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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into 1985 and 1986 Earnings of QUINCY TELEPHONE COMPANY	DOCKET NO. 870453-TL ORDER NO. 20937 ISSUED: 3-27-89

The following Commissioners participated in the disposition of this matter:

MICHAEL McK. WILSON, Chairman
THOMAS M. BEARD
JOHN T. HERNDON

APPEARANCES: NORMAN H. HORTON, JR., Esquire, and DAVID B. ERWIN, Esquire, Mason, Erwin and Horton, P.A., 1020 East Lafayette Street, Suite 202, Tallahassee, Florida 32301, on behalf of Quincy Telephone Company.

JACK SHREVE, Public Counsel, and CHARLES J. REHWINKEL, Esquire, Office of the Public Counsel, c/o Florida House of Representatives, The Capitol, Tallahassee, Florida 32399-1300, on behalf of the Citizens of the State of Florida.

DONALD L. CROSBY, Esquire, Florida Public Service Commission, 101 East Gaines Street, Tallahassee, Florida 32399-0863, on behalf of the Commission Staff.

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FINAL ORDER

BY THE COMMISSION:

I. BACKGROUND

By Order No. 15333, issued November 5, 1985, the Commission approved a stipulation (the Stipulation) entered into on September 30, 1985, by Quincy Telephone Company (Quincy), the Public Counsel (PC) and our Staff. The Stipulation provided as follows:

> 7. For calendar year 1986, if the Company earns in excess of 16.4% return on equity, the Company agrees to a cash refund to the ratepayers based on a 15.6% return on equity. The refund, if any, shall be made within 30 days of the final true-up of 1986 toll revenues from the toll settlements pool, or its equivalent; provided, however, that the refund shall be made no later

than December 31, 1987. Any refund made pursuant to this paragraph shall be to customers of record at the time the refund is made.

The above refund deadline was extended by the following Orders issued on the dates indicated: No. 18644 (January 4, 1988); No. 19184 (April 19, 1988); and No. 19267 (May 3, 1988). The intervention of PC was acknowledged by Order No. 18771, issued January 29, 1988.

In Order No. 19267, the Commission directed Quincy to refund $155,575 in 1986 overearnings plus interest as an interim step in carrying out the company's refund obligation. This action was deemed appropriate in order to avoid further delay which would have lead to certain subscribers who paid these funds not receiving a benefit as a result of their terminating service.

This proceeding was initiated by Order No. 19439, issued June 6, 1988, recon. denied, Order No. 20065, issued September 26, 1988. Its purpose is to determine the proper amount of 1986 overearnings to be refunded to customers by Quincy in implementing Order No. 15333. In establishing this proceeding, the Commission held that the issues to be heard here are only those not excluded under the following two standards:

> 1. First, if an issue was known to the Commission or could have been known about at the time of approving the Stipulation, then this issue is deemed to have been resolved.
>
> 2. For those issues dealing with occurrences in 1986, the standard will be whether the Commission expected that the controverted expense or cost allocation would be a prudent, appropriate and reasonable entry for that year.

An Issue Identification Meeting was held on September 15, 1988. After considering arguments presented by the parties, the Prehearing Officer ruled on the proposed issues in Order No. 20079, issued September 28, 1988. The Prehearing Officer conducted a hearing on October 12, 1988, to consider arguments by the parties regarding PC's request that Quincy produce external auditors' workpapers generated during the audit of the company's books and records. By Order No. 20184, issued October 20, 1988, the Prehearing Officer granted the Motion to Compel production of these workpapers filed by PC on September 26, 1988, in part and denied the Objections to Second Request for Production of Documents and Request for Protective Order filed by Quincy on September 23, 1988.

A Prehearing Conference was held on October 24, 1988. As a result of this conference, Order No. 20263 was issued on November 7, 1988, setting forth the issues to be addressed in this docket and the parties' positions on these issues. Nineteen issues were identified, four were stipulated and one was deleted.

Hearings were held on the remaining fourteen issues on November 8 and 9, 1988, during which an additional issue was added and two more issues were stipulated. Six witnesses gave testimony and presented exhibits in approximately fourteen hours of hearing time. We considered the issues presented in this docket at an Agenda Conference on February 21, 1989. This Order is based upon our study of the extensive record compiled in this proceeding.

II. LEGAL ISSUES

A. JURISDICTION

Quincy has alleged that we lack jurisdiction to hold a hearing on the issues presented here, arguing that we have only those powers and that authority conferred upon us by statute. The company pointed out that Chapter 364, Florida Statutes, does not grant the Commission the authority to conduct a limited issue proceeding for telephone companies as Florida law does for other industries. Moreover, the company asserted that the Stipulation does not confer any greater jurisdiction upon the Commission than does Chapter 364. Further, PC and our Staff agreed not to initiate a reverse-make-whole proceeding against Quincy, but despite this agreement, Quincy claimed that it was subjected to a limited reverse-make-whole proceeding.

PC disagreed with Quincy's position, arguing that the company conferred jurisdiction on the Commission when it entered into the Stipulation and agreed to make customer refunds under the terms and conditions called for in that agreement. PC pointed out that the Stipulation specifically states at paragraph 2 that: "Accordingly, the parties agreed that the terms of this stipulation shall close out the Commission's review of the Company's earnings for calendar year 1984 and all prior periods." This language indicates clearly to PC that a review of future periods was not foreclosed.

After reviewing these arguments, we find that, by entering into a stipulation with PC and our Staff which provided for future activities and by seeking our approval of such a stipulation, Quincy has recognized our jurisdiction to hold a hearing to determine whether those activities appropriately carried out our expectations in approving that stipulation. Under the jurisdiction over telephone companies' earnings granted to us by the Legislature, we have acquired the inherent authority to approve stipulations that dispose of overearnings in an appropriate manner. The authority to enforce such stipulations naturally flows from this power to approve them. To argue that we can order a company to implement a stipulation but can neither investigate whether this order was properly carried out nor force a company to take remedial action where necessary defies logic.

Additionally, Quincy explicitly conferred upon us the authority to approve the Stipulation by agreeing to its terms. Following the logic explained above, the authority to investigate and order remedial action is part and parcel of this explicit authority conferred on the Commission by the stipulating parties. For these reasons, we act here within our authority through ordering Quincy to take the action discussed below. This action is based on the evidence gathered in this proceeding and, as such, is a lawful exercise of our authority.

