

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: INVESTIGATION INTO UNITED)	DOCKET NO. 891239-TL
TELEPHONE COMPANY OF FLORIDA'S AUTHORIZED))	ORDER NO. 22377
RETURN ON EQUITY AND EARNINGS)	ISSUED: 1-8-90
)	

The following Commissioners participated in the disposition of this matter:

MICHAEL McK. WILSON
 THOMAS M. BEARD
 BETTY EASLEY
 GERALD L. GUNTER
 JOHN T. HERNDON

APPEARANCES:

CHARLES J. BECK, Esquire, Office of Public Counsel, 111 W. Madison Street, Room 301, Tallahassee, Florida 32399-1400
On behalf of the Citizens of the State of Florida

JERRY JOHNS, Esquire, United Telephone Company of Florida, Box 5000, Altamonte Springs, Florida 32716-5000
On behalf of United Telephone Company of Florida

MICHAEL W. TYE, Esquire, AT&T Communications of the Southern States, Inc., 315 South Calhoun Street, Suite 505, Tallahassee, Florida 32301
On behalf of AT&T Communications of the Southern States, Inc.

SUZANNE FANNON SUMMERLIN, Esquire, Florida Public Service Commission, 101 E. Gaines Street, Tallahassee, Florida 32399-0863
On behalf of the Commission Staff

PRENTICE P. PRUITT, Esquire, Florida Public Service Commission, 101 E. Gaines Street, Tallahassee, Florida 32399-0862
On behalf of the Commissioners

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FINAL ORDER SETTING UNITED TELEPHONE
COMPANY OF FLORIDA'S RETURN ON EQUITY
FOR PURPOSES OF THIS LIMITED PROCEEDING
AND PLACING REVENUES SUBJECT TO REFUND

BY THE COMMISSION:

I. Background

It has been over seven years since this Commission has thoroughly investigated United Telephone Company of Florida's (United or the Company's) earnings and set its authorized return on equity. Many changes have occurred in the last seven years in the communications industry, as well as the merger of four companies into the present United Telephone Company of Florida. Some of the changes that have occurred include a phase down of the intrastate subscriber plant factor (SPF), the implementation of bill and keep of intraLATA toll for local exchange companies (LECs), the rewrite of the Uniform System of Accounts (USOA) and central office equipment category 3 (CAT 3) separations changes. In the future, at least through 1993, additional changes are expected yearly. In each of the years 1987, 1988 and 1989, significant negative impacts to United's earnings have occurred. Yet for each of the years 1987, 1988 and 1989, the Company's achieved return on equity has been 14.59%, 14.28% and in excess of 14.0%, respectively. Various factors, such as access line growth, increased toll volumes and gains in Company efficiency, appear to have contributed to the level of the Company's earnings over these past few years. There is every reason to expect that United will continue to earn in excess of 14.0%.

Therefore, pursuant to our authority set forth in Section 364.14, Florida Statutes, and by Order No. 22205, issued November 21, 1989, we held a public hearing on Thursday, December 14, 1989, limited to the issues of what is an appropriate allowed return on common equity for United Telephone Company of Florida for the purposes of this limited proceeding and how should the revenue to be placed subject to refund, if any, be calculated. We received testimony from three witnesses, Company Witness Charles M. Linke, Public Counsel Witness James A. Rothschild, and Staff Witness Scott Seery. We also accepted, by stipulation of the parties, the testimony of three other witnesses, Company Witness Richard D.

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McRae, Public Counsel Witness Victoria A. Montanaro, and Staff
Witness Jane E. Brand.

II. Public Counsel's Motion for Reconsideration

The Public Counsel filed a Motion for Reconsideration and Clarification on December 4, 1989, regarding the Prehearing Officer's ruling that the limited proceeding would not consider the issue of the appropriate capital structure for United Telephone Company of Florida. The Public Counsel argued that we should consider the consolidated capital structure of United Telecommunications, Inc., to be the appropriate capital structure for United Telephone Company of Florida for purposes of this limited proceeding. However, because it has been our intent that this proceeding be narrowly focused on the appropriate return on equity for United Telephone Company of Florida, we denied Public Counsel's motion at the outset of the hearing on December 14, 1989. We did not believe it appropriate to broaden the scope of this proceeding to an issue requiring the thorough examination that can only be accomplished in the full rate proceeding to follow.

