30

FLORIDA PUBLIC SERVICE COMMISSION

Fletcher Building
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Tallahassee, Florida 32399-0850

M E M O R A N D U M

February 23, 1995

TO : DIRECTOR, DIVISION OF RECORDS AND REPORTING

FROM : DIVISION OF AUDITING & FINANCIAL ANALYSIS (DAVIS, LEE, MAILHOT) DM
DIVISION OF COMMUNICATIONS (GREER, LONG)
DIVISION OF LEGAL SERVICES (BILLMEIER)

RE : DOCKET NO. 910731-TL - NORTHEAST FLORIDA TELEPHONE COMPANY, INC. - MODIFIED MINIMUM FILING REQUIREMENTS REPORT OF NORTHEAST FLORIDA TELEPHONE COMPANY, INC.

DOCKET NO. 920260-TL - SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY - COMPREHENSIVE REVIEW OF THE REVENUE REQUIREMENTS AND RATE STABILIZATION PLAN OF SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY

AGENDA: 03/07/95 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\AFA\WP\910731.RCM

CASE BACKGROUND

Northeast Florida Telephone Company, Inc. (Northeast or the Company) filed its Modified Minimum Filing Requirements on July 22, 1991. By Order No. PSC-92-0337-AS-TL, issued May 12, 1992, the Commission approved, with certain modifications, a settlement agreement (the Agreement) submitted by Northeast and the Office of Public Counsel. The Agreement required rate reductions and addressed earnings until Northeast's Bill and Keep Subsidy is eliminated.

This Docket has remained open so that the Commission could continue to monitor the results of the rate reductions and monitor compliance with the provisions of the Agreement which address future earnings until Northeast's Bill and Keep Subsidy is eliminated.

This recommendation presents the recommended disposition of 1993 earnings based on staff's review of Northeast's final 1993 Earnings Surveillance Report, filed on September 14, 1994. The *Agreement* provides that to the extent that, subsequent to January 1, 1993, Northeast earns in excess of the 13.20% ceiling established by the Agreement, Northeast will refund such overearnings to the payor of the Bill and Keep Subsidy, Southern Bell (Attachment C), and will also eliminate future subsidy receipts by a like amount. The amount of 1993 earnings is addressed in Issue 1. Issue 3 addresses Northeast's request to write off the Stromberg-Carlson DCO Processor and associated equipment submitted on September 13, 1994. The disposition of the 1993 overearnings is addressed in Issue 4. Prospective changes to the Bill and Keep Subsidy are addressed in Issues 5 and 6.

This recommendation was presented to the Commission at the December 6, 1994, agenda and was deferred to allow the Company to develop more detailed demand forecasts and to allow staff time for more comprehensive research of the DCO Processor change-out. This recommendation incorporates the results of the Company and staff's efforts.

DISCUSSION OF ISSUES

ISSUE 1: Did Northeast Florida Telephone Company earn in excess of its maximum stipulated return on equity (ROE) of 13.20% for 1993?

RECOMMENDATION: Yes, the Commission should recognize $158,432 in revenue which exceeds 13.2% ROE, Northeast's maximum stipulated ROE for 1993, as a final settlement of Northeast's 1993 earnings. (DAVIS)

STAFF ANALYSIS: Northeast filed its preliminary 1993 Earnings Surveillance Report (ESR) in March 1994 and the final 1993 ESR on September 14, 1994. An audit of Northeast's 1993 earnings was completed by staff and a report was issued on July 18, 1994. The audit included disclosures concerning jurisdictional revenue and interest reconciliation which prompted adjustments of the final 1993 ESR.

On September 14, 1994, Northeast filed its final ESR incorporating the revised cost study filed with NECA and the audit findings. Based on staff's review and modification of the final ESR, Northeast's earnings above the maximum allowed ROE of 13.2%, as set forth in the Agreement for 1993 are $158,432, as shown on Attachment A, which is available for disposition in accordance with the Agreement.

ISSUE 2: Is the retirement of the DCO switch processor reasonable?