With regard to Quincy's charge that we are foreclosed from hearing this matter in a limited proceeding, we would point out that we may exercise inherent authority to tailor our proceedings to reach a lawful result. While other industries are regulated under statutes conferring express authority upon us for conducting limited proceedings, we do not interpret this action by the Legislature as being intended to bar our holding limited proceedings to regulate telephone companies. As a result, we believe that an express statutory grant of limited proceeding authority is not the only means by which we may obtain such power. The limitations placed upon the issues considered in this proceeding were within our inherent authority granted by the Legislature and were adopted in order to establish an efficient and effective procedure for reaching the intended result.

Concerning the company's allegation that we have conducted a reverse-make-whole proceeding in this docket after accepting a stipulation not to do so, we find this argument to be disingenuous. The issues considered in this proceeding were limited to those which were not eliminated under the two standards that we adopted. One standard removed from consideration here all issues deemed to have been resolved by our approval of the Stipulation because we knew or could have known about them at that time. The other barred issues dealing with 1986 occurrences where we expected that a controverted expense or cost allocation would be a prudent, appropriate and reasonable entry for that year. The range of issues that would have been considered in a reverse-make-whole case is far more encompassing than the restricted number heard in this case.

B. STIPULATION

Quincy took the position that our decision in this docket should be controlled by circumstances which existed at the time the Stipulation was executed. The parties agreed that there would be no effort to modify the terms of the agreement. To adjust 1986 earnings by disallowing an expense, despite the recognition of that expense in 1985, would be contrary to the terms of the agreement, according to the company, in that it modifies the terms of the agreement and would be retroactive. If an item was included for determining the level of earnings in 1984 and 1985, it should be recognized in 1986 as well, in Quincy's opinion, even though in an appropriate hearing on a "going-forward" basis the decision might be different. PC argued that the Stipulation and the order approving it constitute a basis for us and the parties to determine our intent in approving the Stipulation.

By approving the Stipulation, we intended for Quincy to refund any 1986 earnings that exceeded a 15.6% return on equity as determined after the close of 1986. We expected that the calculation of these earnings would be based on 1986 expenses and cost allocations that are prudent, appropriate and reasonable for that year. With regard to the Stipulation's provision that all issues between the parties have been resolved, we interpret this to mean that those issues were resolved which were known of or could have been known about at the time when we approved the Stipulation. However, this provision cannot be reasonably interpreted as barring Commission action after the approval date to determine whether Quincy carried out its obligations under the Stipulation.

In our judgement, protection against retroactive ratemaking has been afforded Quincy in this proceeding by our adoption and implementation of the two standards for limiting the issues heard here. The first standard, removing issues that were known about or could have been known about when the Stipulation was approved, carried out the Stipulation's assertion that it resolved all issues dividing the parties when they entered into it. Through applying this issue restriction, we have enforced the Stipulation's requirement that these issues would not be considered further.

However, for the reasons explained above, we believed it appropriate to investigate the steps taken by the company to implement our order approving the Stipulation and authorizing the action called for there. The Stipulation contemplated that action would be taken by Quincy after the approval date; therefore, it cannot be reasonably argued that the Stipulation was intended to preclude any examination by the Commission of the propriety of Quincy's action. We expected Quincy to record 1986 expenses and cost allocations that were prudent, appropriate and reasonable for that year. Hence, the second standard was applied in order to eliminate issues that were outside our expectations for the company's 1986 activities. In this manner, the proceeding has properly centered on whether Quincy carried out its obligations imposed by our order approving the Stipulation. Accordingly, we hold that such action was not foreclosed by the Stipulation's assertion that all issues had been resolved.

III. FACTUAL ISSUES

A. STIPULATED ADJUSTMENTS

1. INSURANCE AND AFFILIATE REFUNDS

This issue involved whether adjustments should be made to reverse out-of-period credits for insurance premium refunds from an insurance company and refunds of amounts overbilled by an affiliated company. The parties stipulated to the position that these adjustments should be made because, in a rate case, these credits would normally have been excluded as out-of-period items. We believe that the intrastate amounts proposed by Quincy of $29,723 for the insurance premium credit and $16,220 for the affiliated company's credit are reasonable.

2. UNDERALLOCATION OF NONREGULATED COSTS

An issue was raised as to whether Quincy underallocated costs to the nonregulated or below-the-line portion of the company in 1986. In Quincy's review of its advertising expenses for 1986, the company located some costs associated with nonregulated or image advertising or both that were inadvertently included above-the-line. The parties stipulated to the position that $2,072, on a total-company basis, and

$1,491, on an intrastate basis, should be removed from 1986 expenses. We believe that the stipulated amounts are reasonable.

3. CHARITABLE CONTRIBUTIONS

PC questioned whether all directly and indirectly incurred and allocated charitable contribution expenses had been removed from Quincy's 1986 revenue requirements. The parties stipulated to the position that Quincy has removed all directly-incurred charitable contributions and has agreed to remove $691 of indirectly-incurred contributions. We believe that this is a reasonable resolution of this issue.

4. CLEARING ACCOUNTS

The parties reached a stipulation regarding whether Quincy has incorrectly "over-relieved" clearing accounts related to vacation, sick and holiday time in a manner which reduced Quincy's refund obligation for 1986. The stipulated position is that Quincy has not "incorrectly" over-relieved clearing accounts for 1986; however, some accounts were not reduced to a zero balance and an adjustment to reduce Florida intrastate expenses by $13,771 should be made. This treatment will also require a revision to Quincy's 1987 surveillance report to increase Florida intrastate expenses by $7,945. We accept this stipulation as reasonable.

5. FLORIDA EMERGENCY EXCISE TAX

A question arose as to whether Quincy has improperly recorded as a 1986 expense, the 1985 provision for Florida emergency excise tax. A stipulation reached by the parties asserts that Quincy has not improperly recorded emergency excise taxes in 1986. There was an entry for 1985 emergency excise taxes made in 1986, and because it is an out-of-period entry, an adjustment to reduce Florida intrastate expenses by $13,489 should be made, according to this stipulation. This has also been adjusted to include $697 in 1986 excise tax expense recorded in 1987. We approve this stipulated adjustment.

