BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation of 1996 earnings of Northeast Florida Telephone Company, Inc.	DOCKET NO. 971396-TL ORDER NO. PSC-97-1498-FOF-TL ISSUED: November 25, 1997

The following Commissioners participated in the disposition of this matter:

JULIA L. JOHNSON, Chairman
J. TERRY DEASON
SUSAN F. CLARK
DIANE K. KIESLING
JOE GARCIA

PROPOSED AGENCY ACTION ORDER DETERMINING AND DISPOSING OF OVEREARNINGS, APPROVING WRITE-OFF OF RESERVE DEFICIENCY AND ADDITIONAL DEPRECIATION EXPENSE, AND APPROVING ELIMINATION OF SUBSIDY

BY THE COMMISSION:

NOTICE IS HEREBY GIVEN by the Florida Public Service Commission that the actions discussed herein are 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.

BACKGROUND

By Order No. PSC-92-0337-AS-TL, issued May 12, 1992, we approved, with certain modifications, a settlement agreement submitted by Northeast Florida Telephone Company, Inc., (Northeast) and the Office of Public Counsel (OPC). The agreement required rate reductions and provides that to the extent that Northeast earns in excess of the 13.20% ceiling for return on equity (ROE) established by the agreement subsequent to January 1, 1993, Northeast would refund such overearnings to the payor of the bill-and-keep subsidy (BellSouth Telecommunications, Inc.) and would also eliminate future subsidy receipts by a like amount.

I. OVEREARNINGS

Northeast filed its preliminary 1996 Earnings Surveillance Report (ESR) in March 1997, a revised ESR on April 28, 1997, and the final 1996 ESR on October 22, 1997. The revised ESR was filed to adjust expenses for the allocation of land and buildings, furniture, and computer expenses between Northeast and its holding company. These adjustments decreased the achieved ROE from 14.59% to 14.44%. Our staff completed an audit of Northeast's 1996 earnings and issued a report on August 7, 1997.

In addition to the adjustments by the company, our staff made several adjustments to the original and revised ESRs as a result of its review and audit. After the National Exchange Carriers Association (NECA) Cost Study was filed on July 30, 1997, staff revised the factors used in calculating interstate expenses and investment. Because the interstate expense factors increased, the intrastate amounts decreased and the achieved ROE increased.

Our staff also made an adjustment involving the receipt of a $32,469 cash dividend from the Rural Telephone Bank (RTB) because of the retirement of two RTB loans by Northeast. The company recorded this in a nonoperating income account. For ESR purposes, however, this amount should be treated as a reduction to interest expense. As a result of this adjustment the cost of debt decreased and the achieved ROE increased.

Our staff made a final adjustment to the $14,221 expense the company incurred in producing a cost allocation manual (CAM). The CAM addresses how joint costs should be allocated between regulated and nonregulated operations. In the last six months of 1996, the amount charged to nonregulated operations, both directly and through the CAM, was $89,723. In the first three months in 1997, the amount was $51,382. The amounts charged to nonregulated operations are increasing. Because the CAM relates to the allocation of investments and expenses between regulated and nonregulated operations, a portion of the costs of creating the CAM should also be allocated to nonregulated operations. In the original ESR, the company did not do this. The amount of the adjustment, using the allocation method outlined in the CAM, is a $212 reduction to Corporate Operations Expense. Our staff did not conduct a thorough review of the CAM for 1996. It may, however, review the actual cost allocation methodologies established by the

CAM in the future to determine if the allocations are reasonable.

In its final ESR, Northeast incorporated our staff's audit findings and the revised cost study filed with NECA. Based on our staff's review and modification of the company's final ESR, we find that Northeast's earnings above the maximum allowable ROE of 13.20% are $109,190 for 1996, as shown in Attachment A.

II. RESERVE DEFICIENCY WRITE-OFF

The switching network plan of Northeast in 1994 was to move from the existing Stromberg-Carlson DCO (Digital Central Office) switching platform to the new Electronic Switching System-Digital (EWSD) Vision ONE-UP Platform (Vision ONE) in Macclenny in 1995. The Vision ONE upgrade required the retirement of the DCO processor and associated circuit equipment and the installation of the EWSD. The DCO lines would then be incorporated into the EWSD. Also, Siemens Stromberg-Carlson told Northeast that the existing remote line switching (RLS-4000 and 1000) equipment located in Blackwell, Sanderson, Connor, and Mudlake would also interface with the EWSD. The Vision ONE upgrade would allow Northeast the ability to offer services such as ISDN and to add Advanced Intelligent Network (AIN) and Personal Communications Services (PCS) for an additional price. By Order No. PSC-95-0426-FOF-TL, issued March 29, 1995, in Docket No. 910731-TL, we found that the Vision ONE platform would introduce potential revenue sources that did not currently have a market demand and provide an advanced infrastructure which could potentially provide an economic boost for the Northeast service area. Further, the upgrade was a logical progression of Northeast's switching hierarchy, and, therefore, a reasonable investment.

