State of Florida

Public Service Commission
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DATE: September 8, 2005

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Office of the General Counsel (Teitzman, Rojas)
Division of Competitive Markets & Enforcement (Mann, Bulecza-Banks, Casey, Moses, Salak, Wright)
Division of Regulatory Compliance & Consumer Assistance (Vandiver)

RE: Docket No. 050374-TL – Petition for approval of storm cost recovery surcharge, and stipulation with Office of Public Counsel, by Sprint-Florida, Incorporated.

AGENDA: 09/20/05 – Regular Agenda – Section 120.57(2), Florida Statutes, Post-Hearing Decision – Participation is Limited to Commissioners and Staff

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Edgar

CRITICAL DATES: 09/22/05 (Florida Statute 364.051 Requires the Commission to Act Upon the Petition within 120 days after filing.)

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\GCL\WP\050374.RCM.DOC

Case Background

Between mid-August and late September of 2004, Hurricanes Charley, Frances, Jeanne, and Ivan struck Sprint-Florida, Incorporated's (Sprint) service territory causing damage to Sprint's telecommunications systems. On May 25, 2005, Sprint-Florida, Incorporated filed a Petition for Approval of Storm Cost Recovery Surcharge and Stipulation (Stipulation) with the Commission. The Stipulation involved a factual agreement between Sprint and the Office of the Public Counsel (OPC) concerning the extent of storm damage sustained by Sprint, the number of

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customers affected, and the amount of costs subject to recovery in order for this Commission to determine whether Sprint's Petition meets the criteria set forth in Section 364.051(4), Florida Statutes. The Stipulation also included the parties' agreement that an abbreviated procedure consistent with Section 120.57(2), Florida Statutes, would be appropriate in this proceeding.

By PAA Order No. PSC-05-0735-PAA-TL, issued July 8, 2005, the Commission approved the substantive portion of Sprint and OPC's stipulation, ordered that an average 30-day commercial paper rate shall be applied for the purposes of calculating the carrying costs attributable to the period August 2005, through July 2007, and approved Sprint's proposed true-up of its access line forecast contingent upon the Commission's later determination that any recovery was appropriate. By Order No. PSC-05-0757-PCO-TL, the procedural portion of the parties' stipulation was approved. Pursuant to the parties' stipulation, parties filed initial briefs on July, 8, 2005, and reply briefs on July 25, 2005. The parties' briefs addressed the following agreed upon issues:

1. Do the costs incurred by Sprint as a result of the 2004 hurricanes constitute a compelling showing of a substantial change in circumstances pursuant to Section 364.051(4), Florida Statutes?

2(a). If Issue 1 is answered in the affirmative, how much, if any, of the costs set forth in the stipulation may be recovered from Sprint's basic local service customers?

2(b). If any costs are determined to be recoverable, how should these costs be recovered?

The Commission has jurisdiction over this matter pursuant to Sections 364.01, 364.051(4), 364.051(5).

Discussion of Issues

Issue 1: Do the costs incurred by Sprint as a result of the 2004 hurricanes constitute a compelling showing of a substantial change in circumstances pursuant to Section 364.051(4), Florida Statutes?

Recommendation: Yes, the costs incurred by Sprint as a result of the 2004 hurricanes constitute a compelling showing of a substantial change in circumstances pursuant to Section 364.051(4), Florida Statutes. **(ROJAS, TEITZMAN)**

Position of the Parties

Sprint Initial Brief: In its Brief, Sprint contends that during a six-week period from August 13 to September 25, 2004, Sprint's local exchange service territory was in the direct path and storm swath of four major hurricanes in Florida and thus, significantly impacted. Sprint argues the costs it incurred to restore service to its customers as a result of the 2004 hurricanes were unprecedented and could not reasonably have been anticipated or included in the cost of service when Sprint's price-capped rates were originally set. Therefore, Sprint contends these hurricane-related costs constitute a substantial change in circumstances as contemplated in Section 364.051, Florida Statutes.

Sprint contends that the combination of four major storms in one season was unprecedented in the known history of Florida. Sprint asserts that the four hurricanes caused billions of dollars of damage and affected the provision of telecommunications and utility services to millions of Florida residents. Sprint argues that because its local exchange service territory includes 104 exchanges in widely dispersed geographic areas throughout Florida, Sprint's service territory was directly and materially impacted by all four hurricanes. Sprint asserts that Hurricane Charley inflicted damage on its facilities in Winter Garden, Winter Park, Naples, Ft. Myers and Avon Park, rendered 282,000 Sprint customers out of service and took 651 of Sprint's major network elements out of service, equating to 40% of Sprint's major network elements in the Sprint exchanges within these districts. Sprint asserts Hurricane Frances inflicted damage on its facilities in Ft. Walton Beach, Tallahassee, Ocala, Winter Garden, Winter Park, Naples, Ft. Myers and Avon Park, rendered 200,000 customers out of service and took 521 of Sprint's major network elements out of service, equating to 19% of the major network elements in the Sprint exchanges within these districts. Sprint asserts Hurricane Ivan inflicted damage on its facilities in Ft. Walton Beach, Tallahassee, rendered 46,000 customers out of service and took 292 of Sprint's major network elements out of service, equating to 42% of the major network elements in the Sprint exchanges within these districts. Sprint asserts Hurricane Jeanne inflicted damage on its facilities in Tallahassee, Ocala, Winter Garden, Winter Park, Naples, Ft. Myers and Avon Park, rendered 161,000 customers out of service and took 414 of Sprint's major network elements out of service, equating to 19% of the major network elements in the Sprint exchanges within these districts.

Sprint contends that it does not base its claim of a substantial change of circumstances upon any of these hurricanes alone. Rather, Sprint states it is the cumulative impact of the successive storms hitting Sprint's territory one after the other within a six week period that

constitute a single continuous, unprecedented and unforeseen event entitling it to relief. Sprint asserts that, cumulatively, the four storms resulted in the equivalent of rendering 691,000 Sprint customers out of service and 1,878 (or 67%) of Sprint's major network elements out of service. Sprint points out that of the other utilities seeking storm cost recovery, it appears only Progress Energy Corporation also was impacted by all four hurricanes, and the Commission recently approved $231,839,389 million in cost recovery for Progress.