6. "OUT-OF-PERIOD" ITC AMORTIZATION

Quincy proposed on October 28, 1988, that an issue be addressed in this proceeding dealing with whether Quincy should adjust its 1986 Surveillance Report for an out-of-period investment tax credit amortization entry of $18,319. There was no objection to this proposed issue, and we granted Quincy's request at hearing. The parties were able to reach the stipulation that Quincy should make an adjustment for this amount of out-of-period investment tax credit amortization. We find that this stipulation is reasonable.

B. ISSUES NOT REQUIRING ADJUSTMENTS

1. LEGAL FEES

Legal fees were allocated to Quincy in 1986 by an affiliated service company, and a question addressed in this proceeding was whether this allocation was reasonable, prudent or of any benefit to the Quincy ratepayers. PC asserted that $26,584, on a total-company basis, of legal expenses allocated from the affiliated service company should not be allowed for purposes of calculating the refund, absent some explanation by Quincy as to how they serve a utility purpose. PC recommended that these expenses be disallowed based on its belief that, since the expenses were for outside legal counsel in Chicago, they probably had no direct or indirect benefit to Quincy's ratepayers. PC believed these expenses may have been incurred to support unregulated operations.

The company claimed that, as a part of a consolidated group of affiliates including this service company, Quincy benefits from its ability to draw upon a large source of assistance and information. The legal fees allocated to Quincy cover general corporate matters, employee benefits, financial matters and general regulatory issues. Together with local representation, these services are said by the company to permit Quincy to have representation and ready access to information on a variety of very specialized and complex areas. Quincy was allocated legal fees in 1984 and 1985, and no adjustment was made in the Stipulation for these expenses.

Upon review, we find that these legal fees are part of the normal course of business. Moreover, we believe that Quincy has demonstrated that these costs are utility-related and appear reasonable in comparison with prior allocations. We note that Quincy explained that all legal fees for its parent company's unregulated operations are billed directly to those operations. These expenses appear to us to be typical of the general corporate legal expenses of many regulated utilities. The allocation of these fees has been relatively consistent with those of prior years and could have been known to all parties at the time of our approval of the Stipulation. We find nothing unusual or inconsistent about these expenses; therefore, these expenses will be allowed and the proposed adjustment will not be made.

2. CONVENTION EXPENSE

PC claimed that allocated convention expenses of $12,239 on a total-company basis should be disallowed unless the company can show how these expenses directly relate to and benefit Quincy's ratepayers. PC contended that these expenses were incurred by employees of affiliates in Chicago and Wisconsin and seemed too far removed to be of any benefit to Florida ratepayers. Quincy and PC appeared to agree that benefits generally accrue from attending conferences and conventions; however, their opinions differed over attendance by the Chicago and Wisconsin staff. Quincy argued that attendance at conferences and conventions afford the opportunity to keep abreast of issues and trends in the industry. Quincy said that it benefits because its employees and advisors are informed and knowledgeable on these trends. Quincy incurred these expenses when the Stipulation was signed and this is not a new expense category.

After considering the evidence, we believe that these convention expenses are part of the normal course of business. The expense was allocated from Quincy's parent company in a manner consistent with similar allocations in years prior to the Stipulation. Quincy has demonstrated that these expenses are utility-related, incurred in the normal course of business and benefit Quincy ratepayers. We find that attendance at conferences and conventions by corporate staff is a normal expense and that it benefits the local operating divisions by enabling the corporate staff to better serve them. These activities provide a form of continuing education allowing the corporate staff to maintain a level of expertise and information to furnish better service to local operations. The allocated expenses are reasonable and consistent with similiar such expense levels in the past. Accordingly, these expenses will be allowed and the proposed adjustment will not be ordered.

C. ISSUES REQUIRING ADJUSTMENTS

1. PRIOR PERIOD AND AMORTIZATION ADJUSTMENTS

a. ADVICE IN TELEPHONY

An issue was raised regarding whether the consulting fees charged to Quincy by Advice in Telephony (AIT) are sufficiently explained or justified or of a prudent level in 1986. PC charged that AIT invoices supporting approximately $27,201 in charges contain no explanation or justification for inclusion as appropriate regulatory expenses. The company argued that AIT provided valuable assistance on a variety of dockets in 1986. The AIT invoices identify the work done, according to Quincy, and that work relates to Florida operations, either in docketed items, tariff filings or undocketed inquiries representing above-the-line regulatory costs.

We find that these expenses were incurred for advice and assistance rendered by AIT in regulatory matters as well as temporary office help. Quincy has adequately demonstrated that these expenses were utility-related and incurred in the normal course of business. The AIT charges questioned by PC, which were not directly identified with a docket number, were explained by the company as having been incurred, as described in the invoices, for assistance: (1) in filing Florida tariffs; (2) in representing Quincy at Commission workshops, industry workshops and agenda conferences; (3) in responding to data requests; (4) for participating in general rules dockets and in universal service proceedings; (5) for pre-rate case preparation; and (6) for temporary office help.

Quincy has identified $7,283, on a total-company basis, of these expenses as having been out-of-period, and PC agrees that these out-of-period expenses should be disallowed. The intrastate portion of this amount, $5,240, must be removed as an out-of-period expense in calculating the total refund. This intrastate amount differs from the total-company amount by the separation factors used, and this adjustment increases intrastate net operating income by $2,674.

Upon consideration, we find that the consulting fees were incurred as part of the normal course of Quincy's business. For this reason and since there has been no major change in company policy with regard to these expenses after the Stipulation was approved, we believe that this issue has been resolved and that no adjustment should be made in the refund amount except for the removal of the consulting fees identified above as being out-of-period.

b. ITC AMORTIZATION

In 1986, we ordered Quincy to record $1,089,732 of depreciation expense associated with the write-off of electromechanical central office equipment (COE). PC believes the additional depreciation expense should have led to higher investment tax credit (ITC) amortization for 1986. PC argues that, after considering out-of-period amounts, ITC amortization is understated by $11,703 on a total-company basis. Quincy maintains that it has not understated ITC amortization for 1986. Quincy claims that, if it is compelled to amortize more ITCs, this action may result in an Internal Revenue Code (IRC) violation by amortizing the ITCs more "rapidly than ratably."

