BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Modified Minimum Filing Requirements report of GULF TELEPHONE COMPANY.	DOCKET NO. 910730-TL ORDER NO. 25606 ISSUED: 1/17/92

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD, Chairman
SUSAN F. CLARK
J. TERRY DEASON
BETTY EASLEY

NOTICE OF PROPOSED AGENCY ACTION
ORDER REDUCING ROE AND DISPOSING OF PROJECTED EARNINGS

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are adversely affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

I. BACKGROUND

On July 3, 1991, Gulf Telephone Company (Gulf or the Company) filed Modified Minimum Filing Requirements (MMFRs) for the 12 months ending December 31, 1990. The MMFRs were audited by our staff and an audit report was issued on November 5, 1991. The audit revealed $1,845 of nonutility-related items booked in operating accounts. Subsequently, the Company provided additional 1992 budget information that was not originally available. Gulf's current authorized Return on Equity (ROE) range is 11.9% to 13.9% with a midpoint of 12.9%. See Order No. 22297.

II. 1990 EARNINGS

The results of the audit indicate that the Company did not overearn in 1990. The calculated average achieved ROE for 1990 was 9.56%. This figure was calculated using Gulf's financial statements and a revised 1990 Cost Study filed on July 3, 1991. The Company's most recent complete Earnings Surveillance Report (ESR) and the MMFRs indicate that the Company's achieved ROE was 10.73% for the year ended December 31, 1990. The difference between the filing ESR and the calculated ROE is due to the difference in jurisdictional separations factors. At the time of filing the MMFRs, the 1990 Cost Study had not been completed, thus the Company had used estimated 1990 separations factors. In calculating the preliminary separations factors, the Company failed to take into account its change in LATAs. In November 1989, Gulf Telephone Company changed its LATA from the Jacksonville LATA to the Tallahassee Market Area. Failure to take this change into account caused the Company to use an incorrect weighted Dial Equipment Minute (DEM) transitional factor.

Based on the Company's final revised 1990 Cost Study and the audit, it does not appear that Gulf overearned in 1990. Accordingly, we find it appropriate to take no action concerning Gulf's 1990 earnings.

III. <u>PROJECTED EARNINGS FOR 1991</u>

Using ten months of 1991 actual data, the earnings for 1991 have been forecasted and it appears that the earnings will improve but will still fall within Gulf's authorized ROE range of 11.9% to 13.9%. The contributing factors to the Company's expected improved earnings in 1991 compared to 1990 are a decrease in maintenance expense, an increase in Universal Service Fund, the phase-up of Subscriber Plant Factor (SPF) and the weighted Dial Equipment Minute (DEM).

Since it appears that Gulf will not overearn for 1991, we do not find it necessary to take any action on Gulf's 1991 earnings at this time. We will continue to monitor Gulf's 1991 earnings through the quarterly ESR. Furthermore, we will true-up 1991 earnings using the 1991 Cost Study that will be filed by June 30, 1992. In the event that study indicates further action is necessary, we will address the matter at that time.

IV. <u>EQUITY RATIO</u>

Gulf has steadily increased its equity ratio each of the past three years. We are concerned that if a utility increases its equity ratio above the level necessary for the provision of local exchange service, the utility could increase its revenue requirements and thereby lower any overearnings and any potential refund to the ratepayers.

Standard & Poors (S&P) has established a range of equity ratios for a "low" risk BBB-rated local exchange company (LEC) of

35% to 45%. S&P has also established an equity ratio range for a "high" risk BBB-rated LEC of 38% to 50%. The distinction between a "low" risk and a "high" risk LEC is based on S&P's perception of business risk with respect to competition and regulatory support.

The Rural Electrification Administration is a source of relatively low cost debt financing for small eligible LECs. Gulf is eligible for REA financing. We believe it appropriate to make an adjustment to the capital structure when a small REA telephone utility's equity ratio exceeds 45% of investor capital. This level is the top of the range of equity ratios for "low" risk BBB-rated LECs and is above the midpoint of the range for "high" risk BBB-rated LECs as prescribed by S&P. For the year ended 1990, Gulf's equity ratio was 41%. For the year ending 1991, it is estimated that Gulf's equity ratio will be 44%. However, for the year ending 1992, Gulf's equity ratio is projected to be 46.4% and therefore will be above the top of the S&P range for "low" risk LECs.

To ensure that only the fair and reasonable cost of providing local exchange service is passed on to ratepayers, we find that Gulf's equity ratio should be adjusted from 46.4% to 45.0% of investor-supplied capital for ratemaking purposes. This adjustment, after taking into account the ROE of 12.9% addressed below, will reduce Gulf's overall cost of capital for the year ending December 31, 1992 from 8.49% to 8.39%. We believe the adjustments are reasonable and that the adjusted capital structure is representative of a BBB-rated LEC and is reasonable for the provision of local exchange service.