RECOMMENDATION: Yes, the Company's upgrade to the Siemens Stromberg-Carlson Vision ONE processor is reasonable. (GREER)

STAFF ANALYSIS: Staff is divided as to the criteria to use to support advanced infrastructure deployment for rural areas in a LEC's service territory. Although staff believes there are two criteria that can be used to determine the appropriateness of an infrastructure initiative, staff believes the overall answer in this case is the same regardless of which criteria is used. Staff believes the Commission can review either the overall benefits of a potential retirement or the cost and market demand when determining if the deployment of infrastructure is appropriate. Staff will briefly discuss the two criteria below.

OVERALL BENEFITS OF THE UPGRADE

This criteria recognizes the move to a competitive network and the desire to develop an advanced infrastructure within the various networks, without regard to locale. Staff realizes the ability to provide cost/benefits justification for rural areas is difficult for some companies since the number of present subscribers who express an interest in these advanced services may be minimal. Trying to forecast new demand created by residences and businesses migrating into the area is even more difficult due to the Company's limited resources. For some LECs, the ability to provide advanced services out of other central offices equipped with these types of services is a possible alternative. However, this alternative is virtually impossible for small LECs since the Company may only have one or two central offices in its service territory (as is the case for Northeast), none of which may be capably equipped.

Staff believes there is considerable sentiment for developing an advanced infrastructure that will provide information age services to consumers no matter if the consumer lives in Jacksonville or Macclenny. In order to develop this infrastructure it will be necessary in some cases for companies providing services to rural areas to deploy equipment that may not initially meet the normal economic test, which requires the revenues generated to recover the investment in a reasonable time frame. However, if this economic test is not met, staff believes the infrastructure deployment should be a logical progression of the Company's network plan. In addition to providing consumers in rural areas with the potential to purchase advanced services, deployment of an advanced infrastructure may even provide a economic boost by attracting new businesses into an area. Therefore, it makes the deployment of advanced infrastructure beneficial not only to the Company, but to the consumers located in these rural areas. Staff believes this upgrade meets the overall benefits test since it introduces potential revenue sources that do not currently have a market demand and provides an advance infrastructure which could potentially provide an economic boost for the area.

MARKET DEMAND AND COST SUPPORT

The second possible criteria to use is to require cost support and market demand to justify the deployment of advanced infrastructure within these rural territories. Staff believes the determination of prudency is a very difficult process due to the capability and upgradability of the telecommunications equipment of today; and therefore, must be handled on a case-by-case basis. Generally due to time and personnel constraints associated with depreciation or rate case proceedings, staff is limited to reviewing in detail only the large budget items such as switches or outside plant installations for each Company, unless a specific concern has been brought to its attention. The information reviewed varies depending on the circumstances surrounding the Company's request. For most retirements, staff requires cost and revenue data for the possible alternatives available to the Company, plus any other factors that may affect the retirement of the specific plant such as problems with outages or lack of support by an equipment vendor. This approach ensures the Company has evaluated all the alternatives and chosen the best alternative for the Company's situation. For the other items identified in a depreciation or rate case proceeding, staff generally evaluates the Company's overall projections/assumptions for reasonableness in the specific areas being reviewed such as the strategy of deploying fiber in the Company's network.

In this request, Northeast is asking the Commission to write-off the unrecovered total company investment in current Siemens Stromberg-Carlson (Siemens) DCO processor and associated equipment which is approximately $448,700. The DCO was initially installed in 1984 with the original processor being replaced in 1991. The Company proposes to convert the current processor for this switch to a Siemens Vision ONE Universal Platform. The Company claims this platform will provide increased call processing capabilities and multi-processor functionality with modular growth. Simply put this means that Northeast would be able to offer services such as ISDN and have the ability to add Advanced Intelligent Network (AIN) and Personal Communications Services (PCS) for an additional price.

Northeast's current DCO processor is at software Release 17.3 which provides Custom Calling Features, Advanced Calling Features, Equal Access, SS7, Voice Mail, Interchangeable NPA Codes, Four-Digit CIC codes, as well as Basic Local/Long Distance Services to its customers. Siemens has stated that it will provide upgrades to the current processor through Release 21 at a cost of approximately $50,000 per Release for the base features. It is staff's understanding that the releases between 17.3 and 21 would basically provide enhancements to present services, but would not include all of the services contained in the Vision ONE upgrade.