Sprint asserts that as an ILEC with carrier of last resort obligations under Section 364.025, Florida Statutes, and pursuant to Commission rules, Sprint's primary objective after the storms was to restore service to its customers and repair its damaged facilities as quickly as possible. Sprint asserts the total costs to Sprint to repair its system and restore service reached $148 million through January 2005. Sprint argues this level of costs was not, and could not have been, considered in the rates that were established for Sprint prior to its election of price regulation in 1996. Sprint contends that despite incurred total incremental storm-related costs of $148 million, pursuant to its approved stipulation with OPC, it is not seeking recovery of $118 million or 80% of those costs from basic rates. Sprint argues further that because the costs for which it seeks recovery include only those costs over and above any normally anticipated or budgeted expenses and because the costs exclude average annual storm-related expenditures, they could never have been anticipated or included in the cost of service inherent in the rates Sprint adopted when it elected price regulation in January 1996. Sprint argues a review of the Commission Orders establishing the rates that Sprint adopted when it elected price regulation shows that the cost of service component of the Company's base rates did not include an allowance for extraordinary storm costs and no storm cost reserves. Sprint asserts further that the fact that storm related costs for which Sprint is seeking recovery were not contemplated or inherent in its price-capped rates is clear from Sprint's historical experience with storm related costs. Sprint contends in the twelve years prior to the 2004 hurricane season, Sprint incurred, cumulative total storm-related expenditures of $11 million, including $4 million in capital cost, which have been excluded explicitly from the recovery amount stipulated by the parties. Sprint asserts the average annual hurricane expense for the 12-year period was $598,240.[1]

Sprint opines that if it had incurred costs of this magnitude while under rate-of-return regulation, Sprint would have been entitled to seek recovery on the same basis that the rate-of-return regulated electric companies have sought in recent dockets before the Commission. Sprint argues further that while Section 364.051(4), Florida Statutes, does not require that the Commission consider a company's return on equity in order for a showing of "substantial change of circumstances," Sprint's return on equity if its Petition is approved will still allow Sprint a reasonable rate of return.

Sprint asserts that although Section 364.051, Florida Statutes does not specifically define what constitutes a "substantial change in circumstances," the plain language of the statute and the rules of statutory construction support an interpretation that the provision was intended to cover any change in circumstance, whether in the form of a cost increase or a revenue decrease, that substantially alters the financial picture of a price-regulated ILEC from what it was at the time the price-capped rates were established and adopted.

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[1] Sprint notes that this amount has been explicitly excluded from the amount it seeks to recover.

Sprint argues that Section 364.051(4) only excludes as a substantial change in circumstances expenditures required under part II of ch. 364, Florida Statutes, related to support for educational access to advanced telecommunications services, except under certain circumstances. Citing *Mosher V. Anderson*, 817 So. 2d 812, 816 (Fla. 2002) and *Moonlit Waters Apartments, Inc. v. Cauley*, 666 So. 898, 900 (Fla. 1996), Sprint asserts that it is a well-recognized rule of statutory construction that the mention of one thing implies the exclusion of another. Sprint argues that because the Legislature specifically excluded the specified expenses, which might otherwise be deemed to constitute changed circumstances, it is apparent that they intended the statute to capture any other expenditures not contemplated in the original establishment of a company's rates, except those expenditures that were specifically identified and excluded.

Sprint acknowledges that this is the first formal request for the Commission to determine that an ILEC has made a showing of a compelling circumstance sufficient to justify a basic rate increase. Sprint contends that because the Commission has not issued orders expressing a definitive view of the statute, an examination of the legislative history underlying the statutory enactment is appropriate to shed some light on the purpose and intent of the provision. Sprint argues that the language was first incorporated into the legislation as an amendment adopted in the House Committee on Utilities and Telecommunications. Sprint opines that the provision was intended as a "safety valve" and cites the House sponsor's introduction of the amendment in which it was explained that the amendment allowed a price-regulated LEC to petition the Commission if the company thinks circumstances have changed such that they need to ask the Commission for relief. Sprint also cites the official bill analysis prepared by the Governor's office at the time, which refers to a definition suggested by the Commission that defined "substantially changed circumstances" as "extreme inflation or an onerous and unforeseen increase in operational or personnel costs."

Sprint argues guidance can also be found in prior Commission decisions. Sprint asserts that the first mention of the provision was in a Commission proceeding to implement the local competition provisions of the 1995 Florida law. See, *In Re: Resolution of petition(s) to establish nondiscriminatory rates, terms, and conditions for resale involving local exchange companies and alternative local exchange companies pursuant to Section 364.161, Florida Statutes*, Order No. PSC-96-0811-FOF-TP in Docket No. 950984-TP, issued June, 24, 1996. Sprint asserts that the Commission found that GTE (n/k/a Verizon) could pursue relief under Section 364.051(5), Florida Statues, if GTE determined that as a result of the Commission's rulings it had suffered revenue losses sufficient to constitute a "substantial change in circumstances" under the statute. Sprint cites a similar decision was reached by the Commission in an arbitration proceeding involving GTE and Sprint Communications Company Limited Partnership. See, *In Re: Petition by Sprint Communications Company Limited Partnership d/b/a Sprint for arbitration with GTE Florida Incorporated concerning interconnection rates, terms and conditions, pursuant to the Federal Telecommunications Act of 1996*, Order No. PSC-97-0230-FOF-TP, in Docket No. 961173-TP, issued February 26, 1997.

Sprint asserts the Commission discussed Section 364.051(4), Florida Statutes, in somewhat more detail as an available remedy for a loss in revenue in a proceeding involving the elimination of the interLATA access subsidy received by GT Com (f/k/a St. Joseph Telephone

and Telegraph Company). Sprint cites the Commission's finding that "If GTC believes that the termination of the subsidy payment to GTC amounts to a changed circumstance that justifies a rate increase, GTC may seek relief pursuant to Section 364.051(5), Florida Statutes." (In re: Petition of BellSouth Telecommunications, Inc. to remove interLATA access subsidy received by St. Joseph Telephone & Telegraph Company, Order No. PSC-98-1169-FOF-TL issued August 28, 1998 in Docket No. 970808-TL, at page 12). Sprint also cites the Supreme Court's decision upholding the Commission's decision in which the Court echoed the Commission's finding that Section 364.051(5), Florida Statutes, allowed GTC to apply for a rate increase if it demonstrated that its circumstances had changed due to the elimination of the interLATA subsidy. See, *GT Com v. Garcia*, 791 So. 2d 452 (Fla 2000).

