

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Modified Minimum Filing) DOCKET NO. 920195-TL
Requirements of QUINCY TELEPHONE) ORDER NO. PSC-94-0645-FOF-TL
COMPANY.) ISSUED: May 26, 1994
_____)

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman
SUSAN F. CLARK
JULIA L. JOHNSON
DIANE K. KIESLING
LUIS J. LAUREDO

NOTICE OF PROPOSED AGENCY ACTION
ORDER MODIFYING MINIMUM FILING REQUIREMENTS

BY THE COMMISSION:

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

I. BACKGROUND

This proceeding was initiated to address the Modified Minimum Filing Requirements (MMFRs) filed by Quincy Telephone Company (Quincy or Company) pursuant to Section 364.035, Florida Statutes. By Order No. PSC-92-1472-FOF-TL we approved the MMFRs inter alia but determined to further monitor the Company's earnings and review its MMFRs. By Order PSC-94-0119-FOF-TL we accepted the Company's proposal to cap 1992 and 1993 earnings as well as revised the amount of authorized depreciation expense due to the Company's replacement of a central office switch. As discussed in detail below, we now address the final issues pending in this docket.

II. RETURN ON EQUITY

On January 28, 1994, our Staff sent a letter to Quincy Telephone Company (Quincy or the Company) expressing concerns regarding the Company's authorized return on equity (ROE) and the

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level of its earnings. Subsequently, Staff, the Office of Public Counsel (OPC) and the Company conducted numerous conversations.

On March 2, 1994, Quincy presented a letter proposing to lower its currently authorized ROE from 12.9% +/- 1.00% to 11.65% +/- 1.00% and cap its earnings for 1994 at 12.65%. The Company also proposed to use the newly proposed ROE in the MMFR docket.

As noted above, by Order No. PSC-94-0119-FOF-TL, we approved a cap of Quincy's 1992 earnings at its maximum ROE of 13.9% and a cap of its 1993 earnings at a 13.4% ROE. We note that these ROEs were established for measuring earnings in 1992 and 1993. We also note that the cost of equity for regulated utilities continued to decline during 1993.

We have recognized the decline in the range of cost of equity through our decisions to lower the range of returns for various regulated companies. For example, we lowered the allowed ROEs for water and wastewater companies through the use of our leverage formula to 9.7% to 10.97%. See Order No. PSC-93-1107-FOF-WS. Recently, we approved authorized ROEs for gas companies ranging from 11.00% to 11.25%. See Orders Nos. 93-1772 through 93-1777. In addition, we recently approved a 10.85% ROE for FPUC-Marianna and an 11.35% ROE for Tampa Electric Company. See Orders Nos. PSC-94-0249-FOF-EI and PSC-94-0337-FOF-EI, respectively.

Upon consideration, we find it appropriate to approve the Company's offer. Although Quincy's proposed ROE may not be what would result from an evidentiary proceeding, it appears to be within a reasonable range for an appropriate ROE for this company. In addition, the reduction in the authorized ROE is consistent with our actions in similar cases regarding the authorized ROEs. Accordingly, effective January 1, 1994, Quincy's authorized return on equity shall be 11.65% +/- 1.00% and its 1994 earnings shall be capped at 12.65%.

III. PROSPECTIVE 1994 AND 1995 EARNINGS

In view of our decision to accept the Company's offer to reduce its authorized ROE to 11.65%, it is necessary to examine the Company's earnings in light of the new ROE to determine whether action should be taken to reduce rates to target the new ROE.

A. 1994 EARNINGS

In the course of our investigation in this case we examined the Company's 1994 budget as a basis to calculate prospective

earnings. The examination indicated that certain corrections and numerous adjustments should be made to the Company's budget to more accurately reflect the Company's prospective earnings. In addition, our examination revealed certain expenses that should be disallowed for ratemaking purposes.

Quincy's 1994 budget, as originally submitted, indicates that it will achieve an 11.27% ROE. With the budget corrections, adjustments and accounting disallowances, it appears that the Company will earn 13.79%. This equates to revenues of \$140,000 in excess of the 11.65% ROE. Furthermore, it also appears that the Company will earn approximately \$325,000 in excess of the 11.65% ROE in 1995. A summary of these earnings calculations is attached to this Order as Attachment A. The specific corrections, adjustments and disallowances are set forth below.

