BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for approval of specified accounting treatment by UNITED TELEPHONE COMPANY OF FLORIDA.	DOCKET NO. 921156-TL ORDER NO. PSC-93-0319-FOF-TL ISSUED: 03/01/93

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman
THOMAS M. BEARD
SUSAN F. CLARK
JULIA L. JOHNSON
LUIS J. LAUREDO

NOTICE OF PROPOSED AGENCY ACTION

ORDER GRANTING IN PART AND DENYING IN PART PETITION FOR SPECIFIED ACCOUNTING TREATMENT FOR AMORTIZATION OF DEBT EXPENSE.

BY THE COMMISSION:

NOTICE IS HEREBY GIVEN by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are adversely affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

I. Background

On November 5, 1992, United Telephone Company of Florida (United or the Company) filed a Petition for specified accounting treatment for amortization of debt expense and premium in connection with the redemption and issuance of first mortgage bonds by United. The petition seeks to amortize the unamortized issuance costs and redemption premiums associated with refinancing of its first mortgage bonds over the life of the newly issued series of bonds. In support of the petition, United states that at prevailing interest rates for investment grade securities, the Company can replace a significant portion of its long-term debt with new first mortgage bonds which bear a lower effective interest rate; thus, benefitting ratepayers through a lower cost of capital. The Company also cites to the Commission's action in Docket No. 880069-TL allowing Southern Bell to amortize its debt refinancing costs.

II. Discussion

At prevailing interest rates for investment grade bonds, United can replace a significant portion of its long-term debt with new first mortgage bonds which bear a lower coupon interest rate. Through the end of 1992, United has redeemed six series of its outstanding first mortgage bonds.

The coupon rate of interest is only one component of the effective cost rate of each series of redeemed bonds. The other component of the effective cost rate associated with the redeemed bonds is an unamortized balance of issuance costs, premiums, and discounts. Issuance costs, premiums, and discounts are incurred when the debt is issued and are amortized over the life of the bonds. A premium may also arise in the form of a prepayment penalty if the bonds are redeemed prior to maturity. At any given point in time, then, between the issue date of the bonds and their maturity date, there is an unamortized balance of issuance costs, premiums, and discounts. Added to this balance would be any early prepayment premium that may be incurred upon redeeming the bonds.

Prior to the adoption of Part 32 of the Federal Communications Commission's (FCC) rules, the Uniform System of Accounts (USOA) provided that upon refinancing, unamortized issuance costs and all premiums and discounts would be expensed at the time the refinancing took place unless the regulator specifically approved amortization of these amounts. Such specific approval was sought by United in 1986 and granted by this Commission in connection with the refinancing of other series of United's first mortgage bonds. See Order No. 16375 issued July 17, 1986, in Docket No. 860501-TL.

With the adoption of Part 32, the current USOA does not specifically provide for amortization of costs associated with early redemption of bonds. However, Statement of Financial Accounting Standards (SFAS) 71 recognizes that regulatory accounting may vary from accounting practices for unregulated industries. The main reason for this variance is the different priority associated with the particular accounting principles. Particularly, regulators are more apt to be concerned with the matching principle in an effort to avoid intergenerational inequity. SFAS 71 cites the capitalization of bond issuance costs as an example of an appropriate accounting treatment in a regulatory environment. We note that by Order No. PSC-92-1412-FOF-TL issued December 12, 1992, in Docket No. 880069-TL, we approved the amortization of a portion of the costs incurred by Southern

Bell as part of its refinancing of long-term debt. In that Order, we noted that amortizing a portion of the debt refinancing costs would properly match the savings from reduced interest cost with the cost associated with the decision to refinance. We further note that the Federal Energy Regulatory Commission (FERC) USOA continues to permit utilities to either amortize or expense such costs. All four major electric utilities operating in Florida have elected and the Commission has approved the amortization of the costs associated with the early redemption of bonds. The Commission found in Order No. 16375 that the reasoning for amortizing these costs for an electric utility applied equally to a telephone utility.

In addition to our past decisions, it also appears that amortizing rather than expensing the costs associated with the early redemption of bonds gives a utility a greater incentive to seek lower cost debt financing. In most cases, expensing these costs results in a direct reduction to earnings and ultimately a reduction in the earned return. Such a practice could produce a disincentive for utilities to refinance higher cost debt.

To the extent that early redemption of debt will result in lower interest rates, ratepayers and shareholders will share in the benefits of a lower average cost of outstanding long-term debt. However, as pointed out in United's petition, the Company has not redeemed all the bond issues under consideration for redemption. Until offers are sought for new lower cost bonds, it is not possible at this time to quantify specifically how much, or even if, there will be a benefit from the retirement of any specific series of bonds because the interest rate, issuance costs and premium or discount are not known. These costs increase the effective cost rate of long-term debt, thus increasing the revenue requirements.

To date, United has extinguished six bonds totalling approximately $63.8 million. The associated unamortized debt expense was $333,508, whereas Series AA with $60 million face value has $5.2 million of unamortized debt expense associated with it. Approximately $4.2 million of the $5.2 million is the unamortized debt expense associated with the debt that was extinguished back in 1986. The Company has not refinanced the Series AA and BB to date. If these Series were refinanced with the amortization methods, the new issues will contain unamortized debt expenses from issues that were extinguished twice already. Continuing to roll over these costs puts the Company in a position where these costs may not be fully amortized, thus requiring a permanently higher revenue requirement. Current ratepayers are being burdened with the old discounts and call premiums that no longer exist.

Upon consideration, we find it appropriate to approve the Company's request to amortize the cost of debt refinancing. However, to mitigate the problem of accumulation of unamortized financing expense through successive refinancings, we further find that the costs should be amortized over the life of the new bonds or the old bonds, whichever is shorter. To this extent the Company's petition is granted in part and denied in part. In addition, the Company shall treat all future debt refinancings consistently with our decisions herein. This will avoid the potential problem of management manipulation of earnings through the juggling of accounting treatments.

Notwithstanding our adoption of the requested accounting treatment, we make no decision regarding any rates, terms, or conditions associated with the redemption and subsequent issuance of long-term debt. The prudence of these transactions is properly reserved for review within the context of an earnings review. We reserve the right to disallow any of the costs incurred for ratemaking purposes.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that United Telephone Company of Florida's Petition for specified accounting treatment for amortization of debt expense and premium in connection with the redemption and issuance of first mortgage bonds is granted in part and denied in part as set forth in the body of this Order. It is further

ORDERED that United shall treat all future debt refinancing consistent with our decision set forth in the body of this Order.

ORDERED that this docket shall be closed if no protest is filed in accordance with the requirement set forth below.

By ORDER of the Florida Public Service Commission this 1st day of March, 1993.

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.

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of

Records and Reporting at his office at 101 East Gaines Street, Tallahassee, Florida 32399-0870, by the close of business on March 22, 1993.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party adversely affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater 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 of the effective date 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.