BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition by Citizens of Florida to compel compliance with Rule 25-14.003, F.A.C., by UNITED TELEPHONE COMPANY OF FLORIDA regarding calculation of and method for refunding 1988 tax savings.	DOCKET NO. 890486-TL ORDER NO. 25007 ISSUED: 9-4-91

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD, Chairman
BETTY EASLEY
MICHAEL McK. WILSON

APPEARANCES:

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On behalf of United Telephone Company of Florida.

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On behalf of the Citizens of the State of Florida.

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On behalf of the Commission Staff.

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FINAL ORDER RESOLVING ALL ISSUES RELATED TO UNITED TELEPHONE COMPANY OF FLORIDA'S 1988 AND 1989 TAX SAVINGS

BY THE COMMISSION:

I. Background

By Order No. 19726, issued July 26, 1988, in Dockets Nos. 871206-PU, 880444-TL, and 861616-TL, this Commission authorized a range of return on equity (ROE) with a midpoint of 13.5% for 1988 and 1989 for United Telephone Company of Florida (United). Further, we required United to record additional depreciation expense in an amount sufficient to reduce its earned ROE for 1988 by 100 basis points, and we established an earnings cap of 14.5% for 1988 and 1989. On April 10, 1989, the Office of Public Counsel (OPC) filed a Petition requesting that we order United to refund a portion of its 1988 earnings under Rule 25-14.003, Florida Administrative Code, the "tax rule". OPC's Petition stated that the tax rule required a refund of United's tax savings in excess of its midpoint ROE of 13.5% authorized by Order No. 19726. OPC also argued that the refund must be made as a lump sum payment or in monthly installments and that any access charge reduction is immaterial by the terms of the tax rule and by application of Order No. 19726.

United filed an Answer to OPC's Petition on May 2, 1989, stating that its access charge reduction resolved the tax savings issue. United argued that the Petition should be denied because Order No. 17429, issued April 20, 1987, required United to reduce its access charges and to record additional depreciation expense for 1987 in order to offset tax savings.

By proposed agency action Order No. 22060, issued October 16, 1989, this Commission found, upon review of the many pleadings filed, that Order No. 17429 had the primary effect of reducing carrier common line access charges in recognition of the tax savings resulting from the Act and in lieu of the strict application of the tax rule. We found that the effects of both the access charge reduction and the Act would continue into 1988 and beyond.

We reviewed the Company's March 31, 1989, tax savings report which indicated that its 1988 tax savings were $14,448,254. We reviewed the Company's calculation of the reduction in its 1988 revenues resulting from the access charge reduction implemented in 1987. This review indicated that United had, in fact, experienced a reduction in its 1988 revenues of $14,738,446.

Therefore, by our proposed agency action in Order No. 22060, we found that we had disposed of all of United's 1988 tax savings. Also, by our final agency action in Order No. 22060, we found that the reduction in carrier common line access charges implemented in 1987 by United was a relevant consideration in determining if the Company's 1988 tax savings had been properly disposed of.

Subsequently, OPC filed an appeal with the Florida Supreme Court of our final agency action in Order No. 22060. In addition, on October 20, 1989, OPC filed a protest regarding proposed agency action in Order No. 22060, from which this proceeding ensued. The Florida Supreme Court issued, in October 1990, an opinion affirming our final agency action in Order No. 22060. Therefore, the issue of the disposition of United's tax savings through the access charge reduction was resolved.

As discussed earlier, United's earnings for 1988 and 1989 were capped at 14.5% ROE by Order No. 19726, with any earnings in excess of 14.5% ROE being subject to disposition by this Commission. On March 27, 1991, we held a hearing at which we heard testimony and accepted evidence, to determine the level of United's earnings for 1988 and 1989 and the appropriate disposition of any excess earnings. United, OPC and our Staff participated in the cross-examination of the two witnesses appearing, one sponsored by United and one sponsored by OPC.

II. Stipulations of the Parties Approved

In the Prehearing Order No. 24289, issued March 26, 1991, the following proposed stipulations of the parties were reflected:

1. Rate Base per the December 31 Earnings Surveillance Report (ESR) is $684,810,053 for 1988 and $744,534,769 for 1989.

2. The 1988 Rate Base per the ESR should be decreased by $762,344 to show non-current assets and liabilities per the 1988 Staff Audit.

3. Intrastate Net Operating Income (NOI) should be increased by $975,358 in 1988 and by $1,197,908 in 1989 to show subsequent booked items.

4. The resolution of this proceeding will resolve all issues related to United's tax savings for 1988 and 1989.

We find it appropriate to approve these stipulations and hereby do so.

