Pension Expense - Income Stmt. Only	Staff	$1,239,000
Meals and Entertainment Expense and Tax Effect	Staff	Settled
Generic Software	UTM	$ 0
Annualized Depr - Generic Software	UTM	$ 0
Modernization:		
Reserve Deficiency Amort	Staff	($1,287,000)
Plant Growth	Staff	$ 0
ITC Amortization	Staff	($ 49,000)
Other Permanent Tax Differences	Staff	$ 33,000
OPC ADDITIONAL ISSUES:		
Rate Base-Rate of Return	Staff (see above)	$ 0
GS&L - New Billing System	UTM	$ 0
Annualized Depreciation - Operator	Staff (see above)	$ 0
Annualized Depreciation - Other	Staff/UTM (see above)	$ 0
UTLD Royalty	UTM	$ 0
Modernization-Reserve Def Amort	Staff (see above)	$ 0
REVENUE REQUIREMENT		$1,007,170
TAX EFFECT		$ 0
TOTAL REVENUE REQUIREMENT		$1,007,170

VIII. Rate Design

A. Local Rates

The Commission has determined in the above revenue summary, that UTM is underearning. The Commission also finds that, as a result of its decision, supra, in regard to the allocation of the anticipated costs of UTM's modernization plan, the rate design issue dealing with the UTM proposed two-tier rate structure is moot. Irrespective of modernization or other issues, the Commission would encourage future examination of consolidation of rate groups.

The Staff has offered alternative rate proposals. It is the Staff's position that local service charges for residential and one party service, residential and business trunk lines, residential, business, and trunk line local measured service, and semi-public telephone service should all be increased. This proposal is revenue neutral, according to Staff, if the Commission adopts a Staff proposal that a single zone charge of $2.35 be applied to one-party customers living outside the local base rate area in exchanges that provide only one-party service.

The Staff proposes that the above zone charge be reduced to a flat rate of $2.35 for all customers outside the base rate area. This charge would apply only to customers who are located in exchanges where multi-party service has been eliminated. Currently, UTM has only two exchanges in the State of Missouri which have no multi-party service. UTM takes the position that zone rates are no longer appropriate and serve as a financial impediment to customers outside the base rate area.

Alternatively, as a substitute for the increase in monthly local service charges for both existing single-party service exchanges and other exchanges as they are converted from multi-party to single-party, the Staff is not opposed to the adoption of the UTM proposals to increase charges for rotary hunt, advance business connection, and a late payment charge.

As the Staff is not opposed to increases in the rotary hunt charge and advanced business connection charge, the Commission will approve both charges. The Commission finds that the UTM proposed increases are reasonable. In addition, regarding efforts to modernize the UTM system, the Commission finds that the charges are levied on appropriate services.

In regard to the suggested fee for late payment of balances due, the Staff suggests a flat rate of $1.65. UTM offers a 2.5% late fee to be applied to the outstanding balance due. The Staff suggests the percentage rate offered by UTM is in violation of 4 CSR 240-33.040(5), which states in pertinent part:

> "A telephone utility may not assess a finance, carrying or penalty fee upon a delinquent account, but may assess a charge to cover no more than the cost of handling the delinquent account which charge must be approved by the Commission."

The Staff has estimated the cost of handling a delinquent account to be approximately $1.65 per account, generating a substantial annual revenue of approximately $283,000. The amount of the account balance, according to Staff, has nothing to do with the cost of handling the delinquent account, and therein lies the problem with the UTM suggested 2.5% of the past due balance.

Finally, UTM has offered, and Staff does not oppose, the introduction of a lifeline discount of $3.50, intended to offset the federal subscriber line charge, and funded by interstate IXC's. This proposal is revenue neutral, according to UTM.

The Commission favors the alternative rate treatment proposed by Staff. The Commission will retain the zone charge, but adopt the Staff's suggestion of a flat rate of $2.35 for all customers outside the base rate area. This charge will apply only to customers who are located in exchanges where multi-party service has been eliminated. The Commission feels that this minimum zone charge is a reasonable and appropriate cost of service charge and should serve as an incentive to UTM to eliminate all party lines as soon as possible.

In addition, the Commission will approve the specific rate increases requested by UTM and not opposed by Staff, those being the rotary hunt charge and the advanced business connection charge. The Commission finds these to be reasonable and appropriate.

In regard to the fee for late payment of bills, the Commission finds this to be a prudent business practice. After consideration of the rule, however, the Commission finds that the percentage of unpaid balance rate can only be characterized as a finance charge and, therefore, violative of the rule. The Commission will approve the suggested flat rate of $1.65 per unpaid bill as the cost of handling and collection.

The Commission will approve the $3.50 lifeline discount, but only under the assumption, as stated by UTM, that the discount is revenue neutral.

