BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY for rate stabilization	DOCKET NO. 880069-TL ORDER NO. 24066 ISSUED: 2/5/91

The following Commissioners participated in the disposition of this matter:

MICHAEL McK. WILSON, Chairman
THOMAS M. BEARD
BETTY EASLEY
GERALD L. GUNTER
FRANK S. MESSERSMITH

ORDER EXTENDING SOUTHERN BELL'S RATE STABILIZATION PLAN

BY THE COMMISSION:

I. BACKGROUND

On January 13, 1988, Southern Bell Telephone and Telegraph Company (Southern Bell) filed two petitions with the Commission. The first, Petition for Rate Stabilization Order and Other Relief, summarized Southern Bell's proposal, and the second, Petition for Implementation Order and for Other Relief, detailed the actual rate changes and revenue impact of the proposed changes.

By Order 20162 the Commission announced its decision regarding the rate stabilization petitions. The Commission expanded the authorized range of return on equity to a minimum of 11.5% and a maximum of 16%. Within the expanded range the Commission also implemented an earnings sharing plan. Any earnings in excess of 14% is to be shared with 60% being given to Southern Bell's ratepayers and the other 40% retained by the Company. All earnings in excess of 16% are returned to the ratepayers. In addition, earnings stemming from certain exogenous factors were excluded from the sharing process. In the course of resetting the authorized range of earnings we also established a new rate base, NOI and capital structure.

The Commission also reset certain of Southern Bell's rates at a level to achieve a 13.2% rate of return on equity. The 13.2% return was also intended to serve for other regulatory purposes including IDC calculations. The rate setting point was implemented through reductions to certain rates and the elimination of certain other rates. The rates for the BHMOC charge, OUTWATS, 800 Service, MTS and local residential service were reduced. We also restructured DID rates and eliminated station line lease charges, two- and four-party service and zone charges. In addition we also

implemented the Company's optional extended area service (OEAS) plan on numerous routes.

In the rate setting process we set aside approximately $10 million to cover the implementation of OEAS. We also set aside approximately $17.1 million of 1989 earnings and $147.7 million of 1990 revenues pending the outcome of the depreciation represcription. OEAS has been implemented on numerous routes listed in Order 20162 as well as others coming to our attention since. The final resolution as to the appropriate amount of depreciation expense for 1989 and 1990 is pending.

Pursuant to Order 20162, the rate stabilization expires on December 31, 1990. By Order 23193 the Commission determined to reexamine whether the rate stabilization plan should be continued and set certain issues for hearing. The hearing was held on November 30, 1990. Our decision, reflected below, regarding the issues raised during the hearing were made during our Agenda Conference on December 18, 1990.

II. INTRODUCTION

Our most recent proceeding in this docket was necessitated by the imminent expiration of the rate stabilization experiment for Southern Bell. As described in detail below, we have extended for a period of two years the basic parameters of the experiment. We have retained the current floor, rate setting point, earnings sharing threshold and ceiling with respect to Southern Bell's authorized return on equity. The netting of exogenous factors shall continue as previously. We also have identified certain amounts remaining from previous amounts set aside for certain purposes such as depreciation and extended area service. The amounts identified will be held for further disposition. While we have retained the basic parameters of the plan, we decline to reset earnings for the period of 1991 and 1992.

III. EXTENSION OF THE INCENTIVE REGULATION PLAN

Most of the parties agree that the plan should be extended. Most of the differences in this proceeding arise from the different positions of parties on the terms and conditions under which the plan should be extended. The specific terms and conditions for extending the incentive plan are discussed below.

Southern Bell's witness Denton testified that the incentive plan was originally intended to be a three year experiment but has

only been in effect for approximately two years. According to the Company, a full three years (1989, 1990 and 1991) of operating and financial data under the incentive plan will not be available for review until March of 1992. The Company contends that two years have not been a sufficient period of time for it to change its operations, structure and culture to reflect the incentives of the plan. Public Counsel advocated that the plan should be continued for two years or until a Minimum Modified Filing Requirements review is complete.