III. Rate Base for 1988 and 1989

As noted in Stipulation No. 1 above, the parties agreed to use, as a starting point for determining United's rate base for 1988 and 1989, the amounts reflected in the Company's 1988 and 1989 ESRs, which are $684,810,053 and $774,534,769 respectively. Also, pursuant to the parties' agreement in Stipulation No. 2, the 1988 rate base is hereby decreased by $762,344 to account for non-current assets and liabilities. Therefore, the adjusted 1988 rate base taken from the ESR is $684,047,709.

Working Capital

United has included in its achieved adjustments to rate base, adjustments entitled "Other FPSC Adjustments" which amount to a reduction of the 1988 intrastate rate base of $107,524 and an increase of the 1989 intrastate rate base of $135,082 and "Subsequent Booked Items" which increase the 1989 intrastate rate base $1,063,110 for a total 1989 adjustment of $1,198,192 to intrastate rate base. The Company states that it made these adjustments to show the effects of the reclassification of retained earnings through adjustment of NOI. Adjustments of this type were not made in the 1981 rate case.

The components of working capital are separated between jurisdictional and non-jurisdictional rate base using a factor based on net plant, irrespective of the separation of the related NOI components. To be consistent in the treatment of the components of working capital, we find that no adjustment should be made for the effect of NOI adjustments. This is consistent with our calculations in the 1981 rate case and those we approved in the 1991 rate case. OPC agrees, but did not propose any adjustment. Therefore, we find it appropriate to reverse the UTF adjustments for "Other FPSC Adjustments" and "Subsequent Booked Items" thereby increasing the 1988 intrastate rate base $107,524. The 1989 intrastate rate base should be decreased by $1,198,192, which is the sum of the "Other FPSC Adjustment" of $135,002 and the "Subsequent Booked Items" of $1,063,110.

Non-regulated Dividends

During 1988, common dividends paid to the parent were accrued entirely from regulated equity rather than being apportioned to both regulated and non-regulated operations. The Company's policy is to assign a pro rata share of investor supplied capital to previously regulated operations, such as terminal equipment. Since the common dividends in 1988 came from regulated equity, this pro rata relationship was not maintained. To restore the relationship and keep the equity ratios for regulated and non-regulated operations the same, $1,645,833 was transferred from non-regulated equity to regulated equity. This adjustment was applied to working capital and the intrastate portion, $1,009,077, was added to rate base. Subsequent to filing the 1988 ESR, the Company discovered that an additional $1,628,171 needed to be transferred from non-regulated equity to regulated equity to align the equity ratios at 61%. United proposes this amount be added to working capital and not separated, increasing intrastate rate base by $1,628,171. The total proposed increase to 1988 intrastate rate base is $2,637,248.

OPC objects to the ESR adjustment as artificially lowering the non-regulated equity ratio through internal policy rather than requiring a higher equity ratio for the non-regulated operations due to the higher risk it faces. OPC points to the 1991 rate case in which United admitted to a higher risk associated with non-regulated operations. OPC proposes removing the correcting entry from the ESR, reducing total regulated equity by $1,645,833 and intrastate rate base by $1,009,077 to show the higher risk by maintaining a higher equity ratio of approximately 70% as suggested by UTI for budget purposes. OPC does not accept the proposed subsequent booked correcting entry as a possible double counting of the adjustment and does not propose increasing equity and rate base by $1,628,171. OPC also proposes reducing 1989 equity by $2,637,000, which is the sum of the two 1988 United adjustments to maintain this higher equity ratio for non-regulated operations. The rate base effect of this proposed adjustment is a reduction of 1989 intrastate rate base of $1,198,000.

We believe that the Company policy which assigns the same equity ratio to non-regulated as to regulated operations is contrary to our decisions in the Company's 1981 rate case and those we made in the Company's most recent rate case. Non-regulated operations should be removed entirely from common equity capital. This is consistent with our decisions from 1981 to the present which removed non-utility investment directly from equity. The Utility's ESR and proposed adjustments produce non-regulated equity ratios of 61% in 1988 and 1989. OPC's proposed adjustments produce non-regulated equity ratios of 63% in 1988 and 67% in 1989. To show non-regulated investment removed 100% from equity, long term debt should be increased by $5,450,442 in 1988 and $4,619,168 in 1989 and short term debt should be increased by $906,435 in 1988 and $689,135 in 1989. Since the Utility has included preferred stock as equity capital in its calculations, preferred stock should be increased by $293,664 in 1988 and $148,145 in 1989. Total regulated common equity should be decreased by the total of these increases, $6,650,541 in 1988 and $5,456,448 in 1989. This is a reassignment of debt and equity capital and does not affect working capital, so no adjustment to rate base is appropriate.