Sprint argues that although these three cases strongly suggest that a telecommunication company could seek recovery of lost revenues through the statute, and Sprint did lose significant revenues during the four 2004 hurricanes, the $30 million for which Sprint seeks recovery does not include an amount to cover lost revenues, only incremental, extraordinary storm related costs. Sprint opines that for a telecommunications company's bottom line, $30 million of additional expenses has the same effect as a $30 million loss of revenue, so if lost revenues are recoverable under Section 364.051(4), it follows that incremental expenses should be recoverable.

OPC Initial Brief: In its Brief, OPC contends that because the parties reached a stipulation of undisputed facts related to the hurricane and the maximum potential amount that could be recovered, there only remains the legal issue whether the costs incurred by Sprint as a result of the 2004 hurricane season constitute a compelling showing of a substantial change in circumstances pursuant to Section 364.051(4), Florida Statutes. OPC argues that Sprint's costs do not constitute such a change in circumstances.

OPC asserts that an essential component of any analysis of substantial change in circumstances must include a demonstration by the company that there has been financial harm. OPC asserts that Sprint elected to be a price cap regulated telecommunications company pursuant to Section 364.051(2), Florida Statutes. OPC asserts that the purpose of switching from rate base regulation to a price cap scheme was to allow financial flexibility to transition to a competitive market. OPC asserts that Sprint is free to make as much profit as it can by reducing its costs or increasing its prices within the statutory scheme[2], and since the price cap scheme is consistent with the pro-competitive provisions of Chapter 364, the Commission should treat the company in a manner consistent with a competitive market participant. OPC argues the Commission should disfavor the imposition of a surcharge for hurricane expenses since in a competitive market a competitive business would be unable to impose such a surcharge.

In addition to the greater flexibility to run their business, OPC asserts that by election of price cap regulation pursuant to Section 364.051(2), Florida Statutes, means a strictly limited involvement by the regulators in determining the appropriate costs and profits for a company,

[2] Under the current price cap regulatory scheme, Sprint may adjust its basic service revenues once in any 12-month period in an amount not to exceed the change in inflation less 1 percent. Also, under the price cap regulatory scheme, Sprint has the ability to raise its non-basic services rates 6 percent per any 12-month period or 20 percent if there is another telecommunications provider in the exchange for any non-basic service category.

which comes with a significantly restricted ability by the regulators to intervene to protect the company against losses. OPC argues that the Commission's limited role in setting prices must be considered in determining whether to apply the protection afforded by Section 364.051(4), Florida Statutes.

OPC contends that Section 364.051(4), Florida Statutes, provides a safety net to the companies during the transition period. OPC asserts that Section 364.051, Florida Statutes, refers to pricing regulation by which a company derives its earnings, and thus its profits, and therefore it is reasonable to conclude that in order for a safety net to be triggered, a company must show that despite the pricing flexibility under Section 364.051, Florida Statutes, some substantial change in circumstances is causing the company to suffer financial harm. OPC argues further that the financial harm must be so severe that the duration and magnitude going forward cannot be corrected without a change to basic rates outside the normal price cap scheme. OPC also argues that in determining whether a change of circumstances is of such a nature to trigger the financial safety net, the change should be beyond the control of the company.

OPC asserts that there is no dispute that Sprint suffered damage in its territory as a result of the four hurricanes nor is there a dispute that this damage caused Sprint to incur financial costs to restore services to its customers. OPC contends that pursuant to the parties' stipulation, Sprint incurred a total cost of $149,018,707 million. OPC asserts further that after removing the "double recovery" items as set forth in OPC's guidelines, potential insurance recovery, and average annual storm expense, Sprint is seeking $30 million it argues it cannot absorb. OPC argues that Sprint's contention that it has already incurred approximately $103 million in storm costs rings hollow because a majority of these costs are already recovered through the price of basic service. OPC asserts that there is no reasonable financial harm caused to the company by not allowing it to collect twice for the same costs.

OPC contends the question is whether the $30 million of extraordinary costs incurred by Sprint caused Sprint to suffer financial harm. OPC contends that Confidential Exhibit C, Sprint's Achieved Intrastate Return on Equity from 1999-2004, indicates that Sprint experienced an improvement in its ROE in 2004 despite the hurricanes. OPC argues that this demonstrates that Sprint's contention that it suffered financial harm due to the hurricanes is without merit.

It is not challenged by OPC that the 2004 hurricane season was extraordinary. OPC opines that while the 2004 hurricane season caused a greater than normal financial impact, the fact that hurricanes hit Florida and have a financial impact is not an unusual circumstance and all Florida businesses face the same annual risk of hurricanes. OPC argues that, in and of itself, the occurrence of hurricanes is not sufficient to justify a substantial change in circumstance necessitating an increase in basic telephone rates. OPC contends further that the issue before the Commission is not whether the event itself was extraordinary, but rather whether the financial harm caused by the extraordinary event was of sufficient duration and magnitude that the current pricing scheme cannot correct the financial harm.

OPC asserts that the duration of the financial harm to Sprint in this case, the 2004 hurricane season, is limited to a single year, i.e. it is non-recurring. And, although the risk of hurricanes occurs every year, OPC contends the risk of significant financial harm from

hurricanes is not an annual event, and therefore, it is unlikely that a one-time, non-recurring financial event would require any relief beyond the current pricing scheme.

The next issue raised by OPC is whether the event is of such a magnitude that the financial harm cannot be addressed sufficiently under the current pricing scheme. OPC asserts Sprint's ROE is a reasonable method for determining whether Sprint has suffered financial harm. OPC asserts that even with $30 million of unexpected financial costs, the Company's profits improved in 2004.