Although the incentive plan was applicable to 1988, it was not approved and implemented until September 1988. Further, most of our actions in September 1988 were prospective in nature. Only the sharing concept and the "box" were truly retroactive to January 1, 1988. We make no decision whether two years is a sufficient time for Southern Bell to make significant changes. However, it does appear that the time the plan has actually been in effect is too short a period to measure changes in performance which may have resulted from the incentive plan. We believe that a minimum of three years of data is necessary to measure any change. The third full year of data, 1991, will not be available until March 1992. Therefore, we find it appropriate to extend the duration of the incentive regulation plan until December 31, 1992. This will allow us an adequate opportunity to examine a full three years data before the plan expires.

III. AUTHORIZED RATE SETTING POINT, FLOOR, CEILING AND SHARING THRESHOLD

A. Rate Setting Point

Three witnesses presented testimony on the rate setting point for ROE. Witness Vander Weide, on behalf of Southern Bell, testified that the cost of equity range for Southern Bell is in the range of 14.66% to 15.66% and concludes that "this range is well within the 14% to 16% range I found appropriate in July, 1988," and concludes that the Company's rate setting return on equity of 13.2% should not be changed. Witness Cicchetti, on behalf of the Office of Public Counsel, argued that a cost of equity of 12.0% is the appropriate rate setting point. Witness King, testifying on behalf of The Department of Defense and All Other Federal Executive Agencies, argued that the rate setting point should be at 12.5%.

As usual, we do not fully agree with any of the parties. We acknowledge that contrary to Southern Bell's position, the cost of equity has changed since the incentive plan was instituted.

However, we also do not believe the rate setting point should be reset as recommended by DOD/FEA and OPC.

As discussed in Section II above, we are extending the plan for a twenty-four month period. This extension will allow a longer test period to see the effects the plan has on Southern Bell. For that reason, we do not believe that minor changes should be made in the plan at this time. The incentive plan should continue under the same basic terms and conditions as when the plan was instituted. As in any experiment, making too many changes when the experiment is only half over can produce inconclusive or misleading results. Accordingly, we find that the current rate setting point of 13.2% should continue during the pendency of the extension.

We set the sharing point at 14% return on equity which was 80 basis points above the rate setting point of 13.2% return on equity. The parties are advocating that this 80 basis point spread between the rate setting point and the sharing point be continued.

B. Floor and Ceiling

In Order No. 20162, when we initially established the floor and ceiling for Southern Bell's incentive regulation plan, the floor and ceiling were broadened beyond the typical plus or minus one hundred basis points from the rate setting point. This broader range was to reflect the increased flexibility granted to the Company. In addition, we also established a unique feature for Southern Bell, the earnings threshold.

The ceiling of the Company's authorized range was set 280 basis points above the rate setting point and the floor was set 170 basis points below the rate setting point. The sharing threshold was set 80 basis points above the rate setting point.

Most of the parties supported continuing the current relationship of the floor, ceiling and sharing threshold and the rate setting point. No evidence was presented in the hearing which would support that any other relationship between the floor, ceiling, sharing threshold and the rate setting point other than the relationship would provide Southern Bell with any additional incentive to perform well. The current relationship between the floor, ceiling, sharing threshold and rate setting point is reasonable. We find no reason to change it in the context of extending the current plan. Accordingly, the ceiling shall continue to be set at 280 basis points above the ratesetting point, the floor shall continue to be set 170 basis points below the rate

setting point and the earnings threshold shall continue to be set at 80 basis points above the rate setting point.

C. Netting of Exogenous Factors

In Order No. 20162, we determined that it was not equitable to subject to the sharing process earnings from exogenous factors such as tax or separations changes. We concluded that ideally only earnings attributable to productivity increases should be shared. By Order No. 20162, we excluded from the sharing process the revenue effects of: all rate changes other than regroupings; changes resulting from significant governmental actions with a minimum impact of $3,000,000 of revenue requirements; refinancing of higher cost debt instruments and major technological changes. These items excluded from sharing are included in what has euphemistically come to be known as "the Box". Under the concept of the Box, any rate increases are netted against rate decreases, significant governmental actions, and debt refinancings. If the result is an overall increase in earnings due to the netting process, the net amount will be refunded to ratepayers or disposed of in some other appropriate fashion. If netting produces a decrease in earnings the company absorbs the loss.

Over the course of the plans operation, numerous events have occurred which have been included in the Box. Increases were approved for nonrecurring FX Charges, Toll Terminals, Mobile Service, Custom Calling Services and the Returned Check Charge. Decreases were approved for Megalink, WATS usage, Telephone Answering Service DID, Saver Service, and elimination of the PIC Change Charge. It should be noted that the revenue affects of rate increases and decreases do not reflect growth in units. This reflects the uncertainty of repression/stimulation and cross-elastic effects of customers going to other services.