We do not believe that the regulated and non-regulated equity ratios should be the same. In fact, if the non-regulated investment is to be removed entirely from equity, then the Utility's adjustment to 1988 intrastate rate base in the ESR should be reversed, reducing 1988 intrastate rate base $1,009,077.

Subsequent Booked Items

OPC's discovery revealed several subsequent booked items from the 1989 and 1990 ESRs which apply to 1988 and 1989. In his testimony on behalf of the Utility, Witness McRae proposed including 19 items booked in 1989 which apply to the 1988 rate base and 10 items booked in 1990 which apply to the 1989 rate base. To show these items in the correct year, the Company proposes that the 1988 intrastate rate base be increased by $227,170 and the 1989 intrastate rate base be increased by $146,925.

OPC agrees in concept, but proposes no further adjustment except for that proposed for non-regulated dividends. We have analyzed the subsequent booked items presented by the utility and conclude that all but two of the items represent the working capital effect of NOI adjustments which are not consistent with the Company's last rate case or which deal with unregulated dividends. We find that the remaining adjustments showing additional 1988 depreciation and the 1989 COE/IOT cost study true up are proper corrections of rate base. Therefore, we find it appropriate to reduce the 1988 intrastate rate base by $375,179 to reflect the additional depreciation and to reduce the 1989 intrastate rate base by $566,555 to reflect the cost study true up.

Deferred Taxes Due to Inter-Company Profits

The profit on sales of depreciable property to an affiliate is taxed over the period of years during which the purchasing affiliate depreciates the property. This deferral results in the parent company establishing a deferred federal income tax liability on these profits. Some public utility holding companies entered into closing agreements with the U. S. Treasury Department which permit them to pass back these deferred taxes on intercompany profits to their subsidiaries. United Telecommunications, Inc., (UTI) did not enter into such a closing agreement, and is therefore precluded from passing back its deferred taxes to its subsidiaries.

However, UTI does grant to its affiliates a credit which is designed to represent the revenue requirement impact as if the taxes had been passed back. This is called the General Services and Licenses credit (GS&L credit) and it consists of a credit to General Services and Licenses Expense and an offsetting debit to Accounts Receivable-Affiliates. This credit increases rate base and decreases expenses.

Rule 25-14.010, Florida Administrative Code, requires that the deferred taxes on intercompany profits be included in the capital structure at zero cost as if the deferred taxes were actually passed back to the Company. The Rule is silent as to the appropriate debit to be made.

A company with a closing agreement generally reduces plant by the amount of deferred taxes on intercompany profits, resulting in reductions to rate base, depreciation expense and revenue requirements. To comply with the Rule, these companies credit deferred taxes and debit rate base, with no net affect on the revenue requirement.

To comply with the Rule, United proposed two off-book entries. One reverses the GS&L credit by a debit to GS&L expense and a credit to Accounts Payable - Affiliates, with a corresponding adjustment to income taxes. The other off-book entry is a debit to Accounts Receivable - Affiliates and a credit to Accumulated Deferred Taxes. The net result of these two proposed adjustments is to include deferred taxes in the capital structure, but also to increase the revenue requirement by an increase in expense. In this docket, the increase to the revenue requirement is approximately one million dollars.

OPC Witness Montanaro disagrees with United as to the appropriate account to be debited in compliance with the Rule. She testified that, when companies with closing agreements initially recognized the intercompany profits on their books, they decreased Plant-in-Service by the amount of the intercompany profits. To recognize the impact on the capital structure, these companies increase rate base by the amount of the deferred taxes and assign a zero cost of capital to that portion of the rate base, with no net impact to the ratepayer. Witness Montanaro argues that, while United is increasing rate base just as the other companies have increased rate base, United has never initially reduced its plant in service. She continued that it would be inappropriate to allow United to increase the rate base for the deferred tax, since

United's plant in service was not reduced by the amount of the deferred tax effect at the time it was recorded on the books of the Company.

Witness Montanaro proposes that the offsetting debit should be to debt and equity, because if United had received a cash refund for the amount of the deferred taxes it would have reduced its debt and equity requirements. Company Witness McRae disagreed, countering that cash received would likely be used to acquire additional plant rather than to reduce debt and equity.

