

State of Florida



## Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

**-M-E-M-O-R-A-N-D-U-M-**

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**DATE:** April 20, 2006

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

**FROM:** Office of the General Counsel (Scott, Fordham)  
Division of Competitive Markets & Enforcement (Simmons, Dowds, Higgins)

**RE:** Docket No. 050194-TL – Complaint by Florida BellSouth customers who paid fees to BellSouth Telecommunications, Inc. related to Miami-Dade County Ordinance Section 21-44 ("Manhole Ordinance") and request that Florida Public Service Commission order BellSouth to comply with Section A.2.4.6 of General Subscriber Service Tariff and refund all fees collected in violation thereof.

**AGENDA:** 05/02/06 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Carter

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\GCL\WP\050194.RCM.DOC

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### Case Background

On March 23, 2005, a Complaint of Florida BellSouth Customers Against BellSouth Telecommunications, Inc. and Request for Relief ("Complaint") was filed by Karla Hightshoe, Timothy McCall, and Manuel Garcia, individually, and Best Investment Realty, Inc., a Florida Corporation, as well as on behalf of all other BellSouth customers who have paid the Miami-Dade County Ordinance #83-3 ("Manhole Ordinance") fee, (collectively as the "Petitioners").<sup>1</sup>

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<sup>1</sup> Prior to filing the Complaint, the Petitioners served as representatives of a class of BellSouth customers in a class action suit before Judge Henry Harnage in the Eleventh Judicial Circuit for Miami-Dade County, Florida,

The Complaint alleges that BellSouth has violated the terms of Section A.2.4.6 of its General Subscriber Service Tariff (“Tariff”) since 1983, when a fee was first established to recoup BellSouth’s costs associated with complying with the Manhole Ordinance. Pursuant to the Manhole Ordinance, while anyone is working below ground level, at or near a manhole, another person must provide above-ground surveillance. The Complaint requests that this Commission enforce the Tariff, and order BellSouth to comply with its Tariff and to refund all fees collected in violation of the terms of the Tariff.<sup>2</sup>

On April 18, 2005, BellSouth filed its Motion to Dismiss (“Motion”) the Complaint on the following four bases: (1) the individual customers lack standing to initiate a proceeding, (2) there is no statutory authority for this Commission to hear a class action suit, (3) this Commission has no authority to grant injunctive relief, and (4) this Commission has no authority to award attorney’s fees. On April 28, 2005, the Petitioners filed their Response to BellSouth’s Motion to Dismiss (“Response”) in which they requested that the Motion be denied. Alternatively, the Petitioners suggested that this Commission enter an order acknowledging that the matters in the Complaint are and were properly before the Circuit Court.

By Order No. PSC-05-0762-PCO-TL, issued July 25, 2005, the Commission granted in part and denied in part BellSouth’s Motion to Dismiss the Petitioners’ Complaint. The Commission found that the Petitioners have standing to bring the subject matter of the Complaint before this body and to seek a refund of any charges collected in violation of the Tariff. However, the claim for attorney’s fees was stricken since the Commission lacks the subject matter jurisdiction to grant such a claim. In addition, the request for injunctive relief was not addressed at that time, as additional information was necessary in order to proceed in an appropriate and efficient manner. Staff was directed to investigate this matter, provide the results of its investigation, and advise the Commission.<sup>3</sup> This recommendation provides staff’s assessment based on three sets of discovery responses from BellSouth.

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concerning the same matters brought by the Complaint. See Hightshoe, et al. v. BellSouth Telecommunications, Inc., Case No. 03-26623-CA11. Judge Harnage dismissed the Petitioners’ class action suit for failure to exhaust administrative remedies.

<sup>2</sup> BellSouth General Subscriber Service Tariff, Section A.2.4.6 states:

When the Company [BellSouth] by virtue of its compliance with a municipal or county ordinance, incurs significant costs that would not otherwise normally be incurred, all such costs shall be billed, insofar as practical, pro rata, per exchange access line, to those subscribers receiving exchange service within the municipality or county as part of the price for exchange service.