1. CORRECTIONS

- a) By Order No. PSC-94-0119-FOF-TL, we ordered the Company to record additional depreciation expense in 1993 of \$880,532, total company, and ratably write-off the remaining net investment over the remaining months the Stromberg Carlson DCO switch will be in service. This decision was not made until subsequent to the completion of the Company budget. Therefore, the budget needs to be adjusted to appropriately reflect the effects of the Order. Accordingly, the budgeted intrastate depreciation reserve shall be increased by \$133,389 and budgeted intrastate depreciation expense shall be decreased by \$29,377.
- b) The budgeted amount of customer deposits is overstated. The Company budgeted \$420,037 for 1994. The average amount for 1992 and 1993 has been approximately \$230,000. The Company states that the budgeted amount was in error and that it expects the average customer deposit amount to be \$235,000 for 1994. Accordingly, this amount shall be reflected in the earnings calculations.
- c) The method the Company used to calculate the average amount of short term debt is inaccurate. The budget states that the amount is \$655,500 with a cost rate of 10.24%. However, the appropriate average amount is \$959,125 with Company's projected cost rate of 7.00%.
- d) The budgeted amount of intrastate depreciation expense is overstated by \$53,448. The Company made errors in calculating the amortization expense associated with

amortizable general support assets and two categories of central office equipment, Subscriber Toll Carrier and Digital Concentrator/Fiber Electronic. Intrastate depreciation expense and depreciation reserve shall be decreased by \$53,448.

- e) The Company budgeted \$264,536 of Universal Service Fund (USF) revenue for 1994. Recently, National Exchange Carrier Association (NECA) notified the USF recipients that the 1994's amounts have been changed. The revised amount of USF revenue for Quincy in 1994 is \$248,538. Therefore, intrastate revenue shall be decreased by \$15,998.

2. ADJUSTMENTS:

- a) Intrastate plant in service shall be decreased by \$215,594, accumulated depreciation shall be decreased by \$127,344 and depreciation expense shall be decreased by \$21,615. These adjustments reflect more appropriate allocations of the Company's general support assets attributable the Company's operations in Georgia and more appropriate allocations of expenses to the Company's non-regulated operations.
- b) In past cases with Quincy, we have consistently removed non-utility related investments from equity. The 1994 budget failed to adjust equity for these items. Quincy had an average balance of \$176,407 in 1993 relating to these accounts. Accordingly, in the reconciliation of capital structure to rate base, an adjustment must be made to reduce equity by \$174,500 and deferred taxes by \$1,500 for the following non-utility related items: Investment in non-affiliate (1402); Non-regulated lease inventory and material & supply, and its related depreciation reserve (1406 & 3114); and deferred non-operating taxes (4350).

3. DISALLOWANCES:

- a) Based on the Audit Report on the Expenditures of the United States Telephone Association (USTA) dated December 1993 conducted by NARUC, 28.6% of the monies spent by the USTA are for legislative activities, public relations and litigation as well as meals and entertainment.

The costs associated with such activities, if incurred by the Company would be disallowed for ratemaking purposes. This is consistent with our treatment of such expenses in our recent rate cases with United Telephone of Florida and GTE, Incorporated. The intrastate amount of USTA dues spent in 1993 was \$2,139. Therefore, \$612 (28.6%) shall be disallowed for ratemaking purposes. Operating expenses shall be reduced by this amount.

- b) Our staff's audit of the Company's 1992 earnings noted that the Company recorded \$3,269 of intrastate expenses above-the-line for activities associated with charity, social and community welfare such as Kiwanis Club, various country clubs and the Chamber of Commerce. These activities are for the purpose of entertainment and image building. Our practice is to disallow such expenses for ratemaking purposes. The 1993 amounts associated with these types of activities could not be quantified. For these activities, we find it appropriate to disallow \$3,468 on an intrastate basis for ratemaking purposes. This amount is an appropriately conservative estimate derived by increasing the 1992 amount of \$3,269 to reflect two years of inflation at 3%.
- c) The Company allows the spouses of employees to attend some events such as the state telephone association convention and quarterly Florida Telephone Association Board Meetings. Such costs are for the purpose of entertainment and image building. We disallowed similar costs in the recent rate cases with United and GTE. Our audit of 1992's earnings indicated that the Company expensed \$831, intrastate. The 1993 amounts associated with this could not be quantified without examining all the employee's travel vouchers for entire year. Therefore, we find that on an intrastate basis \$882 [$\$831 \times$ two years of inflation at 3%] for 1994 should be disallowed.
- d) A total amount of \$21,477 relating to acquisition and development activities was allocated to Quincy from TDS, Quincy's parent company, for 1992. The intrastate portion of the amount is \$16,696. For the period 1990 through 1993, TDS purchased 18 telephone companies. The Company states that the majority of the costs incurred at the corporate level are fixed in nature, meaning the expenditures would not increase as the number of companies increase. Thus, the base on which the "fixed charges" are to be allocated is larger.