Quincy amortizes its ITCs using a composite rate over the average service life determined by dividing remaining investment by depreciation expense. Quincy's ITC records track the year that ITCs are generated or utilized, but do not show detail by asset and vintage accounts. Therefore, the unamortized balance of ITCs associated with the written-off COE is not identified on the utility's records. PC attempted to quantify this amount; however, Quincy's witness at hearing testified that he perceived errors in PC's calculation, e.g., the use of the wrong rate to generate ITCs for 1972-1974 and of a composite rate instead of a rate specific to the COE of 10.4%.

Our Staff believes that PC's calculation represents a reasonable methodology by which to quantify the unamortized ITC balance associated with the COE. Staff agreed that the ITC rate for 1972-1974 must be corrected, but it did not agree that a composite rate cannot be used. The ITCs associated with the COE were amortized using a composite rate and would continue to be so amortized if left on the books. Quincy was unable to determine the total composite amortization rates for 1972-1981 but was able to supply the composite rates for 1982-1986. Relying upon the average composite rate for 1982-1986 as a surrogate for the pre-1982 rates, our Staff believed that additional ITCs of $13,135, on a total-company basis, and $9,854, on an intrastate basis, should be amortized in 1986. Included in this amount is an adjustment to increase the ITCs utilized for 1986 from $60,000 to $176,800. After the former figure was presented by Quincy at hearing, the company later submitted tax return schedules showing that the higher amount was actually used in 1986.

Quincy expressed concern that the IRC would be violated if the ITC amortization were increased. Its witness cited Revenue Ruling 86-118 which allowed inside wire to be capitalized for tax purposes and expensed for regulatory purposes. It is permissible to write off all of the ITCs associated with inside wire in the first year and concurrently to expense inside wire for regulatory purposes. This witness did not believe that this ruling applies to Quincy's COE since it focused on the regulatory treatment accorded specific property, inside wiring, which gave rise to the ITCs and not on a composite rate that included property having a different life. He also stated that this ruling cannot be applied in this case because Quincy lacks the necessary tax records to implement the IRS's intent.

We agree that a violation may occur if the additional ITC amortization is not limited by the estimate of the unamortized ITCs associated with the COE. Our Staff has made its best estimate of the necessary amortization, given the tax information available. We believe that this calculation complies with the intent of Revenue Ruling 86-118 by amortizing only the ITCs associated with the written-off COE. To do otherwise, and to permit the ITCs to remain on Quincy's books, would allow the company to earn a return on ITCs that do not have associated assets in rate base.

We have previously ordered Quincy to record additional ITC amortization due to additional depreciation expense being recorded. The Stipulation called for a depreciation reserve increase, and incorporated into this reserve amount was a factor to gross up the revenue reduction for investment tax credit amortization. In view of this earlier action, we believe that Quincy should have recorded additional ITC amortization when the company was ordered to record additional depreciation expense in 1986. After making the stipulated adjustment for out-of-period ITC amortization discussed above in this order, our Staff has calculated the necessary net ITC amortization adjustment to be $9,854 on an intrastate basis. We order Quincy to make this adjustment in order to reflect increased amortization resulting from the write-off of COE.

2. MANAGEMENT PRUDENCE ADJUSTMENTS

a. EQUITY RATIO

PC raised the issue of whether the company increased its equity ratio in order to circumvent the Stipulation and Commission policy. PC calculated that Quincy's equity ratio increased from 37.73% prior to the date of the Stipulation to 40.93% on an average 13-month basis. In PC's opinion, the increase in Quincy's equity ratio is attributable to the company's action in lending funds to nonregulated affiliates instead of paying dividends in prior periods. Since such a large portion of Quincy's equity ratio is said by PC to be devoted purposefully to funding nonregulated, nonutility operations, PC asked that we disallow the cost associated with the increase in Quincy's equity ratio above 37.73% which is all attributable to nonutility equity. The equity ratio reflected on Quincy's June 30, 1985 Surveillance Report on file when the Stipulation was executed should be used for purposes of calculating excess earnings, according to PC.

Quincy pointed out that there is no agreement to maintain a constant equity ratio in the Stipulation. To evaluate earnings using a 1984 or 1985 equity ratio would be inconsistent with the terms of the Stipulation and the requirements of law, in Quincy's opinion. Moreover, Quincy alleged that its equity ratio was not unreasonable.

The company pointed out that its equity ratio and the level of its cash and temporary cash investments were issues in the 1985 negotiations between our Staff, PC and the company which led to the Stipulation. A 1984 audit finding developed by our Staff proposed an $851,548 equity adjustment to the company's retained earnings balance. At a June 19, 1985 meeting, the parties to this proceeding conceded the issue on this audit finding as a means of reaching a settlement. We conclude that this issue, as it relates to 1986 earnings, is barred by the first standard adopted to limit the issues in this proceeding because it was known to us at the time of approving the Stipulation.

We believe that our decision to take no action with regard to 1986 earnings does not fully resolve a concern which has arisen during our consideration of this issue. Quincy's temporary cash investments appear excessive at present, and we intend to deal with this possibility on a prospective basis. Our concern flows from the potential for subsidizing a parent company's non-regulated activities through the cost of capital if the regulated utility is allowed to finance other entities through such lending practices. In theory, this can occur where a utility generates funds at its cost of capital, has that cost of capital recovered from ratepayers and lends funds to affiliates at a lower rate. In addition, if cash beyond the amount necessary for the provision of utility service is accumulated, a utility could increase its equity ratio, increase its revenue requirements and thereby lower any overearnings and any potential refund to customers.

In order to ensure that Quincy's financing capacity is not used to provide a source of permanent capital to any affiliate, our Staff took the position that no loans or advances should be extended to the company's parent or any affiliate. Under this view, any loans by Quincy to an affiliate would be treated as a direct reduction of common equity in determining the company's capital structure. The effect of this regulatory treatment would be to recognize the loan as a dividend to the parent.