An estimated monthly amount of such costs shall be billed to the affected subscribers each month and an adjustment to reconcile these estimates to the actual costs incurred for the six-month periods ending June 30 and December 31 of each year shall be applied.

<sup>3</sup> As part of its investigation, staff has served BellSouth with three sets of discovery. Also, on September 12, 2005, the Petitioners served their First Request for Production to BellSouth. In response, on October 14, 2005, BellSouth filed its Objections and Motion for Protective Order (Motion). On March 21, 2006, Order No. PSC-06-0240-PCO-TL was issued granting in part and denying in part BellSouth’s Motion.

### Discussion of Issues

**Issue 1:** Has BellSouth violated the terms of Section A.2.4.6 of its General Subscriber Service Tariff, with respect to the Manhole Ordinance Fee, for all or part of the period 1983 through 2005? If so, what action should the Commission take?

**Recommendation:** Staff recommends the Commission find that BellSouth violated the terms of Section A.2.4.6 of its General Subscriber Service Tariff, during all or part of the period 1998 through 2005. Given that the per line credit or refund would be less than \$.50, and since a significant number of affected customers may no longer be receiving service from BellSouth, staff recommends that no customer credit or refund be required.

Instead, staff recommends that the Commission set the cumulative overage in collections, with interest, as of year-end 2005 at \$469,176 and require that BellSouth consider this overage and any overage/underage for January 2006 through June 2006, in setting the Manhole Ordinance Fee to be assessed for the period July 2006 through December 2006. In addition, staff recommends the Commission find that, pursuant to existing Section A.2.4.6 of its General Subscriber Service Tariff, BellSouth is required to perform reconciliations for each future six-month period and to apply the overage/underage in collections as an accounting adjustment, to determine the appropriate fee. Finally, staff recommends that in the future, overhead loadings be computed using the same method in general use by BellSouth (i.e., the “original” method).  
**(Simmons, Dowds, Higgins)**

**Staff Analysis:** The Petitioners maintain that semi-annual audits are required under the Tariff, and BellSouth must “compare the costs required to comply with the Manhole Ordinance with the amounts collected and return any excess amounts collected back to its customers.” (Complaint, ¶¶ 21, 24) Further, according to the Complainants, this “return” is to be in the form of a refund of all fees collected by BellSouth in violation of the Tariff, plus interest. (Complaint, ¶ 28) In its Motion to Dismiss, BellSouth stated that the use of the word “reconcile” in the Tariff does not imply that a refund or audit is required. (Motion, p. 5) The tariff language in question appears in Section A2.4.6 of BellSouth’s General Subscriber Service Tariff and provides:

An estimated monthly amount of such costs shall be billed to the affected subscribers each month and **an adjustment to reconcile** these estimates to the actual costs incurred for the six month periods ending June 30 and December 31 of each year **shall be applied** (emphasis added).

From staff’s perspective, the term “reconcile” does indicate that the costs required to comply with the Manhole Ordinance are to be compared with the amounts collected, at the end of each six-month period. Once the comparison is made, however, staff believes that the language indicates that the overage/underage in amounts collected is to be considered in establishing the appropriate fee for the next six months. Staff’s conclusion stems from the words “adjustment,” “reconcile,” and “applied,” which suggest that the process is accounting in nature. Whether BellSouth actually considered the overage/underage in establishing the fee for each subsequent six-month period is very much in doubt, and staff believes that the Commission should determine if there is a cumulative over-collection at this current point in time. Due to the passage of time and the unavailability of data for earlier periods, staff does not believe that an

analysis can be performed for each six-month period since the inception of the fee. Moreover, as will be discussed below, there is a plausible basis for using 1998 as a starting point, to determine whether there is a cumulative overage or underage in collections as of the end of 2005.