B. Access Charges

UTM proposes to reduce its interLATA CCL rates, (switched access proposal) substantially recovering the lost revenue from the local ratepayer in the form of an approximate 10% rate increase (also referred to as a $.95 per bill access increase). UTM maintains that its access rates are among the highest in the state. UTM states that it faces, or will shortly face, significant levels of competition, and therefore, its rates must be reduced to current market levels.

UTM states that the proposed rate increase in local service to cover the reduction in access rates is preferable to the prospect of losing substantial revenue as the result of competition and alternative services. UTM maintains that this rate shift will not present a threat to universal service. UTM produced a fully distributed cost study purporting to show that access charges currently subsidize local service.

The UTM position is supported by Intervenor AT&T, which proposes a more thorough plan, but calls the UTM proposal "a good first step."

The Staff concurs only with the revenue neutral positions of UTM's switched access proposal. Those revenue neutral items are:

1. Restructure of the three end office rate elements into one rate element, called local switching;

2. Eliminate the rate differential between 1s1 and 1s2, with one resulting rate element; and

3. Apply the terminating intrastate intraLATA carrier common line rate, rather than the originating rate, to the open end of 800 service calls, and obtain revenue neutrality by reducing the originating rate by approximately $.005 per minute, to $.0468 per minute.

The Staff is opposed to the UTM proposal for the reduction in intrastate interLATA originating and terminating CCL rates by $.015 per minute, to $.0397 per originating minute and $.0750 per terminating minute.

The Staff's opposition to the intrastate interLATA reduction is based on the adverse impact to the local ratepayer, the lack, according to Staff, of a proper cost study, and the lack of a showing of competition in the access market. The OPC takes substantially the same position as the Staff.

The Commission finds that the revenue neutral proposals by UTM, and to which the Staff concurs, are reasonable and will be approved. The OPC apparently also agrees to these proposals as it states in its brief, "Also, Public Counsel believes that any change to UTM's interLATA switched access service should be on a revenue neutral basis only." The Commission holds that the revenue neutral portions of the UTM proposal are a reasonable and efficient reorganization of rate relationships with no detriment to the public interest and will be approved.

In regard to the remainder of the UTM proposal, the Commission holds that the reduction in intrastate interLATA access rates will be approved to the extent of $.01 which includes $.005 originating and $.005 terminating for the following reasons.

The Commission finds the record to indicate UTM, together with AT&T, have made sufficient showing that the current access rates are markedly higher than comparable access charges in the state. The Commission feels some modification of those rates is appropriate and reasonable in order to bring them in line with current statewide rates charged by other companies.

For this reason, the Commission approves the $.01 reduction as set out above, and the proposal to reduce access charges is modified as set out herein.

C. Coin Operated Pay Telephone (COPT)/Customer Owned Coin Operated Telephone (COCOT)

The Midwest Independent Coin Payphone Association (MICPA), representing private businesses involved in the resale of coin-operated payphone service, presented evidence regarding what MICPA considers unfair rate discrimination in UTM's treatment of COCOT rates. MICPA claims that the existing COCOT charges, a $30.00 per month base charge plus either a per call charge or a $35.00 per month surrogate charge, should be eliminated and replaced by a single line business charge for the rate group in which the pay phone is located.

MICPA presents the following points in its case. MICPA alleges that the service received by the payphone business is indistinguishable from ordinary single line business service. Second, MICPA alleges, no study or other cost determination has been made regarding the cost of providing the service. Lastly, UTM is a direct competitor in the payphone business and, therefore, presumably discriminates in setting rates for the independent payphone operators.

The Staff is opposed to lowering any COCOT rate. In this case, the Staff has recommended that the MICPA concerns be addressed on a statewide basis in a specific pay phone docket.

UTM is opposed to the lowering of rates as suggested by MICPA. UTM proposed and withdrew a reorganization of pay phone rates, and now supports the Staff proposal to allow rates to remain at their current levels.

The Commission finds evidence on the record to support the case presented by MICPA. Evidence indicates that COCOT rates, and in particular the base and surrogate charges, are higher than local business rates. No evidence was presented to indicate that the cost of providing service is any greater than that of a single business line, save the presumed revenue lost by UTM from its own pay phones. Regardless, it is difficult to believe in light of the difference in rates between a COCOT and a single business line, that the bulk of that charge is made up of lost UTM payphone revenue.

In addition, the Commission sees no practical difference between the resale of service by a pay phone provider or any other business, for example, a hotel or motel, as pointed out by MICPA. UTM's allegation that they "compete" in the pay phone market and, therefore, need rate protection does not hold up to scrutiny. UTM clearly has an overwhelming competitive advantage as the result of being a monopoly provider with which all independent pay phone providers must do business and in having the advantage of ratepayer revenue support for its payphone enterprise.

In short, the Commission finds evidence that MICPA is correct in its assertion that there is no reasonable justification for the level of COCOT rates. The question remains, however, as to the selection of the appropriate remedy for this inequity.