One of the largest components of corporate expenses are compensation related expenses. Looking at the change in the number of employees at the corporate offices, the personnel count increased anywhere from 6.3% to 15.8% from 1991 to 1992. The trend in the telecommunications industry regarding employee level has been to downsize. As a result, it appears that the majority of the costs incurred at the corporate level are in fact variable costs, rather than fixed costs as the Company states. Accordingly, it appears that Quincy is receiving a greater amount of allocation from corporate offices due to the increase in personnel.

We note that the increase in size may be offset by the advantages of purchasing additional companies, such as volume discounts from the vendors on purchases. However, it is inappropriate to require the ratepayers to pay for the general overhead costs of searching for and acquiring new companies. We previously disallowed such costs for Quincy in the course of our investigation into Quincy's 1985 and 1986 earnings in Docket 870453-TL. In addition, we made similar adjustments in the recent rate cases with United and GTE. Therefore, we find it appropriate to disallow \$17,713 [\$16,696 x two years at 3% inflation] on an intrastate basis for 1994.

With the aforementioned changes to the budget, it appears that the Company will earn revenues in excess of 11.65% in 1994 by an amount of \$140,000.

B. 1995 EARNINGS

In 1995, it appears that the Company's earnings will improve by at least \$185,000 in addition to the increase for 1994. The improvement in earnings is due to the following:

- 1) The amount of depreciation expense to be recorded for the DCO switch should decrease by \$159,000, intrastate, from 1994 to 1995;
- 2) The Company's Universal Service Fund revenue amount for 1995 is expected to increase by approximately \$81,000;
- 3) The amount of deferred credit write-back will decrease by approximately \$55,000; and

- 4) Quincy will experience some amount of savings from replacement of the Stromberg Carlson DCO switch with the AT&T switch.

With respect the savings from the switch replacement, the Company, in its filing to request the amortization of the DCO switch, stated that the operation of two differing switches (AT&T 5ESS host and DCO) by a small company creates administrative difficulties and increased costs which can be eliminated by the use of a single switch. The difficulties outlined by the company were: required duplicate software upgrades; confusion with operational differences; additional trunking facilities; increased technical assistance costs; local switch administration costs; power consumption; duplication of switch redundancy; lack of trunk efficiency; floor space requirements; and Centrex services. We agreed with some of these claims in determining that the special amortization was appropriate. We note the difficulty of quantifying the savings from the switch replacement. However, it appears reasonable that the Company will experience some going forward savings from the switch replacement.

C. CONCLUSION

Upon consideration of our review of the prospective earnings, we find that the Company will earn in excess of 11.65% by approximately \$140,000 in 1994 and by \$325,000 in 1995. Accordingly, it is appropriate to retarget the Company's earnings at a newly authorized midpoint of 11.65% on a prospective basis by reducing its revenues. The disposition of the excess earnings is discussed below in Section IV of this Order.

IV. DISPOSITION OF EXCESS EARNINGS

One of the principal service concerns we have regarding Quincy is its customers' calling volume to the Tallahassee exchange. We previously considered flat-rate extended area service (EAS) from Gadsden County to Tallahassee in docket 890292-TL. The calling rates from Quincy's Gadsden County exchanges to the Tallahassee exchange exceeded the Commission rule requirements to survey the subscribers for nonoptional, two-way, flat rate toll free calling. However, because of the earnings situation of the Company and the approximately \$10 add-on for residential subscribers, the Commission did not order a survey of Quincy's subscribers. Because residential customers monthly basic local service would have been over \$20 monthly and because of this high rate, we believed that a survey would fail.

Instead, we ordered implementation of a \$.25 message rate, with a monthly allowance of five free calls and reduced basic local residential rates from \$11.34 to \$9.50. The net result was that, based on the calling volumes at that time, over 65 percent of the subscribers essentially received toll free calling to the Tallahassee exchange.

The message rate plan was implemented on August 1, 1990. Due to revenue stimulation from the plan, we reduced the message rate to \$.20 per message on September 1, 1991. At the time of implementation of the \$.25 message rate plan, Quincy's toll revenue loss on these routes was approximately \$1.1 million. The current \$.20 rate has generated approximately \$900,000 in 1993 and the Company estimates that it will produce approximately \$950,000 in 1994.