However, we conclude that ordering Quincy to remove temporary cash investments directly from its equity would be excessive since their current level is approximately 50% of the company's equity. For this reason, we will require that an adjustment be made to Quincy's equity balance shown on the company's surveillance reports in order to reflect the maximum amount of dividends payable under Rural Electrification Administration covenants. This adjustment shall continue to be made until Quincy can prove that the amount of cash and temporary cash investments shown on its financial statements are necessary for the provision of utility service. We define the term "temporary cash investments" as being those investments maturing within one year or one business cycle, whichever is less.

b. NETWORK, ROOF, SWITCH AND SOFTWARE

This issue involves whether Quincy improperly expensed network rearrangement, roof replacement, switch installation, and software development costs in 1986 for the purpose of avoiding a projected refund obligation. These expenses consist of network rearrangement costs of $35,258, roof repair costs of $15,472, building repair costs of $19,008 and software development costs of $22,200. The total amount of expenses at issue is $91,938 on a total-company basis.

PC argued that the evidence adduced at the hearing proved that this treatment was improper because these costs should have been capitalized. Quincy took the contrary position that expensing the costs was appropriate, given the nature of the work done. Some of the costs were capitalized, but those which were expensed were properly treated, according to the company. Quincy did agree that $55,551 of this amount was associated with work done in 1985 and should be removed, but the company argued that the remainder of the costs were correctly expensed.

We will order the removal of prior-period expenses, $55,551 on a total-company basis and $41,651 on an intrastate basis, from 1986 earnings in calculating the additional refunds. Based on the evidence, we believe that the balance of the rearrangement and repair costs, $14,187 on a total-company basis, are part of the normal course of business and appear appropriate as expenses.

All the rearrangement and repair expenses were held in capital work orders; however, although initially recorded as costs incurred in capital projects, these expenses were actually for repairs. Thus, recording them as expenses is consistent with the Uniform System of Accounts and with other similiar expenses incurred prior to the Stipulation. These costs -- $69,738 in total company expenses -- were recorded in Telephone Plant Under Construction accounts for eleven months of 1986 and therefore have overstated rate base.

We have reviewed PC's proposed adjustment of $36,125 to the intrastate portion of Quincy's net operating income and found it to be an incomplete calculation. The effect on rate base of the proposed capitalization and the additional depreciation expense are ignored in PC's computation. Its witness acknowledged that adjustments to rate base and depreciation expense are appropriate, but these adjustments were not made. We will order a reduction in total rate base of $59,738, the average amount of overstatement. This reduces the intrastate portion of rate base by $48,812. The effect on the intrastate segment of Quincy's net operating income of the remaining expenses is $5,464.

Quincy's expensing of software development costs is a departure from usual company-wide operations and could not be foreseen at the time we approved the Stipulation. Accordingly, we find that capitalizing the $22,200 in total-company expenses of software development will return the company to the proper accounting posture. We order that 1986 total-company expenses should be reduced by $22,200 and that Quincy's rate base should be increased by $925, the average amount. Moreover, we will order that one month of accumulated depreciation be recognized, based on a five-year service life of the software since none was taken during 1986. This increases Quincy's total-company expenses by $370, representing one-month's amortization of 20% of $22,200, and decreases rate base by $185, the average amount. The effects of this adjustment are an increase of $287 in intrastate expense and a decrease by $149 in intrastate rate base.

c. TAX DEPRECIATION

PC questioned whether Quincy unreasonably and imprudently increased revenue requirements by discontinuing Accelerated Cost Recovery System (ACRS) tax depreciation solely for the benefit of its parent company's system-wide "business needs." PC claimed that evidence which it introduced at hearing indicates that this treatment was unreasonable and imprudent. Also, PC asserts that the company's testimony on this issue has highlighted the error in the calculation of Quincy's federal tax expense. Since Quincy's tax expense is based on Quincy's marginal tax rate on a stand-alone basis, PC argues that the surtax exemption of $20,250 should be included in the tax calculation. Quincy stated that it has not used the most accelerated form of ACRS since the 1984 tax year. The company points out that this practice was in place at the time the Stipulation was signed and would constitute a modification of the agreement if made. Moreover, Quincy believes that the treatment afforded this item is prudent tax planning and maximizes tax benefits.

We disagree with the company that our consideration of this issue is foreclosed under the standard excluding issues which we should have known about when we approved the Stipulation. While it is true that Quincy elected to use a less-accelerated form of depreciation for tax purposes prior to our approving the Stipulation, we hold that we could not have learned about this fact through any reasonable level of inquiry. Our Staff's audit of the company's books and records was completed on April 11, 1985, and Quincy's external auditors released their report in February of 1985. According to both, accelerated tax depreciation methods were then being used. This change was not implemented until Quincy's parent company instructed the company by memorandum in May of 1985 to change to a slower method of depreciation for tax year 1984. The change took place after all audit steps had been completed and the reports had been issued. Quincy asserts that the parties could have learned about this change through reviewing the workpapers supporting the tax schedules after April of 1985, although it admits that no effort was made to inform the parties about it. Based on the circumstances surrounding the change in tax depreciation methods, we find that it is unreasonable to impute knowledge of it to us, our Staff or PC.

Following the direction of its parent company, Quincy used book depreciation methods to calculate its 1984 and 1985 tax depreciation deductions when ACRS depreciation methods were mandated under the Internal Revenue Code and elected by the company. The company's witness testified at hearing that Quincy's tax returns would have to be amended for those years in order to reflect an appropriate ACRS straight-line method. We agree that the returns must be amended to reflect the appropriate depreciation rates. Once a company has chosen straight line depreciation under ACRS for a given year, it cannot revoke the election for that year.

Since the election is irrevocable, Quincy cannot amend its tax returns to reflect the most accelerated methods of depreciation. For tax purposes, the less accelerated method previously elected by Quincy must be used. Since the tax lives that Quincy must use are longer than the lives prescribed by the Commission, the corrected tax deductions will reduce the amount of deferred taxes by $8,629 on a thirteen-month average, thereby increasing the overall cost of capital.