OPC asserts that in the recent 2005 legislative session, the Legislature created an exception for hurricanes related to the "change in substantial circumstances."[3] OPC notes that as set forth in the exception itself, the new legislation is to be applied to hurricanes after June 1, 2005, and clearly does not apply to the 2004 hurricane season. OPC argues that hurricanes, prior to the new legislation, should be evaluated under a general standard for what demonstrates a compelling showing of substantial changed circumstances and should be developed with all circumstances in mind rather than be tailored specifically for hurricanes.

Sprint Reply Brief: In its Reply Brief, Sprint asserts that OPC's recognition of the extraordinary and unprecedented character of the 2004 hurricane season and the resulting costs supports Sprint's position that the storms and the costs they imposed on Sprint constitute a substantial change in circumstances pursuant to Section 364.051(4), Florida Statutes. Sprint argues further that OPC's claims that Sprint's costs do not constitute a "substantial change in circumstances" within the meaning of Section 364.051(4), Florida Statutes, because Sprint has not demonstrated that the costs harmed Sprint financially are without merit. Sprint contends an earnings test is neither express or implied in the text of Section 364.051(4), Florida Statutes, and furthermore, Sprint was in fact financially harmed by any objective measure.

Sprint asserts that OPC's interpretation of Section 364.051(4), Florida Statutes, violates a number of fundamental tenets of statutory construction. Sprint cites a general rule of statutory construction that courts may not, in the process of construing a statute insert words or phrases into the statute, or supply an omission that was not in the minds of the legislators when the statute was enacted.[4] Sprint argues further that OPC's interpretation of Section 364.051(4), Florida Statutes, also ignores the basic framework of price regulation and violates the requirement that all parts of a statute be read together to achieve a constant whole.[5] Sprint contends that Section 364.051(3), Florida Statutes, recognizes that the prices of goods and services used by an ILEC to provide service are expected to increase and provides incentive for ILECs to become increasingly efficient, but generally allows the recovery of these normal and foreseeable inflationary costs through indexed retail price increases. Sprint argues further that unforeseeable, catastrophic costs such as the costs for which Sprint seeks recovery in this case are not part of normal inflation and cannot be offset by improved productivity.

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[3] Section 364.051(b), Florida Statutes, the new legislation, states: (b) For purposes of this section, evidence of damage occurring to lines, plants, or facilities of a local exchange telecommunications company that is subject to the carrier-of-last-resort obligation, which damage is the result of a tropical system occurring after June 1, 2005, and named by the National Hurricane Center, constitutes a compelling showing of changed circumstances.

[4] See, In Re *Order on Prosecution of Criminal Appeals by the Tenth Judicial Circuit Public Defender*, 561 So. 2d 1130, 1137 (Fla. 1990); *Devin v. Hollywood*, 351 So. 2d 1022, 1025 n.6 (Fla. 4th D.C.A. 1976)

[5] See *T.R. v. State*, 677 SO. 2d 270 (Fla. 1996)

Sprint contends that even assuming arguendo that Section 364.051(4), Florida Statutes, contains an implied earnings test, OPC's analysis of Sprint's ROE in 2003 and 2004 is flawed. Sprint asserts that the stipulated ROE information clearly shows that Sprint clearly has not earned an excessive ROE in any of the years shown and that recovery of $30 million of storm-related costs over two years will not result in extraordinary earnings and certainly not an earnings windfall to Sprint.

Sprint disagrees with OPC's implicit argument that a one-time occurrence, no matter how significant or extraordinary, does not meet the statutory criteria. Sprint asserts the issue is not whether the event qualifying as a "changed circumstance" occurs once or twice, but rather, whether the kind of event and resulting costs qualifying as a "changed circumstance" occurred and was reflected in similar scale in Sprint's cost of service when the base rates in the Company's price-indexed rates were established. Sprint contends that in order for the "changed circumstance" provision to have real meaning, the Commission must compare the submitted "changed circumstance" against some reference point in time, which under the statute, are the circumstances that were, or could have been, recognized in Sprint's rates at the time the price regulation statute was adopted in 1995.

Sprint argues that OPC correctly asserts that amendments to Section 364.051(4), Florida Statutes, enacted by the 2005 Legislature generally are not applicable to a petition filed prior to the effective date of the legislation. Sprint contends further, that although not strictly applicable, the 2005 amendment provides clear insight into the Legislature's view of the scope of Section 364.051(4), Florida Statutes, prior to the 2005 changes. Sprint asserts that by including a "savings clause" that ensures nothing in the 2005 legislation will adversely affect a previously filed petition, the Legislature makes it clear that Section 364.051(4), Florida Statutes, contemplates the filing of a petition to recover extraordinary costs incurred as a result of cataclysmic events such as the 2004 hurricane season. Sprint opines that if the Legislature had not contemplated that the 2004 storms could constitute a changed circumstance meriting recovery, there would have been no reason to include a "savings clause" in the 2005 amendment to preserve a company's right to recover extraordinary costs. Sprint asserts further that the Senate sponsor specifically noted in Senate floor debate on this specific provision that the existing statute authorizes companies to file a petition to recover 2004 storm costs without limiting the amount or duration of any recovery. Sprint argues had there been a desire to limit the consideration of such a petition to only 50 cents per month over 12 months, the Legislature could have done so at that time.

OPC Reply Brief: OPC asserts that the Commission Orders cited by Sprint in its Brief all note that Section 364.051(4), Florida Statutes, could be used by a company suffering "revenue losses" if it could demonstrate a "compelling showing of changed circumstances." OPC asserts that the reference to "revenue losses" clearly demonstrates that the Commission anticipated a financial component in any Section 364.051(4), Florida Statutes, analysis, and thus, a demonstration of financial harm.

OPC agrees that Section 364.051(4), Florida Statutes, acts as a safety net for the caps imposed on rates in existence at the time a LEC elected price regulation. OPC, however, asserts that Sprint's acknowledgements that the provisions of Section 364.051(4), Florida Statutes, are

to be used in extremely rare cases and that no other company has ever petitioned for relief under this section, shows that companies have been able to cope with all kinds of unforeseen, unexpected events under the current price capping scheme without coming to the Commission for relief. OPC asserts it is important the Commission not make Section 364.051(4), Florida Statutes, easily available for every financial down-turn a company may suffer.