The net result of rate increases and rate decreases is a positive number. If growth has occurred, which is a reasonable expectation, this net positive amount is potentially understated. However, the uncertainty of the impact resulting from rate changes, leads us to believe that the numbers should not be adjusted.

Two governmental actions have been identified by Southern Bell since the plan was put into effect. First, the capitalization limit for certain general support assets was increased from $200 to $500. See Order No. 19127 adopting amendments to Rule 25-4.0178, Florida Administrative Code. Implementation of Rule 25-4.0178 resulted in a decrease in Southern Bell's intrastate investment and

a net increase in intrastate expenses. Second, the Federal Communications Commission (FCC) changed its separations procedure for the other billing and collection subcategory of Revenue Accounting.

In Order No. 20162, we stated that any difference between forecasted and actual cost of debt will be excluded from the sharing of earnings. In 1989, Southern Bell refinanced certain debt with lower cost debt. The difference between forecasted and actual cost of debt results in an increase in revenue requirements of $1,316,000 for 1990. The $1,316,000 has been adjusted to exclude the interest savings resulting from the refinancing. By Order No. 22793, the $1.949 million in interest savings for 1990 was added to the amount set aside for the implementation of OEAS. This amount is already targeted for rate reductions and is not included in the Box.

In addition to the exogenous factors discussed above, the Florida Interexchange Carriers Association (FIXCA) argues that the dollars resulting from the payments to Southern Bell by interexchange companies (IXCs) for intraEAEA compensation should be excluded from sharing because they result from the Commission's actions implementing the compensation payments. FIXCA also argues that if the Commission extends the duration of the Rate Stabilization Plan and decides that rates should be reduced prior to doing so, the IntraEAEA surrogate penalty should be eliminated and refunded.

The intraEAEA compensation requirements were part of our decision in Orders Nos. 13750 and 13912 which prohibited the IXCs from carrying intraEAEA traffic over their own facilities unless the IXC could not block such traffic, in which case they were directed to report their intraEAEA traffic to the affected LEC and to pay MTS rates on that traffic. One issue which arose to cloud the intraEAEA compensation process was whether intraEAEA calls originated and terminated over resold LEC access were subject to compensation. For a complete discussion of resold access see Order No. 23540 in Docket No. 880812.

In the course of the events leading to the TMA proceeding, the issue of resold access was raised. It was agreed that the issue would be addressed in the TMA docket and that in the interim the IXCs would pay a compensation rate equal to the difference between MTS and access rates times 3.7 percent of the IXC's intrastate traffic. See Order No. 22122. In the TMA proceeding, we retained intraEAEA compensation including compensation on resold access

until the expiration of toll transmission monopoly areas on December 31, 1991.

Requiring the continuation of compensation on resold access is a government action which resulted in unforecasted revenues to Southern Bell. Southern Bell billed $3.6 million in 1989. However, it collected less than half of that, $1.7 million. We note that this disparity is attributed to a single IXC and that the Company is making diligent efforts to recover the uncollected amount. However, we have doubts about the probability of collection. Accordingly, we find it appropriate to consider only the $1.7 million actually collected as intraEAEA compensation revenues. Since this is less than the $3 million Box threshold, it should not be included in the box.

Another unforseen item which warrants inclusion in the box in 1992 is the impact of the elimination of the toll monopoly areas on December 31, 1991. Southern Bell claims that the current conservative estimate of the impact in 1992 will be $11 million. We note that this is a decided reduction from the original $44.9 million Southern Bell represented it would be in the TMA proceeding. We also note that we could make no accurate determination of the potential revenue loss. See Order No. 23540. In addition, certain events have transpired which cause the $11 million estimate to be overstated. Since that testimony was filed, Southern Bell has experienced two access rate reductions, totalling $26.6 million, and one major MTS reduction, totalling $25.6 million. Southern Bell's intraLATA rates are now lower than ATT-C's interstate rates in all mileage bands. Certainly this will have an impact on the IXCs' ability to attract customers away from Southern Bell. While we do anticipate some revenue loss to the LECs as a result of TMAs being eliminated, we are still not able to quantify it. The only impact that appears reasonably certain is the loss of intraEAEA compensation on December 31, 1991.

