

FLORIDA PUBLIC SERVICE COMMISSION

Fletcher Building
101 East Gaines Street
Tallahassee, Florida 32399-0850

M E M O R A N D U M

February 25, 1994

TO : DIRECTOR OF RECORDS AND REPORTING ALM

FROM : DIVISION OF AUDITING AND FINANCIAL ANALYSIS (MAILHOT, DM
MAUREY) DM
DIVISION OF COMMUNICATIONS (BUTLER) [Handwritten initials]
DIVISION OF LEGAL SERVICES (HATCH) [Handwritten initials]

RE : DOCKET NO. 940196-TL - ALLTEL FLORIDA, INC. -
INVESTIGATION INTO THE AUTHORIZED RETURN ON
EQUITY AND EARNINGS OF ALLTEL FLORIDA, INC.

DOCKET NO. 920260-TL - SOUTHERN BELL TELEPHONE AND
TELEGRAPH COMPANY - COMPREHENSIVE REVIEW OF THE REVENUE
REQUIREMENTS AND RATE STABILIZATION PLAN OF SOUTHERN BELL
TELEPHONE AND TELEGRAPH COMPANY

AGENDA: 03/08/94 - REGULAR AGENDA - PROPOSED AGENCY ACTION -
INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\AFA\WP\940196.RCM

CASE BACKGROUND

On January 28, 1994, the staff sent a letter to ALLTEL expressing its concern over the company's authorized return on equity (ROE) and earnings. The staff met with the company and the Office of Public Counsel. The meeting was followed by numerous conference calls. Eventually the staff made a proposal to resolve its concerns and the company concurred.

DOCUMENT NUMBER-DATE

01916 FEB 25 94

FPSC-RECORDS/REPORTING

ISSUE 1: Should the Commission approve a new authorized return on equity and rate reductions for ALLTEL?

RECOMMENDATION: Yes. The Commission should approve the following:

1. Effective 1/1/94, the company's authorized return on equity is 11.50% +/- 1.0%. Cap on earnings for 1994 at 12.50% ROE with any excess earnings to be deferred to 1995.
2. Rate changes:
 - A. Eliminate EAS additives on the following routes:
 - Florahome (661) to Keystone Heights
 - White Springs to Lake City
 - Hastings to St. Augustine
 - Lake Butler to Alachua, Brooker, Gainesville.
 - B. Change rate grouping plan as follows:

		<u>R-1 Rate</u>
Amend Current Rate Group V	40,001+	\$9.95
to Rate Group V	40,001-200,000	9.95
Create New Rate Group VI	200,001-320,000	10.40
Create New Rate Group VII	320,001+	11.00
 - C. Callahan, which currently has an EAS additive of \$2.60 in addition to a \$9.95 R-1 rate, (\$12.55), will have its additive removed; it will go into new Rate Group VII at the \$11.00 R-1 rate. The net reduction for a Callahan R-1 customer will be \$12.55 - \$11.00 = \$1.55.
 - D. Effective date of eliminating EAS additives and creating new rate groups is May 1, 1994. Estimated 1994 impact is \$194,000. Estimated 1995 impact is \$291,000.
3. Eliminate BHMOC effective July 1, 1994. Estimated 1994 impact is \$170,000. Estimated 1995 impact is \$340,000.
4. Reduce the interLATA subsidy on January 1, 1995 by \$443,000 annually from the current amount of \$543,000 annually to a new amount of \$100,000 annually. Defer \$450,000 of the current subsidy revenue from 1994 to 1995. The remaining \$100,000 of subsidy will be reduced or eliminated, effective July 1, 1995, to the extent that the company earns in excess of 12.5% ROE for 1994.

[BUTLER, MAILHOT, MAUREY]

STAFF ANALYSIS:

1. Return on Equity

ALLTEL's return on equity (ROE) was last considered in a hearing held in November 1992 with the decision rendered by the hearing officer in December 1992. At that time, the average yield on 30 year Treasury bonds was 7.60% for November and 7.43% for December. Although the 30 year bond yield has risen of late, fluctuating around 6.6% following the decision by the Federal Reserve to increase short-term rates, this level is still well below the yield at the time the record was developed and the decision rendered regarding ALLTEL's allowed ROE. In addition, Staff's internal cost of equity models indicate that the cost of equity since this time has dropped commensurately. Staff believes that these developments are indications that the cost of equity for ALLTEL has declined since its allowed ROE was last considered. As a result, Staff believes that the cost of equity should be reduced. Although this may not be the return Staff would testify to in a hearing, 11.5% ROE should be accepted by the Commission. Within the context of ALLTEL's total offer and the fact that approval of the offer will save litigation costs if the order is not protested, the 11.5% ROE should be considered reasonable.