As MICPA has pointed out, the Commission has suggested in the past that MICPA take up its concerns in the appropriate rate case. MICPA has done so. It is, therefore, difficult to accept the Staff suggestion that yet another docket be opened and MICPA be again forced to present its case. Therefore, for the above reasons, the Commission holds that the usage-sensitive rates currently in effect for COCOT providers, including the per-call charge and the surrogate monthly fee, be eliminated, leaving the remaining base charge at its current level.

D. Direct Inward Dial (DID) Trunks

UTM, in the surrebuttal testimony of Witness Harper, agrees with the position taken by the Staff in regard to DID rates. The Staff proposes that DID rates be allowed to increase in proportion to any increase in other services.

The Commission finds this proposal to be reasonable and will, therefore, order DID rates to be raised in proportion to the remainder of the rates dealt with in this order.

E. Miscellaneous

The Commission has determined that any increase in rates as a result of the preceding will be spread in a proportional fashion, over the following rate groups:

a. residential and business one-party service
b. residential and business trunk lines
c. residential, business, and trunk line local measured service
d. semi-public telephone service

IX. Settled Issues/Stipulations and Agreements

At the evidentiary hearing a Stipulation and Agreement regarding quality of service was agreed to and filed by the parties and intervenors. In that agreement, incorporated in this Report and Order as Attachment C, the Staff states that an audit conducted by the Staff during the course of the rate case proceedings revealed instances in which service did not conform to Commission regulations or Staff standards. The Staff stated it believed the instances of non-conforming service to be maintenance related. The Staff audit gave rise to the testimony of Staff witness Myron Couch, and the raising of the quality of service issue as part of this litigation.

UTM stated that, while not necessarily agreeing with the Staff findings, UTM found the recommendations set out in the Stipulation and Agreement to be reasonable and agreed to comply with them.

After review of the testimony of Myron Couch and the contents of the Stipulation and Agreement, the Commission finds the agreement to be reasonable and in the public interest, and will approve the agreement.

During the course of the evidentiary hearing, agreement was reached by the Staff, OPC, and UTM in regard to UTM's Southeast Kansas operation and the proper auditing procedures for that holding. The transcript reflects this agreement on pp. 409-411, reflecting that the parties agreed that UTM will produce a subsidiary-type ledger by January 1, 1994, identifying Southeast Kansas transactions for all revenue, expense and rate base items. In this regard, Exhibit 51 was made part of the record. UTM has agreed to produce auditable books sufficient to allow the Staff to trace transactions and to properly audit for future rate cases. The Commission finds the conditions of this agreement to be reasonable and will order the agreement to be completed by January 1, 1994, as requested.

The revenue requirement and rate design scenarios, as submitted by the parties herein, are hereby marked as Exhibit 129 and admitted into evidence as a late exhibit.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law:

United Telephone Company of Missouri is a public utility engaged in the provision of local exchange telecommunications service in the State of Missouri and, therefore, subject generally to the jurisdiction of the Commission pursuant to Chapters 386 and 392, RSMo. (Cum. Supp. 1992).

The Commission has the authority, under Chapter 392, RSMo., (Cumm. Supp. 1992), to set just and reasonable rates for the provision of telecommunications service by local exchange companies.

Pursuant to 4 CSR 240.32.100(2), United Telephone Company of Missouri is required to provide various service and technology features constituting the minimum necessary elements for basic local and interexchange telecommunications service.

In addition, under 4 CSR 240-32.100, United Telephone Company of Missouri is required to file plans for satisfying the minimum necessary elements for basic telecommunications service as set out in Rule 32.100(2) above.

In regard to Rule 32.100, the Commission finds the seven year plan, as submitted by United Telephone Company of Missouri to be adequate.

Orders of the Commission must be based on substantial and competent evidence, taken on the record as a whole, and must be reasonable and not arbitrary, capricious, or contrary to law. In this regard, and in setting rates which are just and reasonable, the Commission has considered all relevant evidence and determines, as set out in the findings of fact, that UTM's revenue requirement will be raised in the amount of $1,007,170, with shifts in rates as set out in this Report and Order.

IT IS THEREFORE ORDERED:

1. That the proposed tariffs submitted by United Telephone Company of Missouri on December 7, 1992, be hereby rejected, and United Telephone Company of Missouri is hereby authorized to file, in lieu thereof, revised tariffs in accordance with the findings in this Report and Order for service on and after November 7, 1993.

2. That, effective January 1, 1993, United Telephone of Missouri will accrue and record depreciation rates in accordance with telephone authority order #984, appended hereto as Attachment A to this Report and Order.

3. That United Telephone Company of Missouri is hereby ordered to implement its Modernization Plan as filed and approved in this case under Rule 4 CSR 240-32.100, with those specific instructions as set out herein.

4. That the usage-sensitive COCOT charges, those being the per call charge and alternate surrogate charge, are eliminated.