A company witness testified at hearing that the reason Quincy used less accelerated tax depreciation lives was for consolidated tax return purposes. The consolidated entities had investment tax credit (ITC) carryforwards available for use, and in order to make full use of them, the tax liability of the consolidated entities needed to be higher. Thus, the decision was made to slow the consolidated tax depreciation. This witness stated that Quincy had used all of its available ITCs, on a stand-alone basis, and therefore was not in danger of losing any of their benefit. However, Quincy's tax depreciation was slowed for consolidated purposes not directly related to the company. The effect of this tax depreciation treatment is to increase Quincy's overall rate of return by reducing available cost-free capital. We find that this step taken by Quincy was inappropriate, thereby harming the company's ratepayers based on a tax planning decision make in the interest of the consolidated entities.

On January 30, 1970, we issued an order requiring all electric, gas and telephone companies to use accelerated depreciation for tax purposes. This order stated that any company not intending to do so should explain to the Commission its reasons for electing otherwise. We note that Quincy responded to this order, expressing its intent to use accelerated tax depreciation. Moreover, we note that Quincy's rates were set in its last rate case in anticipation of the company's use of accelerated tax depreciation. The company has indicated that it plans to use the most accelerated form of tax depreciation in the future. We will order Quincy to do so in the absence of a showing, on a stand-alone basis, that this would be imprudent tax planning or would cause harm to its ratepayers in the long run.

Quincy's parent company unilaterally decided to decelerate the company's tax depreciation with the certain knowledge that Quincy's revenue requirements would increase for its ratepayers. This effect will be felt by Quincy's ratepayers for 1986 and for prospective years. This action is inconsistent with our policy that utilities shall provide adequate, reliable service at the lowest reasonable cost to their ratepayers. We hold this to have been an imprudent decision for Quincy's management to make on behalf of a utility operating in a regulated environment.

PC has raised an ancilliary tax issue in its brief, urging that a surtax exemption should be included in Quincy's income tax calculation, thus treating the company on a stand-alone basis. A surtax exemption was included in the income tax calculation neither at the time the Stipulation was entered into nor at the time of Quincy's last rate case. For these reasons, we do not believe it is appropriate to consider this issue in this proceeding. The income tax expense should continue to be calculated without the surtax exemption as was done in the company's last rate case.

d. COSTS OF ACQUISITIONS

Quincy has been allocated a portion of the expenses incurred by its parent company's corporate development staff relating to the acquisition of telephone companies. PC has identified $22,122, on a total-company basis, in costs associated with acquisition and development by Quincy's parent company, which it believes to be costs that are related to nonutility operations. PC alleges that Quincy's ratepayers should not bear the expense of these parent company acquisition costs and urges us to disallow them for purposes of calculating a refund. The company believes that, as more operating companies are acquired, a larger base for distributing fixed costs is thereby created and the larger affiliated group can obtain increased discounts based upon greater purchasing power. Quincy argues that these expenses were being incurred at the time of the Stipulation and its approval.

The costs questioned by PC consist of corporate development staff costs relating to business acquisitions allocated from the parent company that are consistent with similar allocations in years prior to the Stipulation. PC's position is that acquisition costs that do not relate to Quincy or regulated operations are not appropriate expenses of the local operating division. Quincy contends that the acquisition of additional telephone companies provides economies of scale to the larger affiliated group, e.g., volume discounts for equipment purchases, fleet discounts on vehicles and an expanded base across which to distribute fixed costs. These costs are far removed from Quincy's utility operations; therefore, we believe that the company must carry a heavier burden of proof as to the prudence of these expenditures as well as the appropriateness and reasonableness of their allocation. We believe that the general overhead expenses of seeking and acquiring additional business operations could provide benefits to existing ratepayers, as argued by Quincy; however, we perceive a possible detriment as well. In this instance, Quincy has not adequately shown that significant benefits accrued to its ratepayers from these acquisitions. The company's 1986 annual report shows increases in general office expenses beyond the level that we would expect, based on growth and inflation, and Quincy has failed to show the effect that acquisitions have had on this increase.

Quincy has not demonstrated that its allocation of such costs from its parent company is reasonable. We would expect such costs to be divided between operating divisions through a rational and fair allocation procedure that distributes costs based on whether the division caused or benefitted from the acquisition. While Quincy shareholders obviously benefit or suffer from the acquisition of additional business operations, the company has not shown that they share in the costs of such activities. In our judgement, these costs could be allocated to the operations being acquired in the same manner as direct costs are applied.

We do not accept Quincy's argument that these allocated costs of acquisitions are utility-related and provide benefits to Quincy's ratepayers. As a result, we disallow $22,122, on a total-company basis, and $15,916, on an intrastate basis, in calculating the total refund of 1986 revenues.

e. ADDITIONAL ADJUSTMENTS

(1) INCREASE IN REFUNDS

Based on the four instances of management imprudence discussed above, we find that the total amount of 1986 earnings that should have been refunded must be increased by $26,758. Through ordering this adjustment, we intend to disallow a portion of Quincy's management expenses for these imprudent decisions. The amount of the disallowance has been derived using a percentage representing the relationship of 1986 administrative and general expenses to 1986 revenues. This percentage, 12.7%, is found by dividing 1986 expenses, $640,084, by 1986 revenues, $5,031,912. The adjustment is computed by multiplying this percentage by total refund called for prior to this adjustment, $210,689.

(2) FUTURE REQUIREMENTS

Because each of the imprudent management decisions discussed above will increase Quincy's revenue requirements for prospective years, we also order a prospective adjustment in Quincy's return on equity of 50 basis points. This 50-basis-point adjustment approximately equals the additional revenue requirement that Quincy's ratepayers must bear in the future. This prospective adjustment is intended to impress upon the management of the company the importance of considering these long-range effects on revenue requirements in its decision-making. This future sanction is deemed reasonable in light of Quincy's violation of our order and policy on accelerated tax depreciation, causing the company to operate at other than the lowest reasonable cost. It is additionally being imposed for the company's handling of its equity ratio, its treatment of the software expenses and its allocation of acquisition costs.

In selecting this reduction in Quincy's return on equity, we have considered the action that we would have taken had this proceeding been a rate case. Were we establishing rates for the company in such a forum, we would reduce the return on equity that we would otherwise authorize for 1986. Since this proceeding's scope does not embrace rate-setting and because we are constrained by our order approving the stipulated 15.6% return on equity, we do not believe that we should take such action with regard to the refund of 1986 revenues. Therefore, we are taking this action on a prospective basis only.