In addressing Sprint's citation of the Commission's alternative definition of "substantially changed circumstances" as extreme inflation or onerous and unforeseen increase in operational or personnel costs, cited in the Legislative Bill Analysis from the Executive Office of the Governor Office of Planning and Budgeting, OPC asserts that its criteria, as set forth in its Initial Brief, is consistent with the Commission's cited definition. OPC argues further that Sprint has failed to show how the costs of the storm are an extreme or onerous increase in operational or personnel costs that have caused the Company financial harm. OPC contends that Sprint has only shown that the hurricanes caused a temporary increase in operational and personnel costs and has failed to demonstrate how such costs cannot be met under the current price-cap scheme.

OPC disagrees with Sprint's assertion that whether or not costs were included as part of its base rates on which the price-caps were set is relevant to this discussion. OPC asserts that there are many events which increase operational or personnel costs and were not included in the original base rates on which the price-caps were established such as new technologies, mergers, and/or competition. OPC contends price-cap companies have many options to meet a temporary or permanent increase in costs such as eliminating other costs or increasing prices for services as allowed under the statute.

OPC further disagrees with Sprint's contention that it should be entitled to the same regulatory treatment as a rate-of-return regulated company, because it would have been entitled to those costs if it was still rate-of-return regulated. OPC asserts it is appropriate in both price-cap and rate-of-return regulation to look at the Company's ROE, the measure of its profitability, to determine if its revenues are sufficient to cover its costs and allow the company to make a profit. OPC contends that clearly Sprint's stipulated ROE from 2003 to 2004 demonstrates that Sprint has been able to make a profit despite the temporary increase in personnel and operational costs.

Summary

This analysis is meant to demonstrate that additional costs incurred by Sprint to restore service to its customers and to repair its damaged facilities as a result of the effect of the four 2004 hurricanes constitutes a substantial change in circumstances as contemplated by the Legislature. The stipulated facts provide a compelling showing that the impact of the four hurricanes that hit Sprint's service territory during a six-week period in 2004 constitute a substantial change in circumstances as contemplated by the statute. An analysis of the events in question, the language of the statute, as well as legislative guidance provided by the revisions to Chapter 364, Florida Statutes during the 2005 Legislative session indicate that these costs represent a "substantial change in circumstances" for Sprint.

Analysis

Section 364.051, Florida Statutes, allows a price-regulated ILEC to request an increase in its basic local service rates if the ILEC makes a compelling showing of a substantial change in circumstance. This safety valve provision of the historic 1995 revisions to the Commission's ratemaking authority has essentially lain dormant for 10 years. The Legislature's obvious intent was for the provision to be used sparingly, and as such, this is a case of first impression.

The combination of four major storms in one season was unparalleled in the history of Florida. Prior to the four storms hitting Florida in 2004, the last time comparable multiple storm impacts were felt in a single season in a single state was in Texas in 1886. While there have been other active hurricanes seasons in the United States during the twentieth century, arguably, none compare to the 2004 season in regards to the impact on a single state.

Sprint does not base its claims of a "substantial change in circumstance" upon any one of these hurricanes alone. Rather, it is the cumulative impact of the successive storms hitting Sprint's territory within a six week period that Sprint believes constitute a single continuous, unprecedented and unforeseen event. Because the hurricanes hit some Sprint areas more than once, network elements made operational after being damaged in one storm were again damaged or disabled in another storm. Cumulatively, these four storms resulted in the equivalent of rendering 691,000 Sprint customers out of service and 1,878 (or 67%) of Sprint's major network elements out of service. These unprecedented and unforeseen costs are arguably the type of costs Section 364.051(4), Florida Statutes, was intended to address. However, Sprint's assertion that the 2004 hurricane season was extraordinary and the hurricanes cost it money not contemplated in the price-cap rates is insufficient alone to justify the requested increase. There are an endless number of scenarios where an event could cost Sprint money and the costs were not contemplated in price-cap rates. There does exist, however, ample legislative history that, when examined, provides evidence that it was the Legislature's intent that damages such as those caused by the 2004 Hurricane season should be interpreted to constitute a compelling showing of changed circumstances.

Statutory Construction

Section 364.051, Florida Statutes, states:

> Notwithstanding the provisions of subsection (2), any local exchange telecommunications company that believes circumstances have changed substantially to justify any increase in the rates for basic local telecommunications services may petition the commission for a rate increase, but the commission shall grant such petition only after an opportunity for a hearing and a compelling showing of changed circumstances. The costs and expenses of any government program or project required in part II shall not be recovered under this subsection unless such costs and expenses are incurred in the absence of a bid and subject to carrier of last resort obligations as provided for in part II. The commission shall act on any such petition in 120 days.

Section 364.051, Florida Statutes, does not define specifically what constitutes a "substantial change in circumstance" which would allow a price-regulated LEC to seek relief. However, the rules of statutory construction, as well as guidance from the Florida Legislature's 2005 revisions of Chapter 364, support an interpretation that the provision would contemplate that Sprint's 2004 hurricane costs amount to a "substantial change in circumstances," although perhaps not to the full extent contemplated by Sprint.

Section 364.051, Florida Statutes, refers to pricing regulation by which a company derives its earnings and thus its profits. The purpose of switching from rate base regulation to a price cap scheme was to allow financial flexibility to transition to a competitive market. Within the current price cap scheme, the company has flexibility to increase its prices within limits based on market conditions and the company's financial interest. Thus, the company is free to make as much profit as it can by reducing its costs or increasing its prices within the statutory scheme. It is however, still constrained by the statutory limitations on increases; in other words, Sprint is neither fully regulated nor a deregulated open market participant. As such, staff does not believe the statute would contemplate recovery to the extent that it might significantly skew the competitive market, since in most instances a competitive business would be unable to request or impose such a surcharge, except to the extent that the market would bear.