During the period 1983-1997, BellSouth operated under rate-of-return regulation. In addition, from 1988 to 1997, BellSouth was operating under a sharing plan whereby earnings above certain rate-of-return levels were refunded, all or in part, to customers. In response to Staff's First Set of Interrogatories, No. 1, BellSouth stated in part:

... "Refunds and Sharing Amounts" for the years 1993 through 1997 arising from the Commission's Order No. PSC-94-0172-FOF-TL also included the [Ordinance-related] revenues and expenses as booked. Therefore, they were included in calculation of achieved Rates of Return (on Equity) that resulted in sharing refunds to BellSouth customers during three of those five years. In 1997, BellSouth earned the maximum allowed by the PSC order and refunded all earnings above that level. Due to reaching this earnings cap on 1997 earnings, BellSouth reset the cumulative under/over balance to zero at the beginning of 1998, thereby forgoing recovery of past un-recovered costs incurred in complying with the Ordinance. (July 15, 2005, Item No. 1, Page 4 of 7)

Staff notes that while BellSouth's calculations show there was a cumulative under-recovery at the end of 1997, the supporting data necessary to confirm this result is not available, and there is a question as to the appropriate method for calculating overhead expenses, which will be discussed later. Nonetheless, based on how BellSouth was regulated over the 1983-1997 period, any over-recovery of company expenses was addressed, in theory, at the aggregate level. Consequently, staff believes that there is no necessity to evaluate whether there was over-recovery specific to the Manhole Ordinance fee. In fact, to do so might be construed as double counting for certain years. Staff acknowledges that this treatment may not be ideal for all years in the period, since BellSouth may have over-recovered with respect to the Manhole Ordinance fee, but not on an overall basis in certain years. However, the reverse situation is also possible – BellSouth may have under-recovered with respect to the Manhole Ordinance fee, but not on an overall basis in certain years. On balance, and in consideration of data limitations, staff believes that BellSouth's approach of setting the cumulative under/over balance to zero at the beginning of 1998 is reasonable.

### Overhead Loadings

Overhead calculations inherently generate questions due to the aggregate nature of the loading factors used. In this case, a loading factor is multiplied by the amount of vouchered security guard expense to determine overhead expense. BellSouth has presented two different methods for developing loading factors. A loading factor is essentially a ratio; the two methods use the same numerator, but a different denominator. Under BellSouth's "original" method, the loading factor was developed by dividing total corporate operations expense by total operations expense (less depreciation and amortization). Under BellSouth's "revised" method, the loading factor was developed by dividing total corporate operations expense by BellSouth salaries and wages. Due to the smaller denominator used in the "revised" method, the resulting loading

factor is higher. In discovery, BellSouth reported that the “revised” method of developing loading factors is consistent with the method used from 1983-1996.

Staff understands from discovery responses that the “original” method is in general use company-wide today. For purposes of the Manhole Ordinance fee, BellSouth apparently used the “original” method from 1998 through 2003, before concluding that this method was incorrect for this application and adopting the “revised” method. BellSouth contends that the “original” method understated the overhead costs as compared to historical calculations made from 1983 through 1996. On this basis, BellSouth believes that any refund or adjustment should be based on the “revised” method, for the entire period in question. As will be discussed below, staff disagrees and believes that this unique handling of overhead loadings is inappropriate.

In theory, how the loading factor is applied should be consistent with how the loading factor is developed, i.e., the loading factor should be applied only to those items included in the denominator of the factor. Accordingly, staff believes that the “original” method is conceptually sound since the loading factor is applied to vouchered security guard expense, which staff believes is clearly included within the total operations expense base.

Under the “revised” method, however, there arguably is an inconsistency between how the loading factor is developed and how the factor is applied. Vouchered expense is not included in the *BellSouth* salaries and wages base, yet the resulting loading factor is applied to vouchered expense. By its very definition, the loading factor should only be applied to *BellSouth* salaries and wages. BellSouth alleges that voucher expense for security guards is “equivalent” to BellSouth salaries and wages. While the security guards substitute for BellSouth employees, staff does not believe the two are equivalent in this context. In order to be equivalent for this purpose, the denominator of the loading factor would need to be defined as salaries and wages for BellSouth employees and vouchered expense for contract labor. On the positive side, the “revised” method is consistent with the method used during 1983-1996, and there is merit to having a uniform approach over time.