The Company has identified six (6) features, Repeat Dialing, Call Return, Priority Ringing, Preferred Call Forwarding, Call Screening and Special Call Acceptance, that it believes will experience an increase in the market demand by 25 - 50 percent with the deployment of Release 18. This release as shown on the table below will cost approximately $75,000, while generating revenue of $26,400 - $52,800, depending on which projected market demand increase is used. In addition, the Company states that it estimates approximately 80 percent of the customers that subscribe to Caller ID (147) have requested Calling Name Delivery which is provided via Release 19 at a cost of approximately $60,000. Using SBT's Calling Name Delivery rate, $7.50, staff estimates the revenue generated per year is in the range of $13,230. The Company has also projected a market demand of 52 business subscribers and one residential subscriber of ISDN, which is provided via the Vision One platform. Staff estimates the revenue generated to be approximately $127,200 per year. This estimate was developed by using SBT's ISDN basic business rate service with 2 ISDN lines with a slow packet switching D channel, approximately $200 per customer. Adding these revenue sources together provides a possible annual revenue of between $195,000 and $222,000. With a cost of $542,000 for the Vision One upgrade, it appears Northeast will recover its investment in at least 5 years assuming the Company's projected demand for these services are accurate. Table 1 shows a breakdown of the approximate costs and revenues associated with Northeast's projected data.

TABLE 1

Upgrades	Cost	Projected Revenues per Release (year)	Total Revenues (year)
Release 18 with optional Automatic Recall Blocking and 1+ presubscription	75,000	26,400 * 52,800 **	26,400 * 52,800 **
Release 19 with optional Calling Name Delivery	60,000	13,230	39,630 * 66,030 **
Vision ONE ** (Includes all features in 18 and 19)	542,489	127,200 ***	166,830 * 193,230 **

* Revenues using projected demand increase of 25 percent.
** Revenues using projected demand increase of 50 percent.
*** Uses $200 per month revenue for each ISDN customer.

In addition to generating sufficient revenue to recover the investment in a reasonable amount of time, the Vision One upgrade will eliminate the need to upgrade the current processor for the projected demand requiring Releases 18 and 19, at a cost of approximately $135,000. It is staff's understanding that the Vision ONE upgrade will provide all of the base and optional features contained in Releases 17.3 - 21 in addition to ISDN, some enhanced Centrex services and some data and dial-up video conferencing services. The Company would also have the ability to offer AIN, PCS, Automatic Call Distribution and a SONET transmission standard known as TR-303 at an additional price with the Vision ONE upgrade. Although staff believes the revenues shown in Table 1 justify the upgrade to the Vision ONE platform, staff is reserving judgement about the projected demand for ISDN in the rural areas. Therefore, staff intends to monitor the development of these services in order to see if Northeast's projections are correct. Nevertheless, Northeast has provided enough support for staff to have reasonable assurance that the Company's plan to replace the current processor with the Vision ONE upgrade is reasonable.

As stated earlier, staff believes there are two different possible criteria to use to justify infrastructure deployment. In this case, staff believes the upgrade to the Vision ONE platform meets both criteria and thus should be approved. Staff believes the upgrade to the Vision ONE platform is a logical progression of Northeast's switching hierarchy, and therefore is a reasonable investment for the Company to make. In addition, staff believes the Company has provided sufficient cost and market demand that would satisfy the second criteria discussed above. Therefore, no matter which criteria is used to justify the infrastructure deployment, staff believes Northeast's upgrade to the Vision ONE platform should be approved.

ISSUE 3: Should Northeast's request to write off the unrecovered investment associated with its present DCO switch processor and related equipment by the end of 1995 be approved?

RECOMMENDATION: Yes. (LEE)

STAFF ANALYSIS: Northeast's present switch is a Siemens Stromberg-Carlson DCO which was placed in service in 1984. The original processor was replaced in 1991. The DCO is now at Release 17.3 and it is staff's understanding that Stromberg-Carlson will continue releases through 21. After that time, however, the DCO will have to be upgraded to the Vision ONE Universal Platform. This platform is now under development and currently scheduled to be available the first quarter of 1996. According to the Company, increased call processing capabilities and multi-processor functionality with modular growth will be provided by this platform.