During 1996, Northeast installed an RLS-4000 switch at Glen St. Mary and the EWSD switch in the Macclenny host office. At the time the installation of the Glen St. Mary RLS-4000 was nearing completion, Northeast learned that this new switch, as well as the existing RLS-4000 equipment at Blackwell and Sanderson, would not integrate with the new Vision ONE upgrade as it had originally been informed by Siemens Stromberg-Carlson. Further, Northeast learned that Siemens Stromberg-Carlson would no longer offer support for the RLS-4000s due to the protocol problems. The only remote switching equipment that was compatible with the Vision ONE upgrade was Remote Control Unit (RCU) equipment and RLS-1000 equipment. Consequently, in order for service to continue to the Blackwell and Sanderson areas, Northeast had to replace the existing RLS-4000 equipment with RCU equipment. Siemens Stromberg-Carlson replaced the Glen St. Mary RLS-4000 with an RCU at no additional charge to Northeast.

The Mudlake and Connor remote offices are RLS-1000s and can interface with the new software. However, the new services provided by the EWSD cannot be provided through these remote switches. Therefore, they must be replaced. The company currently plans to make this replacement in the 1997-1998 time frame. Once the remote switches are converted to RCUs, Northeast will retire the DCO switch, because it will no longer be needed.

III. OVEREARNINGS DISPOSITION

As of December 31, 1996, the net unrecovered costs associated with the RLS-4000 remote switches at Blackwell and Sanderson were $289,334, total company. The net amount recognizes $235,708 in compensation from Siemens Stromberg-Carlson. By letter dated March 10, 1997, Northeast proposes that the 1996 overearnings be applied to the recovery of this net amount, with the residual to be written off in 1997. We find it appropriate to approve this proposal since it corrects the resulting reserve deficiency. The existence of a negative reserve relates to plant no longer serving the public on which the company continues to earn as long as it exists. Deficiencies such as this should be recovered as soon as possible, unless the recovery prevents the company from earning a fair and reasonable return on its investments. Northeast projects that it will have sufficient earnings in 1997 to absorb this recovery and still earn within its authorized range. We conclude, therefore, that, after the application of its 1996 overearnings, the company shall be allowed to recover the remaining unrecovered costs associated with the 1996 retirement of the Blackwell and Sanderson remote switches in 1997. Also, when planning becomes more firm regarding the replacement of the Mudlake and Connor RLS-1000s, Northeast should request a recovery schedule for the unrecovered costs associated with those replacements.

We have identified 1996 intrastate revenues for Northeast of $109,190 in excess of the 13.20% ROE. With interest accrued through December 31, 1996, this amounts to $112,203, which, on a total company basis, is approximately $160,313. The depreciation reserve deficits resulting from the unexpected early retirement of the RLS-4000 units in the Blackwell and Sanderson offices are, as we have noted, $289,334. After applying the company's 1996 overearnings to the reserve deficits, as we found to be appropriate above, there would be approximately $129,021 still to recover. Part of the $129,021 would be recovered by an additional depreciation expense we approve below and the remaining amount would be recovered by the company's 1997 earnings. Accordingly, we approve the application of Northeast's overearnings for 1996, in the amount of $112,203, as a partial write-off of the depreciation deficits resulting from the early retirement of the RLS-4000 units at the Blackwell and Sanderson offices. We note that BellSouth is agreeable to this disposition.

IV. ADDITIONAL DEPRECIATION EXPENSE

Northeast proposes to record an additional $15,000 intrastate depreciation expense applicable to 1996. This would result in approximately $21,428 in additional total company depreciation expense. This amount would also be applied to the negative reserve we discuss above. We find that this is a reasonable proposal because it helps to recover the reserve deficit more quickly without a seriously adverse effect on the company's earnings. This would also reduce further the intraLATA bill-and-keep subsidy and result in the elimination of the subsidy on a prospective basis.