Determining the amount of a cumulative overage or underage in collections as of the end of 2005 turns on how the overhead loadings are computed. Staff notes that the fee remained unchanged at \$.11 throughout the 1998-2003 period and was reduced to \$.08 in January 2004. In staff’s opinion, this rate reduction suggests that BellSouth believed there was a cumulative over-recovery at the end of 2003.

Staff believes that some level of overhead loadings should apply, since BellSouth clearly incurs administrative costs in order to comply with the Manhole Ordinance. From a practical standpoint, staff believes that the Commission has three options for overhead loadings: the “original” method, the “revised” method, or a combination based on which method was actually used for which years. As will be described below, staff has developed results under each option, to assist the Commissioners in considering this matter.

Cumulative Overage/Underage in Collections

Staff has used BellSouth data through the end of 2005, to produce three sets of results: one under the “original” method of developing loading factors; a second under the “revised” method; and a third using the “original” method for 1998-2003 and the “revised” method for 2004-2005. In each scenario, the cumulative under/over balance was set to zero at the beginning of 1998, as both BellSouth and staff believe is appropriate. One approach the Commission could entertain is to treat any cumulative overage as an accounting adjustment flowing from the reconciliation process. While accounting adjustments are usually made at book value, staff believes there is merit, in this instance, to calculate the cumulative overage/underage with interest. This approach would help ensure that the benefit to BellSouth from any over collection and use of these funds flows back to Dade County ratepayers in the form of a lower future Manhole Ordinance fee, than would otherwise apply. If the Commission requires that any cumulative overage be returned to rate payers through bill credits and refunds, different calculations would be required to develop customer-specific amounts. Nonetheless, staff believes that the cumulative overage/underage is a useful composite figure.

For the period 1998-2005, interest was computed monthly and applied to the monthly overage/underage in amounts collected to determine the cumulative overage/underage with interest through the end of 2005. In making interest calculations, staff used the thirty (30) day commercial paper rate for high grade, unsecured notes, regularly published in the Wall Street Journal. This is the same interest rate used for refunds ordered by this Commission (see Rule 25-4.114(4)(a), Florida Administrative Code), and staff believes the same rate would be appropriate in the current context. As a further point of clarification, staff believes that interest only should be considered in the context of calculating the cumulative overage/underage amount; accruing interest would not be appropriate in the context of future six-month reconciliations. This approach of applying interest on a one-time basis would help redress the concern that the Tariff may not have been administered as intended for a lengthy period of time.

The cumulative overage/underage amounts developed using each of these three options is shown below. Staff has provided cumulative figures with and without interest, but recommends that interest be included for the reasons described above.

	<u>Cumulative</u>	<u>Cumulative with Interest</u>
Option 1 (“Original” Method)	\$ 320,408	\$ 469,176
Option 2 (“Revised” Method)	\$ (660,208)	\$ (613,966)
Option 3 (“Original” Method 1998-2003/ “Revised” Method 2004-2005)	\$ 81,528	\$ 223,129

From a conceptual standpoint, staff recommends the first option on the basis that (1) the loading factor is developed and applied in a consistent manner, and (2) BellSouth appears to have used this method for all other purposes since 1998. A uniform method of handling overhead loadings helps to ensure that the various corporate overhead allocations sum to the whole. While the second option is consistent with the method used during 1983-1996, staff believes that this approach has conceptual shortcomings, as discussed previously. Finally, the third option reflects how BellSouth actually computed overhead loadings during the periods in question, but is not consistent over time.