5. That the Stipulation and Agreement filed by the parties in this case and appended hereto as Attachment C is hereby approved, and United Telephone Company of Missouri is ordered to comply with the specifics as contained therein.

6. That the agreement as set out on pps. 409-411 of the transcript in the evidentiary hearing in this matter regarding UTM's Southeast Kansas holding is hereby approved and UTM is hereby ordered to comply with the conditions of that agreement no later than January 1, 1994.

7. Late-filed Exhibit 129 is admitted into evidence.

8. That this Report and Order will become effective November 7, 1993.

BY THE COMMISSION

David L Rauch

David L. Rauch
Executive Secretary

(S E A L)

Mueller, Chm., McClure, Perkins,
and Kincheloe, CC., Concur;
Crumpton, C., dissents with opinion
to follow; and certify compliance
with the provisions of
Section 536.080, RSMo 1986.

Dated at Jefferson City, Missouri,
on this 27th day of October, 1993.

RECONCILIATION
Case No. TR-93-181

	Rate Base Amount ($000)	Rev Req ($000)	
CURRENT UTM POSITION			9,239*
CONTESTED ISSUES BETWEEN STAFF AND UTM:			
RATE BASE:			
Debit Depr Res For Operators	(531)	(82)	
Cash Working Capital	(750)	(115)	
CWC-Long & Short Term Interest	(1,233)	(190)	
Short Term TPUC	(914)	(141)	
Prepaid Pension Asset	(4,879)	(750)	
Deferred Taxes On Pensions	1,954	301	
Generic Software Deleted from Expense	187	29	
Deferred Tax on Alternative Minimum Tax	(252)	(39)	
Sprint Publishing Investment	1,941	299	
RATE OF RETURN (Staff's mid-range of 9.81%)		(3,085)	
REVENUE & EXPENSE:			
Test Period Access Rev-Lind to Jeff City		(108)	
Test Period Long Dist Toll-Inward WATS		(29)	
Test Period Long Dist Toll-Outward WATS		(5)	
Test Period Long Dist Toll-P/L Network		(57)	
Test Period Misc Rev-AT&T Programming		(99)	
Revenue Conversion Factor		(30)	
Sprint Publishing - Income Stmt. Only		(1,157)	
Interest Synchronization		(1,041)	
OPEBs		(1,773)	
Pension Expense - Income Stmt. Only		1,239	
Meals and Entertainment Expense and Tax Effect		(36)	
Generic Software		(187)	
Annualized Depr - Generic Software		13	
Modernization:			
Reserve Deficiency Amort		(1,287)	
Plant Growth		(1,118)	
ITC Amortization		(49)	
Other Permanent Tax Differences		33	
Southeast Kansas Operations		0	
SUBTOTAL			(9,464)
CURRENT STAFF POSITION			(225)**

* Based on UTM's 11.07% rate of return.
** Based on Staff's mid-range rate of return of 9.81%.

OPC ADDITIONAL ISSUES:

. Rate Base-Rate of Return***	(809)
GS&L - New Billing System	(836)
Annualized Depreciation - Operator	(177)
Annualized Depreciation - Other	(1,498)
UTLD Royalty	(75)
Modernization-Reserve Def Amort	(562)
CURRENT OPC POSITION	(4,182)***

*** Based on OPC's 9.47% rate of return.

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

At a Session of the Public Service Commission held at its office in Jefferson City on the 4th day of December, 1992.

TELEPHONE AUTHORITY ORDER NO. 984

In the matter of prescribing depreciation accrual rates for United Telephone Company of Missouri, Inc.

On April 17, 1992, the United Telephone Company of Missouri (United) submitted a comprehensive depreciation study based upon data as of December 1, 1991 to the Staff of the Commission for review. United requested that Staff recommend approval of the depreciation rates set forth in the study or such rates as may be mutually agreed upon. Pursuant to Section 392.280.1 RSMo. Supp. 1991, the Staff has made a study and investigation of the several classes of property of United and has ascertained, determined and fixed the recommended remaining life depreciation rates as set forth in the attached Appendix A. The Company has agreed to the Staff recommendation that the Commission prescribe these depreciation rates to be effective as of January 1, 1993.

Further, United had requested a three year amortization of $731,301 representing unrecovered depreciation expense for the discontinued plant account 2220.10-Operator Systems. Staff recommended granting of this request with the amortization beginning January 1, 1993. As a result of discussions between United, the Office of Public Counsel and Staff, the company has made the following commitment to the Commission:

> "United Telephone Company of Missouri commits that in its upcoming rate case it will offer evidence in its direct case which supports the economic decision to close its operator center in Warrensburg and transfer those operator services functions to United-North Central."

In addition, United voiced its willingness to accept the language to be included as Ordered: 3 below.

United has agreed to compile and submit an annual depreciation study to the Staff by March 1 of each year beginning in 1994, to assist the Commission in maintaining proper and adequate depreciation rates.