Witness McRae testified that the GS&L credit is intended to make United's revenue requirement comparable to those companies with closing agreements. He agreed, however, that the two adjustments proposed by United to put the deferred taxes in the capital structure result in a net increase in United's revenue requirement. The treatment approved by this Commission in United's last rate case, Docket No. 891239-TL, increased the Company's rate base by the same amount as the zero cost deferred taxes added to capital structure, without reversing the GS&L credit. We believe that this method achieves compliance with the Rule without affecting revenue requirement, thus maintaining the comparability achieved by the GS&L credit. OPC Witness Montanaro offered no advantages that would result from her proposed method over that proposed by our Staff, and agreed that both would achieve the same revenue neutral result.

Witness McRae was not able to explain why, if the GS&L credit achieves revenue requirement comparability with those companies with closing agreements, it is necessary to increase the revenue requirement in order to properly reflect the deferred taxes in the capital structure.

We find it appropriate to utilize the same method in this Docket as that we approved in Docket No. 891239-TL. That is, we find it appropriate to include deferred taxes of $8,295,116 for 1988 and $7,921,681 for 1989, due to intercompany profits, in the capital structure, with offsetting debits to rate base. The GS&L credit of $757,758, for intrastate NOI, for 1988 and $706,269, for intrastate NOI, for 1989 should not be reversed, and the effect of the reversal should be removed from working capital. This reflects the deferred taxes on intercompany profits in the capital structure in compliance with our Rule, and leaves the revenue requirement comparable to those companies with closing agreements.

Summary of Rate Base Adjustments

The Company proposes increasing its 1988 rate base by $884,301 and decreasing its 1989 rate base by $958,464. The adjusted rate base proposed by the Company is $684,932,010 for 1988 and $773,576,305 for 1989.

OPC has proposed decreasing the 1988 rate base $5,868,000 and the 1989 rate base $7,600,075. The adjusted rate base proposed by OPC is $678,180,000 for 1988 and $766,935,000 for 1989.

In addition to Stipulation No. 2, we find it appropriate to decrease the 1988 rate base $1,276,732 and the 1989 rate base $1,764,747. Therefore, we hereby find the appropriate adjusted rate base for United is $682,770,977 for 1988 and $772,770,022 for 1989.

IV. Capital Structure

All parties have accepted the average capital structure reconciled to average intrastate rate base as presented in the December 1988 and December 1989 ESRs as the basis for appropriate capital structure development.

After the pro rata reduction in capital of $762,344 for non-current assets and liabilities as agreed to in Stipulation No. 2 for 1988, the Utility proposes decreasing common equity by $971,040 to show the rate base effect of removal of the parent debt adjustment and then increasing common equity $1,994,126 to show the effect of the subsequent booked items. The net result is an increase of $1,023,086 for 1988 in reconciled intrastate common equity. For 1989, the Utility proposes decreasing reconciled intrastate common equity by $1,105,389 to show removal of the parent debt adjustment and increasing intrastate total capital $146,925 to show the effect of subsequent booked items.

OPC has accepted the Utility's adjustment for subsequent booked items and proposes decreasing 1988 intrastate equity by $366,000 and deferred taxes by $138,000, and proposes increasing 1989 total intrastate capital by $147,000. OPC proposes applying the 1988 adjustment for non-regulated dividends to 1989 capital, thereby reducing intrastate common equity by $2,637,000. OPC proposes applying its proposed intrastate rate base reduction of $5,086,00 in 1988 and $5,110,000 in 1989, which removes the

Utility's adjustments for deferred taxes on intercompany profit from investor sources of capital.

We find it appropriate to permit no adjustment to capital for deferred taxes on intercompany profits. We have made adjustments to the capital structure corresponding to the rate base adjustments reflecting the working capital effect of NOI adjustments and of the subsequent booked items. We have also made adjustments to reflect the intrastate impact of our decision to remove non-regulated operations from common equity and to reverse United's 1988 intrastate rate base adjustment for non-regulated dividends. We find the weighted cost of capital at a 14.5% ROE to be 10.51% and 10.61% for 1988 and 1989, respectively.

V. Net Operating Income

Stock Appreciation Rights

The Company has employed stock options with attendant stock appreciation rights (SARs) as a form of employee compensation since 1974. The market value of UTI's stock did not experience much appreciation until 1988 when the value increased significantly. UTI allocates the appreciation of its stock options to its local exchange telephone subsidiaries based on the option holder's affiliation on the date that the option was granted. Formerly, the options were allocated based on the standard allocators. This was changed in 1989 due to a change in generally accepted accounting principles. The change in methodology did not have a major impact on the costs billed to United.

OPC agrees that SARs are proper costs, but does not believe enough of the expense has been removed. There was no comparable expense recorded above the line in the Company's 1981 rate case. Due to the volatile nature of the expense, OPC recommends removal of the remaining SAR costs from jurisdictional expense. The impact on intrastate NOI would be an increase of $291,000 for 1988 and $496,000 for 1989.