The upgrade to Vision ONE will require the current processor and some switching hardware and circuit equipment to be retired. The projected December 31, 1995 total company investment and associated reserve of the assets subject to retirement are $676,578 and $233,874, respectively. A cost of removal is anticipated in the amount of $6,000. By letter the Company has proposed that the projected unrecovered total company investment of $448,704 ($305,119 intrastate) be written off by applying 1993 overearnings with the residual amount to be written off in 1994. This action assumes the present provision for depreciation will continue for 1994 and 1995. In light of the fact that staff is recommending that this retirement is reasonable as discussed in Issue 2, recovery through depreciation for the associated unrecovered investment should follow. Staff therefore recommends approval of Northeast's request to write-off the associated unrecovered investment by year-end 1995.

ISSUE 4: What is the appropriate disposition of the amounts identified in Issue 1?

RECOMMENDATION: $160,968, consisting of the $158,432 in intrastate revenue identified in Issue 1 plus $2,536 in interest accrued through December 31, 1993, should be applied to the Stromberg-Carlson DCO Processor and associated equipment unrecovered intrastate investment of $305,119. The $160,968 will be treated as a reduction to rate base in 1994. (DAVIS)

STAFF ANALYSIS: Issue 1 identifies intrastate revenues of $158,432 in excess of the 13.20% ROE.

On September 13, 1994, Northeast requested that it be allowed to write off its present unrecovered investment of its Stromberg-Carlson DCO Processor and associated equipment by the end of 1995. The amount proposed to be written off for 1993 would offset the excess earnings. In Issue 3, staff recommends that the proposed write-off be approved.

The Agreement provides that to the extent that subsequent to January 1, 1993, Northeast earns in excess of the 13.20% ceiling established by the Agreement, Northeast will refund such overearnings to the payor of the Bill and Keep Subsidy, which is Southern Bell, and will also eliminate future subsidy receipts by a like amount. Northeast's earnings above the maximum allowed ROE of 13.2%, as set forth in the Agreement for 1993 are $158,432, as shown on Attachment A, and should be used to reduce Northeast's intraLATA subsidy receipts as discussed in Issue 5. Based on discussions with Southern Bell and the Office of Public Counsel, staff recommends that $160,968 ($236,718 total company), consisting of the $158,432 in intrastate revenue identified in Issue 1 plus $2,536 in interest accrued through December 31, 1993, using the half year convention, be used to write off part of the present unrecovered investment of the Stromberg-Carlson DCO Processor and associated equipment. The $160,968, which represents the 1993 write off, will be a reduction to rate base for 1994.

ISSUE 5: Should the Commission approve the reduction of Northeast's intraLATA bill and keep subsidy receipts as shown on Attachment C?

RECOMMENDATION: Yes. Northeast's intraLATA subsidy receipts should be reduced by $158,000 annually, effective July 1, 1995. The intraLATA subsidy pool receipts and payments shown on Attachment C should be approved, effective July 1, 1995. (MAILHOT)

STAFF ANALYSIS: On January 1, 1988, the intraLATA LEC toll bill and keep subsidy pool was established in Docket No. 850310-TL, Implementation of Local Exchange Company Toll Bill and Keep, with all LECs except GTE and Vista-United participating. GTE and Vista-United, which experienced net losses from the implementation of LEC toll bill and keep, elected not to receive subsidies and do not participate in the pool. Pursuant to Order No. 21597, ALLTEL, Centel, Florala, Gulf, Quincy, and United were allowed to withdraw from the intraLATA subsidy pool. Pursuant to Order No. 21955, Indiantown was removed from the intraLATA subsidy pool due to its excess earnings. St. Joe's subsidy was reduced and then eliminated by Order Nos. 22418 and 22994, respectively.

The subsidy pool was established as a temporary mechanism to ease the transition from a pooling environment to a pure bill and keep environment. The subsidy amounts were phased down on January 1st of 1989, 1990 and 1991. Through that phase down mechanism, many of the LECs were able to transition out of the intraLATA bill and keep subsidy pool. Since January 1, 1991, the subsidy receipts and payments have not changed and will not change except by specific action of the Commission. The current status of the intraLATA subsidy pool is shown in Attachment B.

Staff recommends that Northeast's intraLATA subsidy receipts be reduced on July 1, 1995 in accordance with the Agreement. The intraLATA subsidy pool receipts and payments shown on Attachment C should be approved, effective July 1, 1995.