United has agreed to maintain detailed and adequate continuing property records which are necessary to the performance of meaningful depreciation studies.

The Commission having considered the above recommendations, finds them to reasonable and proper.

IT IS THEREFORE:

ORDERED: 1. That the United Telephone Company of Missouri be, and it is, hereby ordered to accrue depreciation expense based upon the rates set forth in attached Appendix A beginning January 1, 1993.

ORDERED: 2. That the United Telephone Company of Missouri be granted permission to amortize $731,301 over a period of three years, beginning January 1, 1993.

ORDERED: 3. That nothing in this Order shall be considered a finding of the Commission as to the impact of these depreciation rates or the amortization of $731,301 for ratemaking purposes, and the Commission reserves the right to consider the ratemaking treatment to be afforded these depreciation rates and the amortization of $731,301 in any later ratemaking proceeding."

ORDERED: 4. That the United Telephone Company shall maintain adequate continuing property records to assist in the performance of annual depreciation studies to be submitted to the Staff beginning March 1, 1994.

ORDERED: 5. That this order shall become effective ten (10) days after the date of this Order.

BY THE COMMISSION

Brent Stewart

Brent Stewart
Executive Secretary

(S E A L)

McClure, Chm., Mueller, Rauch,
Perkins and Kincheloe, CC., Concur.

UNITED TELEPHONE COMPANY OF MISSOURI, INC.

DEPRECIATION STUDY AS OF DECEMBER 1, 1991

Account No.	Account Description	% Reserve	P/L Curve	Rem. Life	FNS %	Deprec. Rate %
2112.10	Vehicles - Passenger Cars	45.80	7.5L4	3.7	10.0	11.9
2112.20	Vehicles - Light Trucks	9.53	8LO	6.3	9.0	12.9
2112.30	Vehicles - Heavy Trucks	20.59	12LO	8.8	16.0	7.2
2115.10	Garage Work Equipment	39.98	12R2	6.7	2.0	8.7
2116.10	Other Work Equipment	25.47	13.6R2	9.3	2.0	7.8
2121.10	Buildings	33.05	34L/S	20.5	-5.0	3.5
2121.30	Buildings - Equipment	38.92	20L/S	15.2	-10.0	4.7
2121.40	Buildings - Ant.Suprts & Twrs	41.04	25L/S	13.2	-5.0	4.8
2122.10	Furniture	25.34	12.5R1	9.2	4.0	7.7
2123.10	Office Equip - Office support	-17.47	10R3	4.1	5.0	27.4
2123.20	Office Equip - Co. Communications	49.28	9.5R1	5.9	0.0	8.6
2124.20	General Purpose Computers	31.13	7R2	3.3	20.0	14.8
2212.10	Digital Electronic Switching	20.80	VAR L/S	11.5	0.0	6.9
2212.60	Digital Electronic Switching-AMR	8.69	VAR L/S	10.2	0.0	9.0
2215.10	Step-By-Step Switching	70.37	14.5L/S	4.8	-2.0	6.6
2215.20	Crossbar Switching	100.00	N/A	N/A	N/A	N/A
2215.60	Step-By-Step Switching-AMR	55.79	18.6L/S	7.5	-3.0	6.3
2215.70	Crossbar Switching-AMR	100.00	N/A	N/A	N/A	N/A
2231.30	Other Radio Systems - Other	47.86	8R2	2.5	-3.0	22.1
2232.10	Circuit Equip. - Analog	101.22	8L1	3.5	-3.0	0.5
2232.20	Circuit Equip. - Digital	39.11	11.5L1	7.6	8.0	7.0
2232.30	Circuit Equip. - Digital Fiber	18.48	10.2L1	10.3	8.0	7.1
2232.40	Circuit Equip. - Analog Pair Gain	61.50	8L1	4.4	-3.0	9.4
2232.50	Circuit Equip. - Digital Pair Gain	23.05	11L1	8.6	8.0	8.0
2351.10	Public Telephones	77.52	13L1	9.4	10.0	1.3
2362.10	Other Terminal Equip. - Sub. Mux	49.49	10S2	5.4	10.0	7.5
2362.20	Other Terminal Equip. - LN Cond.	45.57	10R1	7.0	9.0	6.5
2362.30	Other Terminal Equip. - Emer. 911	10.86	8R2	6.3	0.0	14.1
2411.10	Poles	33.04	22R1	12.5	-35.0	8.2
2411.20	Poles - Special Structures	47.80	22R1	12.5	-35.0	7.0
2421.10	Aerial Cable - Metallic	40.85	26R2	15.4	-20.0	5.1
2421.20	Aerial Cable - Nonmetallic	35.61	25R2	19.3	-10.0	3.9
2421.60	Aerial Cable - Drop	15.17	17S2	10.1	-15.0	9.9
2422.10	Underground Cable - Metallic	35.16	28R1	20.0	-10.0	3.7
2422.20	Underground Cable - Nonmetallic	8.03	32R2	30.4	-6.0	3.2
2423.10	Buried Cable - Metallic	20.87	25L1	19.6	-1.0	4.1
2423.20	Buried Cable - Nonmetallic	7.52	30R2	28.0	-3.0	3.4
2423.60	Buried Cable - Drops	18.77	22L2	16.5	-2.0	5.0
2424.10	Submarine Cable - Metallic	8.17	25S5	12.4	0.0	7.4
2426.10	Intrabuilding Cable - Metallic	48.81	22R4	13.1	-2.0	4.1
2431.10	Aerial Wire	93.20	12LO	7.0	-75.0	11.7
2441.10	Conduit Systems	25.06	50R4	35.0	0.0	2.1
	PSC TOTALS	30.99				5.94