As a matter of law, the plain language of Section 364.051(4), Florida Statutes, only excludes one category of costs, thereby making all other categories of costs caused by substantially changed circumstances eligible for recovery. Section 364.05 l(4) only excludes as a substantial change in circumstances expenditures required under part II of Ch. 364, Florida Statutes, related to support for educational access to advanced telecommunications services, except under certain circumstances.

It is a well-recognized rule of statutory construction that the mention of one thing implies the exclusion of another[6]. Because the Legislature specifically excluded the specified expenses, which might otherwise be deemed to constitute changed circumstances, it is apparent that they intended the statute to capture any other expenditures not contemplated in the original establishment of a company's rates, except those expenditures that were specifically identified and excluded.

Public Counsel's interpretation of Section 364.051(4), Florida Statutes, fails to consider the requirement that all parts of a statute be read together to achieve a consistent whole.[7] Subsection (3) of Section 364.051, Florida Statutes, allows a local exchange company to increase certain aspects of its retail prices without Commission action once a year in an amount not to exceed inflation minus a productivity offset of one percent. This portion of the statute recognizes that the prices of goods and services used by an ILEC to provide service are expected to increase and provides a reason for ILECs to become progressively more efficient, but generally allows the recovery of these normal and foreseeable inflationary costs through indexed retail price increases. Unforeseeable, and arguably, catastrophic costs such as those for which Sprint seeks recovery in this case are not part of normal inflation and cannot be offset by

[6] See, e.g., *Mosher* at 816 (Fla. 2002); *Moonlit Waters Apartments, Inc. at* 900

[7] See *T.R. v. State*, 677 So. 2d 270 (Fla. 1996).

improved productivity. Reading subsections 364.051(3) and (4), Florida Statutes, together, as the statutory construction rules require, compels the conclusion that "normal" cost increases were intended to be recovered, less a productivity offset, via annual indexed retail price increases, while substantial, unforeseen and extraordinary costs such as the hurricane costs at issue here can be recovered via the sparingly-used changed circumstances provision of the statute.

Legislative Guidance

In the recent 2005 legislative session, the Legislature substantially revised Chapter 364, Florida Statutes. Of specific note are revisions made to Section 364.051 related to the "substantial change in circumstances" provision.

Section 364.051(b), Florida Statute, the new legislation, states:

> For purposes of this section, evidence of damage occurring to lines, plants, or facilities of a local exchange telecommunications company that is subject to the carrier-of-last-resort obligation, which damage is the result of a tropical system occurring after June 1, 2005, and named by the National Hurricane Center, constitutes a compelling showing of changed circumstances.

As set forth in the revised language itself, the new legislation is to be applied to hurricanes after June 1, 2005. Staff opines that this was enacted to clarify both the legislative intent of Section 364.051, as well as to provide the FPSC with guidance in its role in determining what constitutes a "substantial change in circumstances." It is this recent guidance from the legislature that is most compelling in determining that additional costs incurred by Sprint to restore service to its customers and to repair its damaged facilities during the 2004 hurricane season should be interpreted as "substantial change in circumstances."

Conclusion

Sprint serves a geographically diverse territory throughout Florida, Sprint's territory was in the direct path and storm swath of, and thus was significantly impacted by all four storms. The costs Sprint incurred to restore service to its customers as a result of the 2004 hurricanes were unprecedented. They were not included in the cost of service when Sprint's price-capped rates were originally set. Furthermore, the current statutory language does not prohibit recovery. Additionally compelling, are the provisions of the 2005 legislation deeming damages caused by tropical systems named by the National Hurricane Center, as constituting a compelling showing of changed circumstances, at least on a going-forward basis from the effective date of the legislation. Therefore, staff recommends these costs meet the criteria set forth in Section 364.051, Florida Statutes.

Issue 2(a): If Issue 1 is answered in the affirmative, how much, if any, of the costs set forth in the Stipulation may be recovered from Sprint's basic local service customers?

Recommendation: Sprint should be authorized to impose a surcharge limited to 50 cents per access line for no more than 12 months, which approximates $9 million of recovery. **(ROJAS, TEITZMAN)**

Position of the Parties

Sprint Initial Brief: In its Brief, Sprint argues that the storm costs should be recovered on an access line basis, because restoration of all services depends on the restoration of the underlying access line. Sprint asserts that access lines can either be basic service, single line residential or single line business service or nonbasic service, multi-line business service. Sprint asserts further that 82.4% of its access lines are basic service lines, and it should be entitled to recover a pro rata share of the total storm costs attributable to basic service access lines from its basic services customers.

Sprint contends there are several reasons why it should be permitted to recover its storm costs from its basic services customers in proportion to the number of basic services access lines. Sprint argues first that its carrier of last resort responsibilities require it to provide basic services to any and all customers who request it and basic service customers makeup the majority of Sprint's access line base. Sprint argues that because Sprint is required by statute to provide basic service, and because Commission rules set forth Sprint's obligations to provide and maintain this service, Sprint's hurricane recovery efforts were by necessity directed towards the goal of restoring basic service. Sprint asserts further that because the storm costs it incurred are logically proportionate to Sprint's customer base, Sprint's cost recovery should also be proportionate to that base.

Sprint opines that once it has made a compelling showing of changed circumstances under Section 364.051(4), Florida Statutes, then it is entitled to raise its basic local rates to address these circumstances. Sprint contends that it would be inequitable and inconsistent with the statute to find that Sprint had met the statutory criteria for recovery, but was not entitled to a rate increase for basic local services commensurate with the impact of the changed circumstances on Sprint's provisioning of these services. Sprint also notes that it has committed to also assess nonbasic customers the same recovery surcharge that is authorized to be assessed basic services customers.

OPC Initial Brief: In its Brief, OPC argues that Sprint has not met the standard of demonstrating a compelling showing of substantial changed circumstances that justify an increase in the rates for basic telecommunications services. OPC contends that Sprint's improved ROE for 2004 argues against the idea that Sprint is unable to recover its loss through the current pricing scheme or that Sprint suffered any financial harm.