Based on the cumulative overage developed using the first option (i.e., “original” method), which staff believes is the conceptually preferred method among the options discussed, BellSouth did not perform the required semi-annual reconciliations and adjustments during all or part of the period 1998 through 2005. BellSouth’s failure to do so violated the terms of Section A.2.4.6 of its General Subscriber Service Tariff.

#### Disposition of Cumulative Overage in Collections

The Petitioners are seeking a refund of all fees collected by BellSouth in violation of the Tariff, plus interest. While staff does not believe the Tariff, when administered as intended, contemplates refunds, the cumulative overage in collections indicates a long-standing issue. Consequently, staff believes that refunds could be considered, if such an approach were practical. Rule 25-4.114, Florida Administrative Code, addresses procedures for Commission-ordered refunds, yet still provides latitude for unique situations. Staff has looked to this rule for guidance in helping to determine the appropriate resolution in this instance.

In particular, staff has focused on Rule 25-4.114(5), Florida Administrative Code, which addresses the method of refund distribution. This portion of the rule provides that for customers still on the system, the refund is to be handled as a bill credit. For those customers no longer on the system, the company is to mail a refund check to the last known address, except that no refund of less than one dollar need be made. In this case, with the cumulative overage being calculated over an eight-year period, there are likely to be many affected customers who are no longer on the system. As a result, refunds that are not claimed or not required could be a significant issue, and one the Commission would need to address. Providing proportionately higher bill credits only to existing customers who received service during the period at issue would ensure all monies are returned, but would ignore a portion of the affected customers. Relying on prospective rate relief and not providing refunds has the drawback that the customer base going forward will differ from the customer base over the period during which there was an overage in collections.

Staff recognizes the practical difficulty in targeting compensation to the affected customers. In this instance, staff believes the more prudent course of action is to treat the cumulative overage as an accounting adjustment flowing from the reconciliation process required by the Tariff. Although both over inclusive and under inclusive vis-à-vis the set of affected customers, this approach is workable and reasonable given the small per line amounts at issue. While the number of BellSouth access lines in the Miami exchange varied over the 1998-2005 period, 1.0 – 1.1 million lines is a rough average. Based on staff’s recommended

cumulative overage with interest of \$469,176, the average per line amount would be less than \$.50. Finally, as noted previously, the Tariff does not require refunds, in staff's opinion. Nonetheless, staff considered refunds since the cumulative overage in collections indicated that the Tariff had not been administered as intended.

### Conclusion

Given that the average per line amount would be less than \$.50, and since a significant number of affected customers may no longer be receiving service from BellSouth, staff recommends that no customer credit or refund be required. Instead, staff recommends that the Commission set the cumulative overage in collections, with interest, as of year-end 2005 at \$469,176 and require that BellSouth consider this overage and any overage/underage for January 2006 through June 2006, in setting the Manhole Ordinance Fee to be assessed for the period July 2006 through December 2006. In addition, staff recommends the Commission find that, pursuant to existing Section A.2.4.6 of its General Subscriber Service Tariff, BellSouth is required to perform reconciliations for each future six-month period and to apply the overage/underage in collections as an accounting adjustment, to determine the appropriate fee. Finally, staff recommends that in the future, overhead loadings be computed using the same method in general use by BellSouth (i.e., the "original" method).

**Issue 2:** Should this docket be closed?

**Recommendation:** The Order issued from this recommendation will be a Proposed Agency Action. Thus, the Order will become final and effective upon issuance of a Consummating Order if no person whose substantial interests are affected timely files a protest within 21 days of issuance of this Order. With issuance of a Consummating Order, this docket should be closed. (Scott)

**Staff Analysis:** Staff recommends that the Order issued from this recommendation will become final and effective upon issuance of a Consummating Order, unless a person whose substantial interests are affected by the Commission's decision files a protest that identifies with specificity the issues in dispute, in the form provided by Rule 28-106.201, Florida Administrative Code, within 21 days of the issuance of the Proposed Agency Action Order. As provided by Section 120.80(13)(b), Florida Statutes, any issues not in dispute should be deemed stipulated.