We agree that this is a proper expense and find that it is not biased toward non-regulated operations. Although the nonrecurring nature of this cost would be an issue in a rate proceeding, it should not affect the evaluation of earnings outside a rate case. The expense should be recognized as incurred and no further adjustment is necessary.

Directory Advertising

United has included unpublished and unlisted revenue as a component of directory advertising revenues in its calculation of directory advertising profits to be reclassified as non-regulated revenue. Prior to the adoption of Part 32, these revenues were recorded as local service revenue. Schedule Z-9 of the annual report specifically requires the Utility to exclude these revenues from the calculation of directory advertising gross profit. United contends that, in recording unlisted/non-published revenues in account 5230, as required by Part 32, these revenues are to be included in the calculation of the directory advertising gross profit exclusion pursuant to Rule 25-4.0405, Florida Administrative Code. Paragraph (f) of the Rule requires only directory advertising revenues be considered in determining the gross profit exclusion. The exclusion is based on a comparison between 1982 gross profit and the current level of gross profit. Inclusion of current revenue which was recorded in 1982 as local service revenue is clearly a mismatch and defeats the legislative intent.

In addition to the unlisted and non-published revenue, the Utility also has not included data processing expenses which were formerly recorded as directory expenses, but are no longer included in this account under Part 32.

In 1988, United calculated its directory advertising profit net of taxes to be allocated to non-regulated as $2,416,217 in 1988. Therefore, we find it appropriate to reduce the Company's directory advertising gross profit exclusion adjustment by $1,403,613 to show exclusion of $2,187,606 in unlisted/non-published revenue and increased to show inclusion of $62,856 in data processing expenses, net of $846,849 in taxes. OPC proposes the same adjustment.

In 1989, United calculated its directory advertising profit from Florida operations to be allocated to non-regulated as $12,201,642, which is $7,610,164 net of taxes. Of this amount net of taxes, $1,420,852 is recorded on United's books, the remaining $6,189,312 is recorded on the books of Directories America, the directory publishing affiliate of United. United was directed by Order No. 21364, Docket No. 880149-TL, to include the directory advertising profit from Florida operations which are recorded on the books of Directories America in calculation of the exclusion pursuant to Rule 25-4.0405, Florida Administrtative Code. The directory advertising gross profit exclusion adjustment should be reduced by $1,571,874 to show $2,430,222 in unlisted/non-published revenue, $82,976 in data processing expenses, net of $941,324 in taxes. OPC proposes this reduction, but limits it to $1,421,000, the amount on the books of United. The exclusion is not limited to the $1,421,000 on the books of United, but actually is $7,610,164 which is recorded on the books of both United and Directories America. Therefore, we find it appropriate to reduce the $7,610,164 exclusion by the full $1,571,847.

GS&L Allocation

United's last rate case, Dockets Nos. 810210, 810211 and 810212, for Florida Telephone, United Telephone and Orange City Telephone, which merged to form United Telephone Company of Florida or United, contained adjustments reducing GS&L allocations from the parent company by $1,189,511. The Utility contends that the Order was so nonspecific as to what was being disallowed that it was impossible to track. It also contends that there is little correlation between the disallowances made in the 1981 cases and present categories of allocations. Unable to follow the disallowances, United has not attempted to carry this adjustment to its surveillance reports.

OPC proposes that it is proper to adjust the surveillance report to remove those costs which were not allowed by the Commission in the 1981 rate case. OPC does not dispute the general nature of the language of the 1981 rate orders, but contends that the objectionable costs are still embedded in the allocations. OPC proposes at the minimum, that the same dollar value be removed from current GS&L allocations as was removed in the 1981 cases. As an alternative, OPC proposes removing the same percentage of the current allocations as was removed in the 1981 cases. OPC has not quantified this adjustment.

We agree with OPC that an adjustment should be made to current GS&L allocations to reflect those costs not allowed in the 1981 rate cases. Although not labeled exactly the same, $2,606,566 of the 1991 GS&L allocations were removed in the Utility's 1991 rate case as further proof that such expenses are still embedded in the allocations. We find it appropriate to remove 1988 and 1989 GS&L allocations based on the prior removal in United's 1981 rate case, adjusted for inflation, and the Winter Park Telephone Company which is a part of United, but was not included in the prior cases. The adjustment from the 1981 rate case was $1,189,511.