The current calling rate and distribution of the \$.20 message rate calls to Tallahassee are:

<u>EXCHANGE</u>	<u>MAMs</u>	<u>% MAKING 2 OR MORE CALLS ABOVE 5 FREE CALLS</u>
Greensboro	20.51	70.7
Gretna	29.91	83.1
Quincy	43.66	74.7

Because of the extremely high calling rates on these routes and the necessity to reset Quincy's rates, it appears that it may be appropriate to submit the issue of flat-rate EAS between Quincy Telephone Company's Greensboro, Gretna and Quincy exchanges and the Tallahassee exchange to the Company's subscribers for a ballot survey.

Rule 25-4.063 requires at least forty (40) percent of ballots mailed must be returned and a majority must vote favorably. Using the latest traffic data available, approximately fifty-three (53) percent of the residential subscribers are making twenty-four (24) or more calls per month. If the subscribers make an economic decision, then the survey should pass. To demonstrate the high calling rate, in the Quincy exchange 856 residential subscriber are making more than ninety-six (96) calls a month. Approximately 10.6 percent of the Quincy subscribers made no calls to Tallahassee.

Upon consideration we find it appropriate that Quincy's subscribers be surveyed for nonoptional, flat rate, two-way calling between the Greensboro, Gretna and Quincy exchanges and the Tallahassee exchange at monthly charges of \$12.70, \$35.00, and

\$69.95 for R1, B1 and PBX, respectively. The proposed monthly rates would replace current rates of R1 \$9.10, B1 \$25.10, and PBX \$50.15 plus the \$.20 per call to Tallahassee. The survey shall be conducted pursuant to Rule 25-4.063, Florida Administrative Code.

As discussed above in Section III, it appears that the Company will earn revenues in excess of an 11.65% ROE of \$140,000 in 1994 and approximately \$325,000 in 1995. If the EAS survey passes, it does not appear that EAS will be implemented until August 1, 1994. Therefore, the 1994 revenue impact from implementation of EAS for only a portion of the year will be approximately \$135,417. The 1994 excess earnings will be sufficient to implement the EAS. We note that if the survey passes, Centel's Tallahassee customer's monthly rates will not increase since the Tallahassee exchange is already in Centel's highest rate group.

V. DISPOSITION OF MMFRs

Section 364.035 (3), Florida Statutes, provides that each local exchange company with less than 100,000 access lines shall file MMFR's every five years. This statutory provision insures that all interested persons will have a periodic opportunity to examine the earnings and financial status of companies such as Quincy. Because these periodic reviews offer an opportunity for a full review, we find that this MMFR proceeding should be treated as the most recent rate case proceeding for all future purposes including interim rates pursuant to Section 364.055, Florida Statutes, and the Earnings Surveillance Report Rule.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the proposal by Quincy Telephone Company to reset its authorized Return on Equity at 11.65% +/- 1% and cap earnings at 12.65% is approved as set forth in the body of this Order. It is further

ORDERED that for purposes of calculating prospective earnings for 1994 and 1995, Quincy's 1994 budget shall be adjusted as set forth in the body of this Order. It is further

ORDERED that Quincy shall reduce revenues by \$140,000 and \$325,000 for 1994 and 1995, respectively, as set forth in the body of this Order. It is further

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ORDERED that Quincy's subscribers should be surveyed for nonoptional, flat rate, two-way calling at monthly charges of \$12.70 for R1, \$35.00 for B1, and \$69.95 for PBX trunks as set forth in the body of this Order. It is further

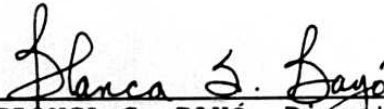
ORDERED that this Modified Minimum Filing Requirements proceeding shall be treated as Quincy's most recent rate case for all future purposes as set forth in the body of this Order. It is further

ORDERED that if any person whose substantial interests are affected by any portion of this Order files a protest to any portion of this Order, the protest must be specific as to which Section of the Order is being protested. A protest of any specific Section of this Order will not prevent the remaining Sections from becoming final if the remaining Sections are not subject to specific protest. It is further

ORDERED that each Section of this Order shall become final and effective unless an appropriate petition is timely filed in accordance with the requirements herein and as set forth below in the "Notice of Further Proceedings or Judicial Review". It is further

ORDERED that this docket should remain open to administer the balloting of Quincy's customers for EAS.

By ORDER of the Florida Public Service Commission, this 26th day of May, 1994.



BLANCA S. BAYÓ, 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 June 16, 1994.

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.