V. 1992 RETURN ON EQUITY

In an attempt to reduce the controversy, difficulty and expense of litigating each small LEC's ROE, we are attempting to develop a leverage formula modeled after the leverage formula used in determining the cost of equity capital for utilities in the water and wastewater industry.

The telephone leverage formula is based on the application of generally accepted financial models of two indices of publicly traded utility stocks. A Discounted Cash Flow (DCF) analysis on each of the seven Regional Bell Holding Companies (RBHC) was performed. A Risk Premium analysis on the companies in the Moody's Natural Gas Distribution index was also conducted. The Moody's index was used as a proxy for the RBHC index in the risk premium analysis because the RBHCs have only been in existence since 1984 and as a result there is insufficient data regarding the RBHCs to do a valid risk premium study. The results of the models were then adjusted to compensate for the difference in risk between the companies in the indices and the small utilities to which the formula is applied. A bond yield differential analysis was conducted to determine the difference in yields between AA-rated bonds (the average bond rating for the RBHC index) and BBB-rated bonds (the assumed bond rating for small telephone utilities.) The difference in yields between these two bond ratings was then applied to the cost of equity capital for the indices to determine the appropriate cost of equity capital for the average small REA telephone utility.

Based on the leverage formula using the most currently available data and an equity ratio of 45% as discussed above, we find an ROE for Gulf of 12.9% with a range of 100 basis points to be appropriate.

VI. PROJECTED EARNINGS FOR 1992

Based on forecasted 1991 earnings, certain pro forma adjustments were made to properly estimate the level of earnings for 1992. The earnings projections indicate that Gulf will overearn in 1992 based on an ROE of 12.9%. The contributing factors to the Company's expected overearnings in 1992 are: an increase in USF revenue of $244,883, an expiration of a $122,000 (total company) capital recovery schedule, a reduction in BHMOC, the SPF and weighted DEM transitional factor phase-ups, and an increase in the intrastate expenses of $120,000.

Gulf Telephone experienced access line growth of 3.8% to 4.7% in the years 1987 through 1990. However, in 1991, Gulf Telephone Company has experienced very minimal access line growth of 0.6% and the Company does not expect the access line growth to improve much in 1992. The access line growth for 1992 at one percent, a slight increase from 1991.

Incorporating these pro forma changes to the 1991 financial data provides a reasonable forecast for 1992. It appears that in 1992 Gulf will earn $181,352 above a midpoint of 12.9%. This was calculated based on the aforementioned pro forma adjustments along with the adjustments to the capital structure and ROE discussed above. This would result in an achieved ROE of 17.31% for 1992.

VII. DISPOSAL OF PROJECTED EXCESS EARNINGS

In view of the projected excess earnings, it appears appropriate to reduce rates to prevent any excess earnings from accruing. The earnings should be disposed of by unbundling the gross receipts tax from the existing rates and separately stating it, eliminating Touchtone rates, reducing MTS rates and reducing the BHMOC rate. Tariffs should be filed as soon as possible, to become effective February 17, 1992. The Company should advise customers of the rate reductions and availability of Touchtone at no additional charge through a bill stuffer.

We have long advocated a reduction or elimination of Touchtone charges for this Company as well as other LECs. The Company is 100% digital and therefore, incurs no additional cost to provide Touchtone service. The Company's current Touchtone rates are $1.00 for residential and $1.50 for business subscribers. Approximately 69% of residential and 83% of business customers have Touchtone. By eliminating the Touchtone charge and removing the GRT without reducing local rates, most residential customers will realize a net reduction of approximately $0.89 ($1.00 - $0.11) and a business customer will receive a net reduction of $1.22 ($1.50 - $0.28). All residential and business customers without Touchtone, would receive the service at no monthly charge. The elimination of Touchtone rates results in a $72,120 reduction in revenues annually.

Gulf's intraLATA toll rates and its time of day discounts should be changed as shown below. These changes will place Gulf in a better competitive position on MTS traffic. We have recently ordered similar changes for Centel and Quincy. The discount period should be from 9 PM to 9 AM and apply the entire weekend. This discount period will be simpler to understand and allow subscribers to make discounted toll calls beginning after 9 PM rather than having to wait until after 11 PM.

The new Time of Day and discount changes are as follows:

	M - F	SATURDAY	SUNDAY
Day 9 AM - 9 PM	Full	40%	40%
Eve/Ngt 9 PM - 9 AM	40%	40%	40%

The new toll rates are as follows:

MILEAGE	1st MIN	Add'l MIN
0-10*	$0.15	0.08
11-22*	0.18	0.12
23-55	0.21	0.18
56-124	0.21	0.18
125-292*	0.21	0.18

* Gulf does not have any intraLATA toll routes in these mileage bands.