To show effects of inflation, we find it appropriate to increase the 1981 adjustment by the increase in the consumer price index from 1981 to 1988 and 1989. The amount is 1.3014 for 1988 and 1.3541 for 1989. The resulting increased adjustment, after separation, decreases intrastate operating expense $1,200,366 in 1988 and $1,323,323 in 1989, which are consistent amounts considering the $1,189,511 disallowed in 1981 and the $2,606,566 disallowed in 1991. The effect of these adjustments on intrastate NOI is an increase of $748,668 in 1988 and $825,357 in 1989.

Although the Winter Park Telephone Company also merged with United, Florida and Orange City Telephone to form United Telephone Company of Florida, it was was not included in the 1981 rate case. It is now a part of United and receives a portion of the GS&L allocations from UTI. Since these are the same costs that are being excluded from the rest of the Company, it is only proper that Winter Park's share of these costs be excluded as well. To estimate the amount of GS&L to be excluded which has been allocated to the Winter Park System, we have used the percentage of Winter Park access lines to total United access lines. The 1981 exclusion should be increased to include the GS&L allocations made to Winter Park. The factor is 1.1932 for 1988 and 1.1906 for 1989.

Sale of Non-Depreciable Assets

We recognized gains and losses from the sales of nondepreciable property above the line, amortized over five years in Dockets Nos. 810210, 810211 and 810212, the Utility's last rate case. A similar adjustment was made in Docket No. 891239, the Utility's most recent rate case. This lessens the possibility of cross-subsidy where capital generated from the same resources of capital that provide for telephone operation is used for these purchases. The customer's rates are set to recover such capital costs. The Company is not in the real estate business and the purchases were made with the intention of using the property in the telephone operation.

It is the Utility's position that such gains and losses should accrue to or be borne by the stockholder rather than the ratepayer. The ratepayer provides a return on the invested capital, but does not provide recovery of the invested capital. Based on this position, the Utility has chosen to ignore this Commission's decision in its last rate case and continue recording these sales as it believes proper. The Utility has also chosen to ignore this Commission's Rules that adjustments consistent with the last rate case be applied to the ESR. Therefore, we find no adjustment for gains and losses from the sale of nondepreciable property to be appropriate for 1988 nor 1989.

OPC proposes recognizing gains and losses from the sale of nondepreciable property amortized over five years above the line consistent with the prior rate case. We agree. The accounting treatment of these gains and losses has not changed due to the switch from Part 31 to Part 32 accounting. For regulatory purposes, this Commission's position on the treatment of these gains and losses has not changed. These gains and losses were amortized above the line in the 1981 rate case and the Utility's 1991 rate case. Therefore, we find it appropriate to recognize these gains and losses above the line amortized over five years for regulatory purposes which is consistent with the 1981 rate case. Therefore, intrastate NOI is hereby increased by $62,300 for 1988 and by $66,538 for 1989 to recognize the amortized gains and losses net of taxes.

Parent Debt Adjustment

Rule 25-14.004, Florida Administrative Code, is based on the rebuttable presumption that debt at the parent level supports a portion of the parent's equity investment in the utility. Since the interest expense on such debt is deductible by the parent for income tax purposes, the income tax expense of the regulated subsidiary is reduced by a portion of that tax effect.

On November 27, 1990, the Internal Revenue Service (IRS) issued proposed regulations that might have caused the parent debt adjustment, required by the Rule, to result in violation of the normalization requirements of the Internal Revenue Code for orders made final after December 20, 1990. In rate cases since that time, this Commission has not made or has counteracted the effect of the parent debt adjustment. When the adjustment has not been made, we have required that the associated revenues be held subject to refund or other disposition with interest, pending resolution of the proposed regulations.

There was disagreement among the parties as to whether or not these proposed regulations might affect the parent debt adjustment in this proceeding. OPC Witness Montanaro contended that the regulations would not apply because the regulatory decision to make the adjustment for ratemaking purposes was made in prior dockets, in which the final orders were issued prior to the December 20, 1990, critical date. Company Witness McRae argued that because the final order in this docket will be a rate order issued after December 20, 1990, it will be subject to the proposed regulations.

On April 25, 1991, after the hearing in this docket was held, the IRS withdrew the proposed regulations, and the regulations project was closed. Therefore, we find it appropriate to take administrative notice of this withdrawal.

In its brief, United expressed concern that the existing IRS normalization requirements, apart from the withdrawn regulations, might preclude this Commission from making a parent debt adjustment, and requested that the associated revenues be held subject to further disposition until the IRS rules on a letter ruling request filed by Peoples Gas System, Inc. or by United. OPC, on the other hand, argued that since the IRS has withdrawn its proposal the Commission is free to follow its own policy and rule without exposing the Company to the risk of normalization violation.