Our actions eliminating the TMAs justify including the financial impact that decision in the Box. However, since we are unable to reasonably quantify the amount, it is incumbent on Southern Bell to provide a reliable quantification of the impact of the elimination TMAs. If the Company can provide such quantification, it may then be accounted for in the Box for 1992.

Consistent with our decision to extend the plan while making as few changes as necessary, we find that the amounts in the Box shall continue to be tracked for the duration of the plan.

Southern Bell will still be required to identify any new impacts on earnings for 1991 and 1992 due to rate changes, exogenous factors, and debt refinancings.

D. Recalibration of Earnings

In Order No. 20162, we adjusted Southern Bell's rates to achieve an earnings level of 13.2 percent return on equity. In determining the extent of the plan the issue arises whether we should recalibrate Southern Bell's 1991 and 1992 earnings. Southern Bell argues that rates should not be adjusted at all to reflect 1991 and 1992 projected earnings. Southern Bell claims this would eliminate any benefits it is receiving from the efficiencies, new services and innovations it has been able to achieve since 1988.

OPC and the other parties argue that rates should be recalibrated. OPC further argues that failure to target earnings at some rate setting point for 1991 and 1992 would amount to an abandonment of the plan, not an extension of it. OPC primarily advocates that rates be reset to a new ROE based on Southern Bell's 1990 Commitment View. Alternatively, OPC argues that rates be reset for 1991 and 1992 based on the 1988 Commitment View.

In initially setting rates at the beginning of the plan for 1988, we used the 1988 Commitment View and targeted earnings for 1988, 1989 and 1990, respectively, at a 13.2% ROE based on projections for each of those years. We identified increases in earnings for each year due primarily to the expiration of amortization schedules in 1989 and 1990 anddue to a "normal" level of increased productivity for each year. In resetting rates, we determined that Southern Bell should only be allowed to retain earnings in excess of a "normal" level of productivity gains, using the 1988 Commitment View as the measure for a "normal" level.

Upon consideration, we agree with Southern Bell. To reset earnings would eliminate the productivity gains of the Company achieved since the plan was implemented. This would be inconsistent with our decision to continue the plan with as few changes as necessary. Accordingly, we decline to recalibrate Southern Bell's earnings for 1991 and 1992. However, our decision to not reset earnings does not extend to those items previously identified which are not related to any productivity gains such as the expiration of amortization schedules. As we determined previously, Southern Bell's earnings should not be allowed to increase simply because of the decline in amortization expense.

Pursuant to Order No. 23132, issued June 29, 1990, certain amortization schedules will expire at December 31, 1990 and December 31, 1991, respectively. This will lead to improved earnings in 1991 and 1992. Consistent with our previous action in this docket, we find that the Company shall not be allowed to retain the improved earnings from the expiration of amortization schedules established by Order 23132. Based on Order No. 23132, the expiration of amortization schedules improves 1991 earnings by $18,420,620 and 1992 earnings by $21,868,551.

Consistent with our actions in Order No. 20162, $18,420,620 of 1991's earnings and $40,289,171 ($18,420,620 + 21,868,551) of 1992's earnings shall be held subject to further Commission disposition. We defer the issue of the appropriate disposition of these revenues to a later date. Our Staff is directed to investigate and propose an appropriate disposition of these revenues.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Southern Bell Telephone and Telegraph Company's incentive regulation plan is hereby extended until December 31, 1992, as set forth in the body of this Order. It is further

ORDERED that the rate setting point for Southern Bell's incentive regulation plan is 13.2 percent return on equity as set forth in the body of this Order. It is further

ORDERED that Southern Bell's authorized ceiling for its return on equity is 280 basis points above the rate setting point, that its authorized floor is 170 basis points below the rate setting point and that the threshold for earnings sharing is 80 basis points above the rate setting point as set forth in the body of this Order. It is further

ORDERED that Southern Bell's exogenous factors pool shall continue as set forth in the body of this Order. It is further

ORDERED that Southern Bell's earnings shall not be recalibrated for the reasons set forth in the body of this Order. It is further

ORDERED that $18,420,620 of Southern Bell's 1991 and $40,289,171 of its 1992 earnings shall be held for further Commission disposition as set forth in the body of this Order.

By ORDER of the Florida Public Service Commission, this 5th day of FEBRUARY, 1991.

STEVE TRIBBLE, Director
Division of Records and Reporting

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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.