These MTS rates result in an annual reduction of $120,574. The reduced MTS rates should become effective February 17, 1992.

In addition to the above changes, we also find it appropriate to reduce the Company's Busy Hour Minute of Capacity (BHMOC) charge by $.035. Gulf's BHMOC is currently $4.50, which is higher than most small LECs. Reducing Gulf's BHMOC to $4.15 will reduce the Company's earnings by $18,653.

Historically, as we have reduced the access charges of the LECs, we also required ATT-C to flow the benefits of the reductions to customers by reducing its MTS rates. In this case, the BHMOC reduction is too small in isolation to effect a reduction in ATT-C's MTS rates. However, each of the other small LECs has MMFR filings pending before the Commission. As other LECs' MMFRs are addressed, we anticipate that the BHMOC rates of those companies can be reduced and that the cumulative total of these reductions will be sufficient to effect a reduction to ATT-C's rates. Until the results of the various MMFR reviews are completed, we find it appropriate to place a credit on Gulf's customers' bills in the amount of Gulf's BHMOC reduction. The amount of the credit will be $0.14, $0.36 or $0.90 for residential, business or PBX customers, respectively. The credit will continue only until six months from the date of this Order. The credit will appear on customers' bills in the first billing cycle beginning after the date of this Order. Gulf customers should be informed through a bill stuffer, that the credits are temporary and will be removed from the customer's monthly bill within the next six months.

VIII. CURRENT MMFRs AS THE MOST RECENT RATE CASE

Section 364.035(3), Florida Statutes, provides:

> It is the legislative intent in requiring the mandatory filing of the minimum filing requirements that the Public Counsel and other substantially affected persons be assured of periodically obtaining the necessary information to reasonably ascertain whether the rates and charges of a local exchange telecommunications company are just, reasonable, not unjustly discriminatory, not in violation of law, and not yielding excessive compensation for the service rendered.

Section 364.035(3) provides a less burdensome review of a company than a full rate case and yet contains sufficient information to make a reasonable assessment whether the rates of a company are just and reasonable.

Section 364.035(3) mandates local exchange companies with less than 100,000 of access lines to file MMFRs every five years. In the past, most of the small local exchange companies had a formal rate proceeding on an average of once every ten years. The new statute provides all parties an opportunity to address accounting adjustments and an appropriate return on equity on a regularly scheduled basis. Because these periodic reviews offer an opportunity for a full review, we find that this MMFR proceeding should be treated as the most recent rate case proceeding for all future purposes.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Gulf Telephone Company is hereby determined to have not earned in excess of its maximum authorized Return on Equity of 13.9% for 1990. It is further

ORDERED that, based on the financial analysis of Gulf Telephone Company's filings, the Company is not expected to exceed its authorized Return on Equity for 1991 and no corrective action is required at this time. It is further

ORDERED that Gulf Telephone Company's equity ratio for all future regulatory purposes shall be reduced to 45% of investor-supplied capital. It is further

ORDERED that the appropriate Return on Equity for all future regulatory purposes is determined to be 12.9% with a range of plus or minus 100 basis points. It is further

ORDERED that, on the projected earnings for 1992, Gulf Telephone Company shall reduce its revenues for 1992 by $181,352. It is further

ORDERED that the 1992 projected excess earnings of $181,352 and $29,995 of gross receipts tax shall be disposed of by reducing rates as set forth in the body of this Order. It is further

ORDERED that Gulf Telephone Company shall file tariffs reflecting the aforementioned rate reductions as soon as possible, and such tariffs shall become effective February 17, 1992. It is further

ORDERED that Gulf Telephone Company shall inform its subscribers of the aforementioned rate reductions by means of a bill stuffer. It is further

ORDERED that this Modified Minimum Filing Requirement proceeding shall be treated as the most recent rate case for future purposes. It is further

ORDERED that any protest of this Order shall be filed pursuant to the requirements below. It is further

ORDERED that if no timely protest of this Order is filed, this docket shall be closed at the conclusion of the protest period.

By ORDER of the Florida Public Service Commission, this 17th day of JANUARY, 1992.

STEVE TRIBBLE, Director
Division of Records and Reporting

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Commissioner Deason dissented from the Commission's decision with regard to the equity ratio adjustment for the year ending December 31, 1992. Chairman Beard dissented with regard to eliminating Touchtone rates.

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.

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and

Reporting at his office at 101 East Gaines Street, Tallahassee, Florida 32399-0870, by the close of business on 2/7/92.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party adversely affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.