OPC asserts further that even if the Commission finds a "substantial change in circumstances" it still must determine if the "substantial change in circumstances" justifies an increase to the rate for basic telecommunications services. OPC contends that, at a minimum, the maximum potential amount of the financial harm, approximately $30 million, should be

netted by the Company's ability to raise its basic telecommunications rate in a given year. OPC argues that no recovery should be granted if the annual increase is greater than the financial harm. OPC asserts the offset amount is not set forth in the parties' Stipulation, but could either be obtained from Sprint or approximated by use of the publicly available Regulatory Assessment Fee Form.

OPC offers another method in its Brief to determine a reasonable offset. OPC asserts that the Commission could use the level of increase in Sprint's ROE from 2003 to 2004. OPC contends this methodology is appropriate because if Sprint had suffered financial harm one would expect that its profits would decrease not increase. OPC argues that by removing the amount of increase in profit from the recovery, the Commission would better match the financial harm, if any, to Sprint.

OPC argues further that if the Commission finds a "substantial change in circumstances" based on rationale related to the new legislation, the Commission should also apply the remainder of the new legislation. OPC asserts that it is clear that Sprint has met the threshold amount of $1.5 million in damage to its infrastructure for recovery under the new legislation. OPC asserts further that since the threshold is met, Sprint's recovery should be limited to 50 cents per customer line for no more than 12 months pursuant to the new legislation. OPC opines that using the average access lines for basic customers would result in approximately a $9 million recovery instead of $30 million.

Sprint Reply Brief: Sprint disagrees with OPC's suggestion that it should subtract any increase realized from its annual price cap filing from the recovery amount. Sprint argues this suggestion ignores both the purpose of the allowable annual price cap increases and the purpose of Section 364.051(4), Florida Statutes. Sprint asserts that this increase is not intended to capture the ordinary price increases that would be expected due to a general increase in the prices of consumer good and services. Sprint opines that this is evidenced by the statute's tying of the inflation increase to the Gross Domestic Products Fixed 1987 Weights Price Index, or successor fixed weight price index.

Sprint argues further that OPC seeks to have the Commission read into the statute a netting process that was not stated by the Legislature and therefore must be presumed not to have been intended. Sprint contends further that the same argument applies to OPC's suggestion that any increase should be netted against its allegedly improved ROE. Sprint argues the Legislature did not expressly include a consideration of a company's earnings in Section 364.051(4), Florida Statutes, much less express an intent to take a company's ROE trending into account in establishing the costs that may be recovered once a compelling showing of changed circumstances is made.

Sprint contends the suggestion by OPC that the Commission limit Sprint's recovery based on the provisions of the new legislation not only reads a requirement that does not exist into the law, but actually contravenes the unambiguously stated intent of the law. Sprint argues that any limitation on recovery of legitimate and undisputed costs based on the language of the 2005 revisions would expressly violate the statutory admonition that the petition cannot be adversely affected by the 2005 Act. Sprint opines that the Commission would be acting outside the scope of the authority delegated to it by the Legislature if it were to take this approach.

OPC Reply Brief: OPC asserts that Sprint has not set forth any arguments that meet the standard of showing a compelling showing of substantial changed circumstances that justify an increase in the rates for basic telecommunications services. OPC contends that Sprint's improved ROE in 2004 argues against the idea that Sprint is unable to recover its loss through the current pricing scheme or suffered any financial harm that would require an increase in the basic telecommunications rate and therefore is not entitled to any additional recovery even if the hurricanes could be considered a "substantial change in circumstances."

Summary

Staff recommends that the Commission should authorize Sprint to recover 50 cents per access line for no more than 12 months. Although, the 2005 legislation specifically provides that it is not intended to ***adversely*** affect the Commission's consideration of any petition for recovery pending on the effective date of the Legislation, staff believes that using the method of recovery so clearly delineated by the Legislature does not constitute an adverse effect as contemplated by the law. Staff interprets the statement that the legislation should not adversely affect Commission consideration of a petition for recovery under 364.051(4) to primarily be intended to clarify that the new law does not preclude recovery for 2004 storms. Nothing in the new law specifies that all costs incurred must be deemed recoverable.

Analysis

The maximum potential $30 million recovery stipulated to by the parties was based on a set of accounting guidelines developed through the electric storm dockets. Order PSC-05-0250-PAA-E1, issued March 4, 2005, in Docket No. 050093-EI, the Commission approved these guidelines as part of the Gulf Settlement.

Sprint argues that it should be entitled to the same regulatory treatment as a rate-of-return regulated electric company, arguing that it would have been entitled to those costs if it was still rate-of-return regulated. Sprint rationalizes this position by saying that it would still be well within a reasonable rate of return. This logic circumvents the unmitigated reality that Sprint is not a rate-of-return regulated electric company, and voluntarily opted into a price-cap regulatory scheme. Implicit with this more flexible regulatory treatment comes a significantly restricted ability by regulators to intervene to protect the company against losses.

The new legislation permits a telecommunications company with carrier-of-last-resort obligations to petition for recovery from tropical storms if the damage is greater than a specific amount based on access lines. Thus, Sprint, having demonstrated more than $1.5 million in damage from a tropical system, could petition for relief. In this case, there is no dispute that Sprint suffered greater than $1.5 million in damage to its infrastructure. Once this threshold is met, under the new legislation the amount of recovery is limited to 50 cents per customer line for no more than 12 months. Using the average access lines for basic customers would result in approximately $9 million recovery instead of $30 million.

OPC and Sprint are in agreement that amendments to Section 364.051 (4), Florida Statutes, enacted by the 2005 Legislature generally are not applicable to a petition filed prior to

the effective date of the legislation. However, while not strictly applicable, the 2005 amendment provides insight into the Legislature's view of what constitutes "changed circumstances."

Staff's position is that the legislative revisions further clarify the ambiguous term "substantial change in circumstances." The Legislature, by including a "savings clause" that ensures that nothing in the 2005 legislation will ***adversely*** affect (emphasis added) a previously filed petition contemplates the filing of a petition to recover extraordinary costs incurred as a result of events such as the 2004 hurricane season. Simply put, the Legislature did not intend to preclude a finding that the 2004 storms constitute a changed circumstance meriting recovery. In addition, the Legislature provided a clearly delineated recovery mechanism for a telecommunications company with carrier of last resort obligations to petition for recovery from tropical storm damage on a going-forward basis. While not required to be applied to cases initiated prior to the effective date of the new legislation, the recovery mechanism does serve as helpful guidance as to one way to approach recovery for telecommunications companies. It serves as an indication that the Commission has discretion to determine the appropriate recovery mechanism and amount for petitions filed prior to the effective date of the new legislation, and indicates that the Commission is not required to take an "all or nothing" approach to recovery.