V. BILL-AND-KEEP SUBSIDY ELIMINATION

On January 1, 1988, we established the intraLATA local exchange carrier (LEC) toll bill-and-keep subsidy pool (Docket No. 850310-TL). All LECs except GTE Florida, Incorporated, (GTEFL) and Vista-United Telecommunications (Vista) participated. GTEFL and Vista, which experienced net losses from the implementation of LEC toll bill-and-keep, elected not to receive subsidies. Pursuant to Order No. 21597, issued July 21, 1989, ALLTEL Florida, Inc., Central Telephone Company of Florida, Florala Telecommunications, Gulf Telecommunications, Inc., Quincy Telephone Company, and United Telephone Company of Florida were allowed to withdraw from the intraLATA subsidy pool. Pursuant to Order No. 21955, issued September 27, 1989, Indiantown Telephone System, Inc., was removed from the intraLATA subsidy pool due to its excess earnings. St. Joseph Telecommunications, Inc.'s, subsidy was reduced and then eliminated by Order Nos. 22418, issued January 16, 1990, and 22994, issued May 25, 1990, respectively. In Order No. PSC-95-0426-FOF-TL, issued March 29, 1995, Northeast's subsidy was reduced from $282,000 to $124,000, effective July 1, 1995.

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 the phase-down mechanism, many of the LECs were able to withdraw from the intraLATA bill-and-keep subsidy pool. The current status of the intraLATA subsidy pool is shown in Attachment B.

We find it appropriate to reduce Northeast's intraLATA subsidy receipts by the amount of its 1996 overearnings, $109,190, on January 1, 1998, in accordance with its agreement with OPC. We have approved herein Northeast's proposal to record an additional $15,000 in intrastate depreciation expense applicable to 1996, in order to resolve all the issues related to the company's 1996 earnings. Northeast's annual bill-and-keep subsidy is currently $124,000. Reducing the subsidy by $109,190 plus $15,000, results in the elimination of Northeast's intraLATA subsidy. The intraLATA bill-and-keep subsidy pool receipts and payments are shown in Attachment C. We approve the elimination of Northeast's intraLATA subsidy, effective January 1, 1998.

Based on the foregoing, it is, therefore,

ORDERED by the Florida Public Service Commission that overearnings in 1996 for Northeast Florida Telephone Company are as set forth in the body of this Order and as developed in Attachment A, which is incorporated herein by reference. It is further

ORDERED that the overearnings in 1996 for Northeast Florida Telephone Company as set forth in the body of this Order shall be applied to the recovery of the reserve deficiency arising from the retirement of switches at Blackwell and Sanderson. It is further

ORDERED that Northeast Florida Telephone Company shall take an additional depreciation expense for 1996 as herein described. It is further

ORDERED that the residual reserve deficiency after application of the overearnings in 1996 for Northeast Florida Telephone Company shall be recovered by means of the additional 1996 depreciation expense approved herein and 1997 earnings. It is further

ORDERED that the intraLATA bill-and-keep subsidy for Northeast Florida Telephone Company, which is further described in Attachments B and C, incorporated herein by reference, shall be terminated effective January 1, 1998. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective unless an appropriate petition, in the form provided by Rule 25-22.036, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

ORDERED that in the event this Order becomes final, this Docket shall be closed.

By ORDER of the Florida Public Service Commission, this 25th day of November, 1997.

Blanca S. Bayó

BLANCA S. BAYÓ, Director
Division of Records and Reporting

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CJP

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), 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.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The actions proposed herein are 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 actions 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, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on December 16, 1997.

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 substantially 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.

ATTACHMENT A

NORTHEAST FLORIDA TELEPHONE COMPANY, INC.

CALCULATION OF 1996 OVEREARNINGS

NET OPERATING INCOME PER ESR			$708,183
Staff Adjustment:			
Portion of CAM costs to nonregulated operations	101		
Total Adjustments			101
Adjusted NOI			$708,284
RATE BASE PER ESR			$8,155,170
ROR @ 13.20% ROE		x	7.85%
Maximum allowed NOI			640,181
Achieved NOI			708,284
Excess NOI			68,103
NOI Multiplier		x	1.6033
TOTAL 1996 OVEREARNINGS			$109,190

ATTACHMENT B

INTRALATA TOLL BILL-AND-KEEP
CALCULATION OF SUBSIDY PAYMENTS
July 1, 1995
($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	158 *	(124)		(124)
FRONTIER	(151)	23		(128)		(128)
BELLSOUTH	10,099				252	
TOTAL					$252	($252)

* NORTHEAST INCLUDES THE $158,000 REDUCTION APPROVED IN DOCKET 910731-TL.

ATTACHMENT C

INTRALATA TOLL BILL-AND-KEEP
CALCULATION OF SUBSIDY PAYMENTS
January 1, 1998
($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
FRONTIER	(151)	23		(128)		(128)
BELLSOUTH	10,099				128	
TOTAL					$128	($128)