By Order No. 18831, issued February 9, 1988, Quincy's authorized return on equity range was set at 12.8% to 14.8% with a 13.8% midpoint. The action we take here will result in Quincy's authorized return on equity range being reduced to between 12.3% and 14.3% with its midpoint being lowered to 13.3%. We hold this to be a reasonable return on equity range to be authorized for Quincy until the company's next rate case or until it can demonstrate that management decisions are being made in consideration of the costs to its ratepayers.

3. CASE EXPENSE ADJUSTMENT

Quincy claimed that the costs associated with this docket should be incorporated in the 1986 Surveillance Report. To apply these costs to any other period, according to the company, would deny recovery or result in future subscribers paying this expense. PC charged that no expenses incurred subsequent to December 31, 1986, should be allowed as a proforma adjustment into 1986 operations for purposes of determining a refund.

We will accept our Staff's recommendation that Quincy be allowed to include $31,921 as an expense in the 1986 refund calculation, which represents the costs associated with this proceeding that were presented by Quincy at the hearing. Quincy claimed that $31,921 in 1988 expenses -- incurred between April 15th and September 1st -- were related to this docket, consisting of hearing preparation, participation at agenda conferences and response to inquiries by PC and Staff. We find that these costs are directly related to this proceeding, and we believe that to assign them to any period other than 1986 would burden those ratepayers with costs for which they will receive no benefit.

We accepted the Stipulation in anticipation of saving Quincy's ratepayers the costs of a hearing. Since a hearing was held, we find that its costs to the company should become part of the refund calculation since they serve no other purpose. We will allow the costs presented at the hearing, $31,921 in intrastate expense, as a decrease in the refund calculation. The adjustments that we approve herein will result in a further refund, and we conclude that Quincy should be allowed to recover these costs from the customers who benefit. We are aware that, in most cases, such expenses are required to be recorded in the year in which they are incurred, but the expenses of determining a prior year's earnings have usually been relatively small in those cases. The hearing expenses have become significant in this case, and we believe that this is an additional reason underlying our decision to include this $31,921 charge in the 1986 refund calculation.

IV. FURTHER REFUNDS OR OVER-REFUNDS

PC urged us to order Quincy to refund to its customers the additional amount of $209,854, plus interest from January 1, 1986. The company took the position that further refunds are not necessary because it believes that it has overrefunded by $75,879, excluding interest. Based on the foregoing discussion, we hold that Quincy has underrefunded by $82,322 and should refund that amount plus interest from January 1, 1986, as shown on Attachments A, B, C and D. Order No. 19267, issued May 3, 1988, required Quincy to refund to its customers the amount of $155,575 in 1986 overearnings plus interest during the May 1988 billing cycle in accordance with the relationship among various classes of basic local exchange services. We find that the additional refunds ordered here should be carried out in a similiar manner. Refunds should go to those customers of record as of January 31, 1989.

In view of Quincy's opinion that it has overrefunded, the company claimed that it should be permitted to recover the amount of these over-refunds identified above by a surcharge on its customer bills. PC took the position that Quincy is not entitled to any such recovery. As a result of our decision that further refunds are due, we find that Quincy has not overrefunded and hence is not entitled to any recovery.

V. MOTION TO DISMISS

At the conclusion of PC's case at hearing, Quincy moved to dismiss the following issues which are discussed above at the sections of this Order indicated below:

SECTION:	ISSUE:
III.C.2.a.	Equity Ratio
III.C.2.b.	Network, Roof, Switch and Software
III.C.2.c.	Tax Depreciation
III.B.1.	Legal Fees
III.C.1.a.	Advice in Telephony
III.B.2.	Convention Expense
III.C.2.d.	Costs of Acquisition

The Commission took this motion under advisement at that time and decided to rule upon it later. In support of its motion, Quincy argued that these issues were excluded from consideration in this proceeding by the standard which rules out any issue that was known about or could have been known about when the Commission approved the Stipulation. PC argued that these issues were not excluded because they concerned improper allocations or charges, e.g., an equity ratio increase. Moreover, PC asserts that the Commission has properly decided to hold this hearing and to hear these issues.

Quincy's motion to dismiss is denied because of the action taken herein with respect to these issues. For the reasons explained above where each issue is addressed, we have determined that the contested issues were not excluded by either of the two standards adopted to govern the scope of this proceeding. Accordingly, we believe that our action disposing of these issues is a proper application of the scope limitations adopted for this proceeding.

VI. MISCELLANEOUS MATTERS

On October 28, 1988, Quincy filed a Motion to File Supplemental Testimony of James W. Butman relating to the company's advertising expense. Quincy maintained that it lacked knowledge of the specific issue until our Staff completed its audit of Quincy's 1987 surveillance report. As a result, the company said it could not address this issue in direct or rebuttal testimony. There was no objection to this motion, and we granted it at hearing.

On November 3, 1988, Quincy filed a Motion to File Testimony of David A. Kelly relating to Quincy's amortization of Investment Tax Credits. Quincy alleged that it lacked knowledge of the specific issue until PC presented the issue at the Prehearing Conference beyond the deadline set for filing testimony. There was no objection to this motion, and we granted it at hearing.

VII. ORDERING CLAUSES

It is therefore,

ORDERED by the Florida Public Service Commission that each and all of the specific findings herein are approved in every respect. It is further

ORDERED that the Florida Public Service Commission has jurisdiction over the subject matter of this proceeding and has conducted this proceeding under its authority to determine whether Quincy Telephone Company has properly carried out its obligations under Order No. 15333, issued November 5, 1985. It is further

ORDERED that the Stipulation entered into on September 30, 1985, and approved by Order No. 15333, issued November 5, 1985, does not preclude the Florida Public Service Commission from determining whether Quincy Telephone Company has properly carried out its obligations under Order No. 15333, issued November 5, 1985. It is further

ORDERED that the stipulated or proposed adjustments to the total refund of 1986 revenues to be made by Quincy Telephone Company are hereby disposed of in the manner adopted in the body of this Order. It is further

ORDERED that Quincy Telephone Company shall refund to its customers $82,322 in 1986 earnings plus interest from January 1, 1986, in accordance with the directions provided in the body of this Order. It is further

ORDERED that the Motion to Dismiss made at hearing by Quincy Telephone Company is hereby denied. It is further

ORDERED that the Motion to File Supplemental Testimony of James W. Butman filed on October 28, 1988, by Quincy Telephone Company is hereby granted. It is further

ORDERED that the Motion to File Testimony of David A. Kelly filed on November 3, 1988, by Quincy Telephone Company is hereby granted.