Sprint argues that this suggestion, disregards the stated intent of the law. Sprint's argument is, that should the Commission attempt to limit recovery of legitimate and undisputed costs, based on language from the new law, it would expressly violate the statutory admonition that a Section 364.051(4) petition cannot be adversely affected by the 2005 Act. This logic is flawed, as it is the duty and power of the Commission to interpret and determine matters such as this. In making such a determination, in a case of first impression, the Commission should look to any conceivable guidance provided to it by the Legislature. Simply put, the Legislature provided a clear and well reasoned recovery mechanism meant not only as an instrument to be applied to the future but as clear and unambiguous guidance in interpreting the current statutory language applicable to this matter. Furthermore, nothing in Section 364.051(4) mandates, or even indicates, that full recovery of <u>all</u> costs incurred as a result of "changed circumstances" is required.

<u>Alternative Recovery</u>

<u>Option 1 – No Recovery</u>: It can be argued that since this is a case of first impression that Sprint's arguments fail to demonstrate that it is entitled to any recovery since it was unable to demonstrate a compelling showing of a substantial change in circumstance. Since Sprint's arguments do not support that it is not entitled any surcharge recovery, Sprint may instead implement any mechanism appropriate under the current pricing scheme.

<u>Option 2 – Full Recovery</u>: Sprint should be able to recover the stipulated amount of costs attributable to its basic services access lines, that is, $30,319,521, from its basic services customers. The costs should be recovered through a surcharge calculated based on Sprint's average number of access lines for a period not to exceed 24 months. The 30-day commercial paper rate should apply to the recovery period. Staff and Sprint agree that recovery should be subject to a true-up that will ensure that Sprint customers do not pay any more than the approved recovery amount. This option would be most appropriate if the Commission finds that limiting

the amount of recovery at 50 cents per access line based on the 2005 legislation does constitute an "adverse affect" on the Commission's consideration of Sprint's petition.

Conclusion

Staff recommends that the Commission should authorize Sprint to recover 50 cents per access line for no more than 12 months. The 2005 legislation specifically provides that it is not intended to ***adversely*** affect the Commission's consideration of any petition for recovery pending on the effective date of the legislation. Staff believes that this provision was primarily intended to indicate that companies were not precluded from seeking recovery of costs associated with 2004 storms, even though the new legislation addresses only recovery on a going-forward basis.

Issue 2(b): If any costs are determined to be recoverable, how should those costs be recovered?

Recommendation: Staff recommends that the Commission should authorize Sprint's recovery in the manner provided in 2005-132, Laws of Florida. Specifically, Sprint should be authorized to impose a surcharge limited to 50 cents per access line for no more than 12 months. **(ROJAS, TEITZMAN)**

Position of the Parties

Sprint Initial Brief: Sprint asserts in its Brief that it should be permitted to impose a surcharge for a maximum of 24 months, at a level that will recover the stipulated costs approved by the Commission. Sprint contends further that it should be permitted to use the basic access line methodology approved by the Commission in PAA Order No. PSC-05-0735-PAA-TL, issued July 8, 2005 and will cease its assessment of the surcharge if it achieves recovery of the storm cost amount assigned to its basic services customers prior to the end of the 24 month period as provided in its letter to the Commission dated July 5, 2005. Sprint asserts it will impose the identical surcharge on its nonbasic access lines, pursuant to its nonbasic pricing authority under Section 364.051(5), Florida Statutes.

Sprint contends its proposed recovery mechanism is reasonable and consistent with Section 364.051(4), Florida Statutes, and should be approved by the Commission.

OPC Initial Brief: OPC argues that Sprint is not entitled to any recovery through an increase in basic rates but may recover its storm costs through any mechanism that is appropriate under the current pricing scheme.

If the Commission determines that the "substantial change in circumstances" has been met based on rationale related to the new legislation, then the methodology set forth in the statute should be followed. OPC contends under this scenario Sprint should be permitted to assess 50 cents per basic access line for a period of no more than 12 months and an average access line count should be used.

Sprint Reply Brief: Sprint asserts that other than OPC's proposal that the Commission apply the post-2005 mechanism to Sprint's 2004 costs, there does not appear to be a material disagreement between the parties concerning the appropriate mechanism for Sprint to recover any storm costs determined to be recoverable by the Commission.

OPC Reply Brief: OPC argues that Sprint may recover its storm costs through any mechanism that is appropriate under the current pricing scheme by implementing the price increase allowed under the statues or forego raising its rates.

Analysis

Staff recommends that if the Commission determines that the "substantial change in circumstances" has been met based on rationale related to the new legislation, then the methodology set forth in the statute should be followed. As set forth in the previous issue, Sprint

should assess 50 cents per basic access line for a period of no more than 12 months. However, if the Commission opts to authorize the Full Recovery Option, the costs should be recovered through a surcharge calculated based on Sprint's average number of access lines for a period not to exceed 24 months. The 30-day commercial paper rate should apply to the recovery period. Staff and Sprint agree that recovery should be subject to a true-up that will to ensure that Sprint customers do not pay any more than the approved recovery amount.

Issue 3: Should this Docket be closed?

Recommendation: If the Commission finds recovery to be inappropriate, then this docket should be closed. However, if the Commission finds recovery on the part of Sprint to be appropriate this docket should remain open for a period of time consistent with the methodology of recovery deemed appropriate. **(ROJAS, TEITZMAN)**

Staff Analysis: If the Commission finds recovery to be inappropriate, then this docket should be closed. However, if the Commission finds recovery on the part of Sprint to be appropriate this docket should remain open for a period of time consistent with the methodology of recovery deemed appropriate in order to monitor Sprint's compliance with this order.