ISSUE 6: Should Southern Bell's reduced subsidy payment be treated as an additional set aside amount in Docket No. 920260-TL?

RECOMMENDATION: Yes. The Commission should treat Southern Bell's reduced subsidy payment as an additional set aside amount to be disposed of in Docket No. 920260-TL. (MAILHOT)

STAFF ANALYSIS: If the Commission approves Issue 5, then the amount paid into the intraLATA subsidy pool by Southern Bell will decrease. In the past, when a company's payments into the subsidy pool have decreased, the Commission has disposed of the money by applying it to some specific purpose. Consistent with prior actions of the Commission, staff recommends that the reduction in subsidy payments by Southern Bell be added to the set aside amount to be disposed of in Docket No. 920260-TL.

ISSUE 7: Should Docket No. 910731-TL be closed?

RECOMMENDATION: Yes. If no person whose substantial interests are affected files a protest within 21 days of the issuance of the Order, the Order will become final and this docket will be closed. Staff will continue to monitor earnings in 1994 and beyond until Northeast's Bill and Keep Subsidy receipts have been eliminated as set forth in the Agreement. (DAVIS)

STAFF ANALYSIS: The Agreement provides that earnings in excess of 13.20% in 1993 and beyond shall be used to reduce the Bill and Keep Subsidy receipts of Northeast until such time as Northeast's subsidy is eliminated. Staff will continue to monitor Northeast's earnings and provide the Commission with recommended subsidy reductions based on the agreement as necessary.

ATTACHMENT A

NORTHEAST FLORIDA TELEPHONE COMPANY
YEAR ENDED DECEMBER 31, 1993
REVENUE SUBJECT TO COMMISSION DISPOSITION

Reported Achieved Net Operating Income	$663,599
Reported Achieved Rate Base	6,983,009
Return on Achieved Rate Base	9.50%
Adjusted Achieved Return on Equity	17.72%
Maximum Return on Equity Allowed By The Agreement	13.20%
Return in Excess of Stipulated ROE Ceiling	4.52%
NOI in Excess of Stipulated ROE Ceiling of 13.20%	$97,184
Revenue Expansion Factor	1.630234
1993 Revenue in Excess of Stipulated ROE Ceiling	$158,432
Interest Accrued through December 31, 1993	2,536
Total 1993 Revenue to be Disposed / Subsidy Reduction per Agreement	$160,968

DOCKET NO. 910731-TL, 920260-TL
DATE: FEBRUARY 23, 1995

ATTACHMENT B

INTRALATA TOLL BILL AND KEEP
CALCULATION OF SUBSIDY PAYMENTS
January 1, 1991
($000)

	1	2	3	4	5	6
COMPANY	INTRALATA BILL/KEEP IMPACT	PREVIOUS PHASE DOWN OF SUBSIDY	PREVIOUS COMM ACTION	TOTAL IMPACT (1+2+3)	SUBSIDY CONTRIB	SUBSIDY RECEIPTS
NORTHEAST	(322)	40		(282)		(282)
SOUTHLAND	(151)	23		(128)		(128)
SO. BELL	10,099				410	
TOTAL					$410	($410)

* EXCLUDING ALLTEL, CENTRAL, FLORALA, GTE, GULF, INDIANTOWN, QUINCY, ST. JOSEPH, UNITED AND VISTA-UNITED

ATTACHMENT C

INTRALATA TOLL BILL AND KEEP
CALCULATION OF SUBSIDY PAYMENTS
July 1, 1995
($000)

	1	2	3	4	5	6
COMPANY	INTRALATA BILL/KEEP IMPACT	PREVIOUS PHASE DOWN OF SUBSIDY	PREVIOUS COMM ACTION	TOTAL IMPACT (1+2+3)	SUBSIDY CONTRIB	SUBSIDY RECEIPTS
NORTHEAST	(322)	40	158 *	(124)		(124)
SOUTHLAND	(151)	23		(128)		(128)
SO. BELL	10,099				252	
TOTAL					$252	($252)

* NORTHEAST INCLUDES THE $158,000 REDUCTION PROPOSED IN THIS RECOMMENDATION.