It was the issuance of the proposed regulations on November 27, 1990, that caused the parent debt adjustment to be questioned. Since the proposed regulations have been withdrawn and the project has been closed, the Company's argument that the proposed regulations might cause the parent debt adjustment to violate the proposed regulations is moot. As to the Company's argument that existing IRS normalization regulations would be violated, prior to January 25, 1983, the effective date of the Rule, a similar adjustment was made in response to the decision in Citizens of Florida vs. Hawkins, 356 So.2d 254, Florida 1978. From 1978 until the request by Peoples, the parent debt adjustment has not been the subject of a ruling request by a company subject to the jurisdiction of this Commission.

Therefore, we find it appropriate to reduce income tax expense by $1,942,080 for 1988 and $2,210,778 for 1989 calculated in accordance with the Rule as shown on the ESR.

NOI Adjustment for Costs Associated with Sporting Events, Florida Night Activities, Political Action Committee Expenses and Lobbying/Ski-Trip Expenses

OPC took issue with costs associated with sporting events, Florida Night activities, Political Action Committee expenses and lobbying/ski trip expenses in the prehearing order. These items were identified during discovery in the 1991 rate case as being incurred during 1989, the base year for the 1991 forecast. Projections of these expenses were disallowed in the 1991 rate case as not being appropriate operational expenses. The Utility has agreed that these expenses should be taken below the line in 1988 and 1989, but has proposed no adjustment to take them below the line. The parties have identified these amounts as $6,530 in 1988 and $10,781 in 1989 on an intrastate basis.

OPC questioned Witness McRae about the activities of the Company's Tallahassee office and discovered that many of the expenses of this office were recorded below the line as lobbying expenses. The remaining expenses are in operating expense as liaison costs. OPC called for a deposition of Mr. Robert L. McCullers of the Tallahassee office to determine the nature of these remaining costs. The deposition was held on May 7, 1991, and, based on the information gathered at this deposition, OPC is now proposing to remove the entire cost of the Tallahassee office as lobbying expense. Late-filed Exhibit 5 shows the remaining costs to be removed as $154,934 in 1988 and $102,818 in 1989. The intrastate amounts are $100,682 in 1988 and $70,427 in 1989.

Based on the May 7, 1991, deposition, we agree with OPC that these costs are lobbying in nature and should be removed. Since there is some overlap with the costs identified in the prehearing order, we find it appropriate to remove only the costs of the Tallahassee office, $100,682 in 1988 and $70,427 in 1989. Intrastate NOI should be increased by $62,795 in 1988 and $43,925 in 1989.

<u>Net Operating Income for 1988 and 1989</u>

All parties have used the intrastate NOI from the December, 1988 and 1989 earnings surveillance reports as the basis for further adjustment. In Stipulation No. 3, all parties have agreed to apply the Utility's proposed adjustment for subsequent booked items to the ESR amounts. The stipulated basis NOI is $72,470,797 for 1988 and $84,494,436 for 1989.

In addition to the adjustment from Stipulation No. 3, the Utility has proposed adjustments that reduce intrastate NOI by $1,950,565 in 1988 and $2,210,778 in 1989. The Utility proposes that adjusted intrastate NOI is $70,520,232 in 1988 and $82,283,658 in 1989.

OPC proposes adjustments that increase intrastate NOI by \$2,546,000 in 1988 and \$2,709,000 in 1989, in addition to the adjustment from Stipulation No. 3. OPC proposes that adjusted intrastate NOI is \$75,017,000 in 1988 and \$87,204,000 in 1989.

In addition to the adjustment from Stipulation No. 3, we find it appropriate to increase intrastate NOI by \$3,129,590 in 1988 and \$3,308,682 in 1989. Therefore, we find that adjusted intrastate NOI is \$75,600,387 in 1988 and \$87,803,118 in 1989.

VI. Achieved Rate of Return on Common Equity

The achieved return on rate base is 11.07% in 1988 and 11.36% in 1989. Removing the weighted cost of debt, preferred equity, customer deposits and the related components of deferred investment tax credits (ITCs) and dividing by the weight of equity and the equity component of ITCs produces an ROE of 15.63% for 1988 and 15.98% for 1989.