III. Our Authority to Hold This Limited Proceeding Set Out in Section 364.14, Florida Statutes

The Company takes the position that Chapter 364, Florida Statutes, does not authorize this Commission to place revenues subject to refund during the pendency of this docket. We find our authority to initiate this limited proceeding within the general authority granted this Commission to regulate the telecommunications industry as set forth in Section 364.14, Florida Statutes. That Section predates the specific provisions of Section 364.05, Florida Statutes, commonly called the "interim statute". In this limited proceeding, we are resetting the authorized return on common equity for this telephone company. If the provisions of the interim statute adequately addressed the factual particulars of this telephone company's situation we would be utilizing its specific provisions. However, the last authorized return on common equity set for this Company was set so long ago and in such a different financial climate, that it would be inappropriate to utilize it at this time. It is imperative that this Commission protect the Company's ratepayers by placing the appropriate

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surveillance report for non-recurring depreciation expense and an adjustment to reflect the consolidated capital structure of United Telecommunications, Inc. As a result of these adjustments and Public Counsel's position that an appropriate return on equity for United is 13.0%, Witness Montanaro proposed that we should place \$29,480,000 of United's revenue subject to refund during the pendency of this docket.

United Witness McRae has proposed two pro forma adjustments to reflect the annualization of the subscriber plant factor (SPF) and dial equipment minutes (DEM) changes for the last four months of 1989. These adjustments reduce United's achieved return on equity by .83%. Witness McRae testified that these normalizing adjustments must be made to United's August, 1989, surveillance report to reflect a full year of 1989 jurisdictional cost shifts.

Staff Witness Brand testified that we should make two adjustments, one to reduce depreciation expense by \$4,830,000 on an intrastate basis to reflect non-recurring depreciation expense and another to reflect deferred taxes on intercompany transactions. The adjustment to reflect deferred taxes on intercompany profits is pursuant to our Rule 25-14.010, Florida Administrative Code. The Company has already reflected such an adjustment on its surveillance report, however, Staff Witness Brand testified that it was not made correctly. Making the two adjustments proposed by Witness Brand results in an achieved return on equity of 14.68%. Therefore, Staff Witness Brand testified that the appropriate amount of revenues in excess of 12.70% to be placed subject to refund is approximately \$12,000,000.

United states that use of its August, 1989, surveillance report as a proxy for its calendar year return on equity will result in an overstatement of its 1989 return on equity and the resulting placement of too much money subject to refund. If any amount is placed subject to refund, the Company states, it should be trued up after the December 31, 1989, surveillance report is filed on March 15, 1990. We do not find it necessary or appropriate to "true up" the revenues we place subject to refund this date.

Because we believe that these adjustments will more accurately reflect the earnings United will achieve in calendar year 1989, we find it appropriate to make the two adjustments

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III. Our Authority to Hold This Limited Proceeding Set Out in Section 364.14, Florida Statutes

The Company takes the position that Chapter 364, Florida Statutes, does not authorize this Commission to place revenues subject to refund during the pendency of this docket. We find our authority to initiate this limited proceeding within the general authority granted this Commission to regulate the telecommunications industry as set forth in Section 364.14, Florida Statutes. That Section predates the specific provisions of Section 364.05, Florida Statutes, commonly called the "interim statute". In this limited proceeding, we are resetting the authorized return on common equity for this telephone company. If the provisions of the interim statute adequately addressed the factual particulars of this telephone company's situation we would be utilizing its specific provisions. However, the last authorized return on common equity set for this Company was set so long ago and in such a different financial climate, that it would be inappropriate to utilize it at this time. It is imperative that this Commission protect the Company's ratepayers by placing the appropriate

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amount of revenues subject to refund at this point, the outset of a full rate proceeding that will require many months to complete. We can calculate the correct revenue amount only if we first adjust the Company's allowed return on common equity to a more appropriate level.

Section IV. The Appropriate Allowed Return on Common Equity for United Telephone Company of Florida for the Purposes of This Limited Proceeding

United Witness Linke testified that, based on his discounted cash flow analysis (DCF analysis) of United's equity capital cost and his risk premium analysis, United's required return on equity is 14.0%. Public Counsel Witness Rothschild testified that United is earning far more than a reasonable return on capital. Therefore, Witness Rothschild proposed that we utilize the consolidated capital structure of United Telecommunications, Inc., with a cost of common equity of 13.0%. However, if we utilize the capital structure of United Telephone Company of Florida, Witness Rothschild testified that we should allow a cost of common equity of 11.25%. Staff Witness Seery testified that, based on his analysis of return requirements for comparable risk common equity investments, an appropriate allowed return on common equity for United, for the purposes of this limited proceeding, is 11.45%. The Staff's position in this proceeding as reflected in the Prehearing Order, however, is that an appropriate allowed return on common equity for United, for purposes of this limited proceeding, is 12.70%, the ceiling of a 100 basis points range around a midpoint of 11.70%.

