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FLORIDA PUBLIC SERVICE COMMISSION

Fletcher Building
101 East Gaines Street
Tallahassee, Florida 32399-0850

MEMORANDUM

November 21, 1994

TO : DIRECTOR, DIVISION OF RECORDS AND REPORTING

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

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: 12/06/94 - 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 2 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 3. Prospective changes to the Bill and Keep Subsidy are addressed in Issues 4 and 5.

DISCUSSION OF ISSUES

ISSUE 1: What amount of 1993 revenues are available for Commission disposition?

RECOMMENDATION: The Commission should recognize $158,432 in revenue in excess of 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: 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: No. While the switch processor and related equipment will have to be upgraded sometime in the future, the company has not provided evidence of current and future demand for the services the upgrade will provide to warrant installation of the upgrade in 1996. (LEE, GREER)

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.

It is Staff's understanding that the only services that cannot be provided with the current switch processor are ISDN, AIN, TR303 (SONET transmission standard) and wireless (PCS). Northeast currently has no requests for any of these services and has indicated that it has no projected demand. Staff believes that Northeast's network should evolve to most of these capabilities but does not believe that the lack of demand and near term use of these services warrants the need for the switch upgrade in 1996. While AIN, PCS and, to some extent, ISDN will certainly play a role in all LECs' territories in the future, Northeast has not provided evidence that the need and demand for these capabilities are in its near future.

Staff has been informed by other LECs that medical, educational and computing services will come to expect imaging, data and video conferencing, distance learning and other features which drive demand for ISDN and more sophisticated networks. The Company has indicated, however, that it currently has no written requests for these services. Additionally, it is Staff's understanding that the current DCO processor with some additional software can provide imaging, data and video conferencing and distance learning.

While upgrading to the Vision ONE Platform appears to be the most prudent action rather than purchasing a new switch, the question to be considered is whether that upgrade is necessary at this time. Based on the information provided by Northeast regarding the demand for new services in its territory, Staff does not believe that Northeast has provided adequate justification for the upgrade at this time. In fact, the company has indicated that it has no current demand or projected demand for any of these services. Further, in response to Staff inquiries and after several telephone discussions, the company has not been able to provide any information that justifies or supports the need for Vision ONE in 1996.

Staff is concerned with the fact that Northeast does not currently have in place any means of projecting demand for potential services. Staff believes the Company will be at a considerable disadvantage in a competitive environment if it does not develop this capability. Further, Staff believes projected demand is the fundamental driver for retirements and major modifications such as this upgrade. As the telecommunications environment moves more toward competition, projected demand for a service will be more important to distinguish whether an upgrade should be recovered by the monopoly ratepayers. In the meantime, Staff believes that Northeast should conduct a survey to determine if its customers would purchase any of the services that are provided by the Vision ONE upgrade.

While Staff believes that the switch upgrade will some day be required, Staff does not believe that the time is now. For this reason, Staff recommends that Northeast's request for a write off of its DCO switch processor and related equipment be denied.

ISSUE 3: What is the appropriate disposition of the amounts identified in Issue 1?

RECOMMENDATION: The $158,432 in intrastate revenue identified in Issue 1 should be held in a deferred credit account, accruing interest at the commercial paper rate in accordance with Rule 25-4.114 F.A.C. until Northeast files its 1995 Depreciation Study at which time the appropriate disposition of the revenue will be determined. (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 DCO switch processor and associated equipment by the end of 1994. The amount proposed to be written off in 1993 would offset the excess earnings. In Issue 2, Staff recommends that the proposed write-off be denied at the present time, acknowledging that the switch upgrade will some day be required.

Northeast will file its depreciation study by June 9, 1995 which will give Staff an opportunity to review the DCO switch processor and associated equipment in a broader context. 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. Based on discussions with Southern Bell and the Office of Public Counsel, staff recommends that the $158,432 in excess earnings identified in Issue 1 be placed in a deferred credit account until the 1995 depreciation study, at which time a determination can be made as to its appropriate disposition rather than being refunded at this time. Interest should be accrued in accordance with Rule 25-4.114 F.A.C., Refunds, beginning in 1993 using the half year convention.

ISSUE 4: 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 January 1, 1995. The intraLATA subsidy pool receipts and payments shown on ATTACHMENT C should be approved, effective January 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 Orders 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 January 1, 1995 in accordance with the Agreement. The intraLATA subsidy pool receipts and payments shown on ATTACHMENT C should be approved, effective January 1, 1995.

ISSUE 5: 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 4, 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 6: Should Docket 910731-TL be closed?

RECOMMENDATION: Yes. Docket 910731-TL can 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	2,523
Total 1993 Revenue to be Disposed / Subsidy Reduction per Agreement	$160,955

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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

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ATTACHMENT C

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

COMPANY	1 INTRALATA BILL/KEEP IMPACT	2 PREVIOUS PHASE DOWN OF SUBSIDY	3 PREVIOUS COMM ACTION	4 TOTAL IMPACT (1+2+3)	5 SUBSIDY CONTRIB	6 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.