By ORDER of the Florida Public Service Commission, this 27th day of MARCH, 1989.

Steve Tribble

STEVE TRIBBLE, Director
Division of Records and Reporting

(S E A L)
DLC

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

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QUINCY TELEPHONE COMPANY ADJUSTED RATE BASE ATTACHMENT A

ISSUE NO.	DESCRIPTION	(1) TOTAL COMPANY	(2) SEPARATION FACTOR	(3) INTRASTATE
	RATE BASE PER ESR			
	PLANT IN SERVICE	$15,874,566	80.58%	$12,792,261
	DEPRECIATION RESERVE	(6,209,355)	82.20%	(5,103,988)
	NET PLANT IN SERVICE	$9,665,211	79.55%	$7,688,273
	TPUC (NO IDC)	1,017,586	87.35%	888,900
	FUTURE USE PROPERTY	0		0
	WORKING CAPITAL ALLOWANCE	(58,728)	79.55%	(46,716)
	AVERAGE RATE BASE	$10,624,069	80.29%	$8,530,457
	ESR ACCOUNTING ADJUSTMENTS	(144,614)	100.00%	(144,614)
	ADJUSTED AVERAGE RATE BASE PER ESR	$10,479,455	80.02%	$8,385,843
	ADJUSTMENTS TO ESR			
8.	a. REMOVE EXPENSES FROM TPUC	($59,739)	81.71%	($48,813)
	b. INCLUDE SOFTWARE DEVELOPMENT COSTS	740	80.54%	596
	TOTAL ADJUSTMENTS ...	(58,999)	81.73%	(48,217)
	ADJUSTED RATE BASE	$10,420,456	80.01%	$8,337,626

QUINCY TELEPHONE COMPANY — ADJUSTED NET OPERATING INCOME — ATTACHMENT B

ISSUE NO.	DESCRIPTION	(1) TOTAL COMPANY	(2) SEPARATION FACTOR	(3) INTRASTATE
	NOI PER ESR			
	BOOKED REVENUE	$6,472,467	77.76%	$5,033,194
	UNCOLLECTIBLES	(1,282)	100.00%	(1,282)
	NET BOOKED REVENUE	$6,471,185	77.76%	$5,031,912
	OPERATING EXPENSES	$4,865,113	77.68%	$3,779,044
	OPERATING TAXES	690,298	78.70%	543,265
	TOTAL OPERATING EXPENSES .	$5,555,411	77.80%	$4,322,309
	PER BOOK NOI	$915,774	77.49%	$709,603
	ESR ADJUSTMENTS	197,231	71.80%	141,604
	ADJUSTED NOI PER ESR	$1,113,005	76.48%	$851,207
	ADJUSTMENTS TO ESR			
4.	EXPENSES OF THIS CASE			($16,289)
8.	a. OUT-OF-PERIOD WORK ORDER EXPENSES			21,254
	b. SOFTWARE DEVELOPMENT COSTS			7,796
9.	DISALLOWED GENERAL EXPENSES DUE TO IMPRUDENT MANAGEMENT .			13,655
11.	AIT CONSULTING			2,674
14.	BUSINESS ACQUISITION COSTS			8,122
18.	RESTATEMENT OF ITC AMORTIZATION REVERSAL			9,854
3.	STIPULATED: AETNA & TSSD CREDITS			(23,445)
12.	STIPULATED: NON-REGULATED ADVERTISING			761
15.	STIPULATED: CHARITABLE CONTRIBUTIONS			353
16.	STIPULATED: OVER/(UNDER) RELIEVED CLEARING ACCOUNTS			7,028
17.	STIPULATED: OUT-OF-PERIOD EMERGENCY EXCISE TAX			6,884
	INTEREST SYNCHRONIZATION			(895)
	TOTAL ADJUSTMENTS			$37,752
	ADJUSTED NOI			$888,959

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QUINCY TELEPHONE COMPANY — ADJUSTED COST OF CAPITAL — ATTACHMENT C

ISSUE NO.	DESCRIPTION	(1) AMOUNT	(2) RATIO	(3) COST RATE	(4) WEIGHTED COST
	CAPITAL COMPONENTS				
	LONG TERM DEBT	6,408,927	47.23%	7.40%	3.50%
	CUSTOMER DEPOSITS	100,826	0.74%	8.00%	0.06%
	COMMON EQUITY	4,441,096	32.72%	15.60%	5.10%
	INVESTMENT TAX CREDITS	$713,380	5.26%	10.76%	0.57%
	DEFERRED TAXES	1,906,229	14.05%	0.00%	0.00%
	TOTAL CAPITAL	$13,570,458	100.00%		9.23%

ADJUSTMENTS TO CAPITAL COMPONENTS

ISSUE NO.	DESCRIPTION		
	LONG TERM DEBT		6,408,927
	CUSTOMER DEPOSITS		100,826
	COMMON EQUITY		4,441,096
	INVESTMENT TAX CREDITS	$719,948	
18.	INCREASED ITC AMORTIZATION	(6,568)	
	ADJUSTED INVESTMENT TAX CREDITS		$713,380
	DEFERRED TAXES	$1,914,858	
9.	DEPRECIATION ADJUSTMENT	($8,629)	
	ADJUSTED DEFERRED TAXES		1,906,229
	ADJUSTED TOTAL CAPITAL		$13,570,458

QUINCY TELEPHONE COMPANY — REVENUE REQUIREMENTS — ATTACHMENT D

Adjusted Achieved Intrastate Net Operating Income		$888,959
Required Net Operating Income:		
Adjusted Intrastate Rate Base	$8,337,626	
Required Rate of Return (Max)	9.23%	
Required Net Operating Income		769,563
Excess Intrastate Net Operating Income		$119,396
Revenue Expansion Factor		1.992510
Intrastate Revenue to be Refunded		$237,897
Less May 1988 Refund per Order No. 19267		155,575
Additional Refund before Interest		$82,322