Based upon our consideration of the testimony and the evidence presented at the hearing, we have determined that an allowed return on common equity of 12.8% with a range of 5~~7~~ basis points, or a low of 12.3% to a high of 13.3%, is appropriate for United Telephone Company of Florida for the purposes of this limited proceeding.

Section V. The Calculation of the Revenue to be Placed Subject to Refund

Public Counsel Witness Montanaro testified that we should make an adjustment to the Company's August 31, 1989,

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surveillance report for non-recurring depreciation expense and an adjustment to reflect the consolidated capital structure of United Telecommunications, Inc. As a result of these adjustments and Public Counsel's position that an appropriate return on equity for United is 13.0%, Witness Montanaro proposed that we should place \$29,480,000 of United's revenue subject to refund during the pendency of this docket.

United Witness McRae has proposed two pro forma adjustments to reflect the annualization of the subscriber plant factor (SPF) and dial equipment minutes (DEM) changes for the last four months of 1989. These adjustments reduce United's achieved return on equity by .83%. Witness McRae testified that these normalizing adjustments must be made to United's August, 1989, surveillance report to reflect a full year of 1989 jurisdictional cost shifts.

Staff Witness Brand testified that we should make two adjustments, one to reduce depreciation expense by \$4,830,000 on an intrastate basis to reflect non-recurring depreciation expense and another to reflect deferred taxes on intercompany transactions. The adjustment to reflect deferred taxes on intercompany profits is pursuant to our Rule 25-14.010, Florida Administrative Code. The Company has already reflected such an adjustment on its surveillance report, however, Staff Witness Brand testified that it was not made correctly. Making the two adjustments proposed by Witness Brand results in an achieved return on equity of 14.68%. Therefore, Staff Witness Brand testified that the appropriate amount of revenues in excess of 12.70% to be placed subject to refund is approximately \$12,000,000.

United states that use of its August, 1989, surveillance report as a proxy for its calendar year return on equity will result in an overstatement of its 1989 return on equity and the resulting placement of too much money subject to refund. If any amount is placed subject to refund, the Company states, it should be trued up after the December 31, 1989, surveillance report is filed on March 15, 1990. We do not find it necessary or appropriate to "true up" the revenues we place subject to refund this date.

Because we believe that these adjustments will more accurately reflect the earnings United will achieve in calendar year 1989, we find it appropriate to make the two adjustments

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proposed by Staff Witness Brand and the two adjustments proposed by United Witness McRae. The adjustments proposed by Company Witness McRae for the SPF and DEM factors take into account the effects of separations changes that the Company experienced in 1989. One of the adjustments proposed by Staff Witness Brand brings the Company's 1989 earnings into line with our current Rule regarding deferred taxes on intercompany profits. The other adjustment proposed by Witness Brand accounts for non-recurring depreciation expense that the Company had in 1988.

Because of our acceptance of the Company's proposed adjustments for the SPF and DEM factors, we find it necessary to adjust the Staff's proposed non-recurring depreciation adjustment to remove the effects of these separations changes that were embedded in the Staff's proposed amount. Therefore, we find it appropriate to decrease depreciation expense by \$9,270,000. Although the calculation is not identical, the depreciation adjustment proposed by Public Counsel is addressed in this depreciation adjustment.

Pursuant to the Company's August 31, 1989, surveillance report which reflects an achieved return on equity of 13.66% and the four adjustments adopted above, we find United's achieved return on equity to be 14.53%. Based upon our determination that the appropriate allowed return on equity for United Telephone Company of Florida for purposes of this limited proceeding is 12.8% with a range from a low of 12.3% to a high of 13.3%, and our determination that United's achieved return on equity is 14.53%, we find it appropriate to place a revenue amount subject to refund that will bring United's achieved return on equity down to the ceiling of 13.3%. Placing a revenue amount subject to refund that will bring the Company's achieved return on equity down to the ceiling of the authorized range of returns on equity for the Company is in accordance with the provisions of the interim statute. Therefore, we find it appropriate to place \$7,605,000 annually of United's revenues subject to refund with interest effective January 1, 1990.

Based on the foregoing, it is, therefore,

ORDERED by the Florida Public Service Commission that United Telephone Company of Florida's return on equity for purposes of this limited proceeding is hereby set at 12.8% with

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a range of 50 basis points with a low of 12.3% and a high of 13.3%. It is further

ORDERED that \$7,605,000 annually in revenues of United Telephone Company of Florida is hereby placed subject to refund with interest effective January 1, 1990.

By ORDER of the Florida Public Service Commission
 this 8th day of JANUARY, 1990.


 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

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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.