NOTES:

a = Overaccrued reserves were adjusted and reallocated in these accounts.

(telephone service). This rule sets forth certain criteria applicable to equipment connected to the telephone network by customers, in order to assure safe and adequate telephone service. Automated dialing-announcing devices used for solicitation purposes, where a called party cannot terminate the connection with the calling party may prevent the rendering of safe and adequate service.

(1) Automated Dialing-Announcing Devices. No telephone utility shall knowingly permit connection to or operation over the telephone network of an automated dialing-announcing device used for solicitation purposes where calls initiated by the device cannot be terminated at will by the called party and dial tone restored to the called party promptly upon termination of the call by the called party. Any prerecorded message issued by an automated dialing-announcing device shall be preceded by an announcement which states the name and address of the calling party, the purpose of the message and that the message is coming from automated equipment.

Auth: sections 386.040, 386.250, 386.310 and 392.200, RSMo (1986). Original rule filed July 13, 1978, effective Jan. 13, 1979.*

**Original authority: 386.040, RSMo (1939); 386.250, RSMo (1939), amended 1963, 1967, 1977, 1980, 1987, 1988, 1991; 386.310, RSMo (1939), amended 1979, 1989; and 392.200, RSMo (1939), amended 1987, 1988.*

4 CSR 240-32.100 Provision of Basic Local and Interexchange Telecommunications Service

PURPOSE: This rule prescribes the minimum technologies and service features constituting basic local and interexchange telecommunications service as provided by local exchange telecommunications companies.

Editor's Note: The secretary of state has determined that the publication of this rule in its entirety would be unduly cumbersome or expensive. The entire text of the material referenced has been filed with the secretary of state. This material may be found at the Office of the Secretary of State or at the headquarters of the agency and is available to any interested person at a cost established by state law.

(1) This rule shall apply to the provision of basic local and interexchange telecommunications service by local exchange telecommunications companies.

(2) The following technologies and service features shall constitute the minimum necessary elements for basic local and interexchange telecommunications service:

(A) Individual line service;

(B) Availability of dual tone multifrequency signaling;

(C) Electronic switching with Enhanced 911 (E-911) access capability or an enhanced version of it;

(D) Digital interoffice transmission between central office buildings, excluding analog private line service;

(E) Penetration of the International Telephone and Telegraph Consultative Committee's Signaling System Number Seven (CCITT SS7), or an enhanced version of CCITT SS7, down to the tandem level of the switching hierarchy;

(F) Availability of custom calling features including, but not limited to, call waiting, call forwarding, three (3)-way calling and speed dialing; and

(G) Equal access in the sense of dialing parity and presubscription among interexchange telecommunications companies for calling between Local Access and Transport Areas (interLATA presubscription).

(3) Within one hundred eighty (180) days (June 1, 1993) of the effective date of this rule (December 3, 1992), all local exchange telecommunications companies shall submit to the telecommunications department of the commission three (3) plans for satisfying the minimum necessary elements of basic local and interexchange telecommunications service as set forth in section (2) of this rule. The first of these plans shall set targets to satisfy this rule within three (3) years, the second plan shall set targets to satisfy this rule within five (5) years and the third plan shall set targets to satisfy this rule within seven (7) years. An additional plan which the company considers is optimal in light of its individual business circumstances may be submitted to satisfy the elements set forth in section (2). These plans shall include the following:

(A) Additional capital expenditures and current expenses, including increased depreciation, amortization expenses, or both, that would be incurred annually over and above what would be needed in the absence of a requirement to satisfy the minimum necessary elements of basic local and interexchange telecommunications service;

(B) Annual targets in terms of exchange access lines for the elimination of party line service;

(C) Annual targets in terms of exchange access lines for the replacement of electromechanical switches and the modification of electronic switches;

(D) Annual targets in terms of exchange access lines for the availability of dual tone multifrequency signaling, custom calling features and E-911 access capability;

(E) Annual targets in terms of specific routes for the elimination of analog interoffice transmission systems;

(F) The quarter and year that CCITT SS7 will become operational at each tandem; and

(G) Annual targets for the number of exchange access lines that will be subject to interLATA presubscription according to the process described in section (4) of this rule.