VII. Revenues Subject to Commission Disposition

Order No. 19726, issued on July 26, 1988, authorized a maximum ROE of 14.50%. The ROE achieved by United was 15.63% in 1988 and 15.98% in 1989, both of which exceed the maximum authorized ROE. The NOI associated with the excess return is \$3,848,484 in 1988 and \$5,787,745 in 1989. The appropriate revenue expansion factor is 1.629819, and the revenues subject to Commission disposition are \$6,272,332 in 1988 and \$9,432,977 in 1989. Interest shall be calculated from January 1 of the year in question to August 31, 1991, after which the excess revenue will be added to the depreciation reserve. The interest amounts through August 31, 1991, are \$1,820,980 for 1988 and \$1,734,001 for 1989. This includes estimated interest amounts for July and August, 1991. The revenue plus interest subject to Commission disposition is \$8,093,312 for 1988 and \$11,166,978 for 1989. The total revenue subject to Commission disposition is \$19,260,290.

By Order No. 19726, issued on July 26, 1988, in Docket No. 880444-TL, this Commission has the authority to dispose of any 1988 and 1989 earnings of United in excess of 14.5% ROE. Based on our decisions herein, this Commission may determine, in its discretion, how to dispose of \$19,260,290 of the Company's earnings in excess of 14.5%, which includes \$3,554,981 of interest effective August 31, 1991. We find it appropriate to require that United place \$19,260,290 into an unclassified intrastate depreciation reserve

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account, effective September 1, 1991. This amount is to be made account specific at the time of the Company's next depreciation represcription. Placing the money in the depreciation reserve results in a reduction in rate base and, therefore, a reduction in revenue requirements on a going forward basis. The $19,260,290 reduction to rate base reduces revenue requirements by $2,503,837 annually based on United's currently authorized ROE of 13.0%.

By Order No. 24049, issued in Docket No. 891239-TL, this Commission reduced United's zone charges by approximately $3 million, or 45%, leaving approximately $3.7 million in zone charges. A further reduction of approximately $890,000 was ordered effective July 1, 1991, by Order No. 24648. Therefore, approximately $2,800,000 in zone charges remains. United is the only remaining local exchange company (LEC) with two-party service and zone charges.

We believe it is appropriate to eliminate the zone charges and to require that the Company upgrade its two-party service to one-party service. We find that these rate reductions are more beneficial to the ratepayers than a one-time refund in the long run. The revenue impact of upgrading to one-party service is approximately $327,000 annually. Therefore, all two-party service shall be upgraded to one-party service by January 1, 1992, or as facilities become available.

Existing two-party subscribers shall be given the opportunity to voluntarily upgrade until January 1, 1992. After January 1, 1992, United shall automatically upgrade customers after they have been notified 60 days in advance. These changes will be revenue neutral to the Company due to the varying dates that the upgrades will become effective. In addition, United shall change out the ringers of affected subscribers' telephones as needed at no charge. Appropriate tariff revisions shall be filed by August 23, 1991, for review and approval by our Staff, to become effective September 1, 1991.

No issues remain outstanding regarding United's 1988 and 1989 earnings. Therefore, after appropriate tariffs revisions are filed and approved, this docket shall be closed administratively.

Based on the foregoing, it is, therefore,

ORDERED by the Florida Public Service Commission that United Telephone Company of Florida shall place $19,260,290, which

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includes $3,554,981 of interest, into an unclassified intrastate depreciation reserve account, effective September 1, 1991, which will be made account specific at the time of the Company's next depreciation represcription. It is further

ORDERED that United Telephone Company of Florida shall reduce rates by $2,503,837 effective September 1, 1991, to reflect the reduction in revenue requirements which results from placing money in the depreciation reserve and, thus, decreasing rate base. It is further

ORDERED that each and every specific finding in the body of this Order is hereby affirmed in all respects. It is further

ORDERED that United Telephone Company of Florida shall eliminate all remaining zone charges, totalling approximately $2,800,000, effective September 1, 1991. It is further

ORDERED that United Telephone Company of Florida shall upgrade all two-party service to one-party service by January 1, 1992, or as facilities become available. Until January 1, 1992, all existing two-party subscribers shall be given the opportunity to voluntarily upgrade to one-party service. Upon January 1, 1992, United shall automatically upgrade customers provided they have been given notice 60 days in advance. In either the voluntary or automatic upgrades, the secondary service order connection charges shall not apply. It is further

ORDERED that United Telephone Company of Florida shall change out the ringers of affected subscribers' telephones as needed at no charge. It is further

ORDERED that United Telephone Company of Florida shall file appropriate tariff revisions no later than August 23, 1991, to become effective September 1, 1991. It is further

ORDERED that once appropriate tariff revisions have been filed and approved by Staff, this Docket shall be closed.

By ORDER of the Florida Public Service Commission, this 4th day of SEPTEMBER, 1991.

STEVE TRIBBLE, Director
Division of Records and Reporting

(S E A L)

SFS

by: Kay Flynn
Chief, Bureau of Records

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.