(4) The equal access presubscription and processes shall be conducted in accordance with the requirements of the Federal Communications Commission (FCC) as set forth in 101 FCC2d 911 (1985), 101 FCC2d 935 (1985) and 102 FCC2d 505 (1985). Copies of the FCC orders may be obtained by contacting the Telecommunications Department of the Missouri Public Service Commission at P.O. Box 360, Jefferson City, MO 65102.

(5) Upon receipt of the plans pursuant to section (3), the commission will establish a docket setting a schedule under which the staff will review each plan and make a recommendation to the commission either to a) approve a joint stipulation for implementation by the company or b) set the matter for hearing on the adequacy of that company's existing telecommunications facilities and plans.

(6) Upon proper application and after due notice, the commission may waive any provision of this rule for good cause shown.

Auth: sections 386.040, 386.250, 386.310, 392.200, 392.240 and 392.250, RSMo (Cum. Supp. 1990). Original rule filed Dec. 31, 1991, effective December 3, 1992.*

**Original authority: 386.040, RSMo (1939); 386.250, RSMo (1939), amended 1963, 1967, 1977, 1980, 1987, 1988, 1991; 386.310, RSMo (1939), amended 1979, 1989; and 392.200, RSMo (1939), amended 1987, 1988; 392.240 and 392.250, RSMo (1939), amended 1987.*

Attachment C Vergue

FILED
AUG 13 1993
PUBLIC SERVICE COMMISSION

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of United Telephone Company of Missouri's Tariff Sheets Designed to Increase Rates for Telephone Service to Customers in the Missouri Service Area.	))))	Case No. TR-93-181

STIPULATION AND AGREEMENT REGARDING QUALITY OF SERVICE

The audit conducted by the Staff of the Missouri Public Service Commission (the Staff) of the service provided by United Telephone Company of Missouri (UTM) revealed instances of service that did not conform to Missouri Public Service Commission (Commission) regulations or Staff standards. The Staff believes these instances of non-conforming service to be maintenance-related. This audit gave rise to recommendations set forth in the direct testimony of Staff witness Myron E. Couch. While not necessarily agreeing with the Staff's service findings, UTM finds the following recommendations reasonable and agrees to comply with the recommendations with the following clarifications:

1. By January 1, 1994, UTM will replace temporary repairs made in response to the Staff's outside plant cable audit with permanent repairs, and will report to the Staff when such replacements were completed.

2. By January 1, 1994, UTM will correct all major faults identified in Mr. Couch's direct testimony, Schedule 1, and report its findings and corrective actions to the Staff.

3. By January 1, 1994, UTM will mark circuits in all UTM wire centers within the Commission's jurisdiction which, in UTM's judgment, provide safety-related services, and report to the Staff when such identification was completed.

4. When the Staff informs UTM that the Staff will audit the outside plant cable pairs of a specific UTM wire center and requests a list of outside plant working cable pairs served by that office, UTM will provide such list within twelve (12) hours of the request.

5. Each quarter, UTM will perform routine tests of its step-by-step switches within the Commission's jurisdiction, and report the results of such tests to the Staff. The routine tests will include local-to-local completions, local-to-CAMA, local-to-TSPS and local-to-EAS (if applicable).

6. Each quarter, UTM will perform 4-TEL tests, at the "C" level of sensitivity, of all UTM wire centers within the Commission's jurisdiction, and report the results of such tests to the Staff.

7. Mr. Couch's and UTM witness Harold G. Rohrer's prefiled direct testimony and schedules pertaining to quality of service and customer service shall be received into evidence without the necessity of Mr. Couch or Mr. Rohrer taking the stand.

8. If the Commission accepts the terms of this Stipulation and Agreement, the signatories waive their rights

(a) to cross-examine witnesses regarding quality-of-service issues addressed herein,

(b) to present oral argument and written briefs regarding quality-of-service issues addressed herein pursuant to Section 536.080.1 RSMo 1986, and

(c) to judicial review contesting the terms of this stipulation pursuant to Section 386.510 RSMo 1986.

The Commission should not construe this Stipulation and Agreement as waiving rights with regard to any other issues in this docket.

9. The Staff shall have the right to explain its rationale for entering into this Stipulation and Agreement to the Commission, and to provide to the Commission whatever further explanation the Commission requests. The Staff's explanation shall not become part of the record of this proceeding and shall not bind or prejudice the Staff in any further proceeding. In the event the Commission does not approve this Stipulation and Agreement, the Staff's explanation shall not bind or prejudice the Staff in this proceeding. Any rationales advanced by the Staff are its own and are not acquiesced in or otherwise adopted by the other signatories.

10. This Stipulation and Agreement represents a negotiated settlement. Except as specified herein, the parties to this Stipulation and Agreement shall not be prejudiced, bound by, or in any way affected by the terms of this Stipulation and Agreement in any future proceeding, any proceeding currently pending under a separate docket, or this proceeding, should the Commission not approve this Stipulation and Agreement, nor shall the parties in any way condition the approval of this Stipulation and Agreement.

11. None of the parties to this Stipulation and Agreement shall be deemed to have approved or acquiesced in any question of Commission authority that may underlie this Stipulation and Agreement, or for which provision is made in this Stipulation and Agreement.

12. The provisions of this Stipulation and Agreement have resulted from negotiations among the signatories and are interdependent. In the event the Commission does not

approve the terms of this Stipulation and Agreement in total, it shall be void and no party shall be bound, prejudiced or in any way affected by any of the agreements or provisions hereof.

WHEREFORE, the signatories respectfully request that the Commission issue an order that approves this Stipulation and Agreement.

Respectfully submitted,

UNITED TELEPHONE COMPANY OF MISSOURI

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 13th day of August, 1993.

Eric Witte

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Phase 1 Projects

Switch Conversions		Access Lines Year 1994	Access Lines Year 1995
1994		8176	
Butler	3334		
Holt Summit	2421		
Lake Lotawana	1435		
Lincoln	986		
1995			8604
Eugene	820		
Holden	2162		
Mound City	1447		
Russellville	1236		
Taos	941		
Windsor	1998		

Availability of DTMF Signalling	8176	8604
Availability of Custom Calling Features	8176	8604
Availability of E-911	8176	8604
InterLATA Equal Access	8176	8604

Party lines eliminated	
1994 Total	827
Buckner	36
Butler year 1	35
Craig	25
Odessa	89
Richland	189
Warsaw	453
1995 Total	354
Butler year 2	141
Fairfax	33
Holt Summit	5
Lake Lotawana	3
Lincoln	63
Newburg	63
Salem year 1	46

Interexchange Conversions
1994
Butler
Calhoun
Holt Summit
Lake Lotawana
Leeton
Lincoln
Mound City
Russellville
Wellington
Windsor
1995
Appleton City
Eugene
Holden
Houstonia
Lexington
New Bloomfield
Sweet Springs

Schedule 1

Attachment D

News Release

United Telephone

For Immediate Release: Oct. 27, 1993

United Telephone Disappointed with PSC Ruling

JEFFERSON CITY -- United Telephone of Missouri today expressed disappointment with the Missouri Public Service Commission's (PSC's) ruling on its proposed TeleProgress case. The PSC approved a rate increase of $1 million, only about 10 percent of the $9.5 million requested by United Telephone to cover its current costs of doing business and to fund the first two years of its seven-year plan to fully modernize phone service for all United Telephone of Missouri customers. This will result in an increase ranging up to 80 cents a month for residential customers and up to $1.60 a month for business customers.

United Telephone's rate filing, made in December 1992, included a plan to modernize telecommunications services for all its Missouri customers by the year 2000. This modernization plan was in response to the PSC's new definition of basic local service, which included digital switching; elimination of multiparty service; capability for E-9-1-1, touch tone dialing and customer calling features; and the ability for customers to choose their long distance company. The PSC had asked all Missouri telephone companies to provide plans for achieving this level of service.

"We're quite concerned with the overall results of the case, particularly the PSC's failure to recognize many of our basic costs of doing business," explains Bill Roche, vice president-governmental and public affairs. "However, we're pleased the PSC positively viewed our modernization plan and that their award recognized most of the associated modernization costs in the current rate increase."

In a separate filing, the PSC also increased basic local rates another 65 cents a month to offset United Telephone's costs in implementing an extraexchange calling plan expanding the areas customers may call without incurring toll charges.

The new rates go into effect Nov. 7. However, because of the complexity of the PSC ruling, Roche says it will take several days to determine the specific impact on individual customer rates. He adds that the company will issue another statement before Nov. 8 with specific rate information. In addition, customers will receive inserts in their telephone bills beginning Nov. 13 providing specific rate information for their local service.

The PSC also authorized a lifeline discount of $3.50 for low income customers. Eligibility will be based on criteria used by the Department of Social Services.

The PSC also approved a provision allowing United to charge delinquent customers a $1.65 late payment fee.

Charges for directory assistance, long distance calling, 9-1-1 emergency services, public pay phone local calls, touch tone dialing, custom calling features, and service connection charges are not affected.

"We want to thank the many individuals who spoke out in favor of our TeleProgress plan at public hearings across the state and all the residential and business customers who wrote letters in support of our plan," says Roche. "Our desire is to provide all our customers access to the new level of basic modern telecommunications service. However, we'll need additional time to fully assess the implications of the PSC's order and the various options available to the company since the timeframe for the company's TeleProgress modernization plan was closely linked to the overall results of this order.

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