2. EAS

When the Commission orders two way flat rate EAS, it typically assesses whatever regrouping charges apply for the added calling scope, plus an additive which is typically (but not always) 25% of the rate for the stand-alone exchange(s) being added. In the past couple of years, the Commission has removed the so-called 25/25 additive after the customers have paid it for several years, in rate case or overearnings situations. In the case of ALLTEL, the company went through an MMFR review in 1992 and the staff overlooked the EAS additives that were in place at that time. Currently the following EAS routes have additives:

<u>ROUTE</u>	<u>IMPLEMENTATION DATE</u>
Callahan to Jacksonville	6/6/87
Florahome (661) to Keystone Heights	3/17/90
White Springs to Lake City	6/29/90
Hastings to St. Augustine	7/6/90
Lake Butler to Alachua/Brooker/Gainesville	10/10/91
Wellborn to Lake City	4/30/93

The staff does not believe the additive for the Wellborn to Lake City route should be removed, since it has been in place less than a year. However, it is time to remove the additives on the other routes, which have been in place for between two and a half and seven years. We propose to totally remove the additives on the Florahome (661) to Keystone Heights, White Springs to Lake City, Hastings to St. Augustine, and Lake Butler to Alachua, Brooker, and Gainesville routes. This means that customers in these exchanges will be paying the same as other ALLTEL customers with similar calling scopes.

The Callahan to Jacksonville route is a little different, however. Callahan has a local calling scope of 365,464 (as of 12/31/93). Under ALLTEL's existing rate group plan, its highest rate group is 40,000+. ALLTEL today has ten exchanges whose calling scopes fall into that highest rate group. The exchange with the highest calling scope, except for Callahan, is High Springs with 132,131. Totally removing the 25/25 additive from Callahan will place it paying the same rate as exchanges, which have a much lower calling scope. The proposal is to add two new rate groups to the top of ALLTEL's existing rate group structure, as follows:

		<u>R-1 Rate</u>
Amend Current Rate Group V	40,001+	\$9.95
to Rate Group V	40,001-200,000	9.95
Create New Rate Group VI	200,001-320,000	10.40
Create New Rate Group VII	320,001+	11.00

The effect of this is to recognize the expanded calling scope of Callahan, while making an interim step between the \$9.95 rate of the highest rate group today and the new \$11.00 highest rate (\$9.95 to \$10.40 to \$11.00). This has no impact on any of the current exchanges in the existing rate group V. It removes the current \$2.60 R-1 additive from Callahan's \$12.55 rate and gives it a permanent rate of \$11.00. Of course, similar rate reductions will occur with other rates relating to the R-1 rate, such as B-1, PBX, semi-public phones, PATS phones, as shown in ATTACHMENT C.

3. Access Charges - BHMOC

We propose to eliminate the BHMOC charge. Currently ALLTEL's BHMOC rate is \$1.60. Removing it totally will bring ALLTEL's intrastate access charge rates very close to its interstate access rates. ALLTEL uses the NECA tariff for interstate, and at last assessment, the NECA rate for originating and terminating access

was \$.1397 per minute. Removing ALLTEL's BHMOC brings its intrastate access rates to \$.136 per minute. The staff believes the BHMOC is a good place in which to reduce revenues. The estimated annual dollar value of this action is \$548,000. However, due to the scheduled reduction in access charges by Southern Bell on July 1, 1994, ALLTEL will save an estimated \$208,000 annually in access expense. Therefore, the net loss in earnings to ALLTEL is \$340,000 annually. Implementing this change on July 1, 1994, concurrent with the reductions in Southern Bell's access rates, yields a 1994 impact of \$170,000.

4. InterLATA Subsidy

The interLATA access charge bill and keep subsidy pool was established on July 1, 1985 by Order No. 14452. The subsidy pool was established as a temporary mechanism to ease the transition from a pooling environment to a bill and keep environment. Originally, all 13 LECs participated in this pool. By Order No. 21678, Gulf's subsidy was eliminated, effective July 1, 1989. By Order No. 21954, Indiantown's subsidy was eliminated and Florala, Gulf, Indiantown, Quincy, Southland, United, and Vista-United were removed from the subsidy pool, effective September 1, 1989. By Order No. 22421, St. Joseph's subsidy was reduced and Centel was removed from the pool, effective January 1, 1990. By Order No. PSC-92-0337-AS-TL, Northeast's subsidy was reduced to \$23,000, effective July 1, 1992. By Order No. PSC-93-0228-FOF-TL, Northeast was removed from the interLATA subsidy pool, effective January 1, 1993. By Order No. PSC 93-0562-FOF-TL, ALLTEL's subsidy was reduced by \$690,000 and GTE was removed from the pool, effective April 1, 1993. By Order No. PSC 94-1176-FOF-TL, ALLTEL's subsidy was further reduced by \$140,000, effective October 1, 1993. The current status of the interLATA subsidy pool is shown in ATTACHMENT A. The subsidy receipts and payments do not change each year except by specific action of the Commission.

As discussed above, the subsidy pool was established as a temporary mechanism for the transition to pure bill and keep. The Commission has reduced subsidies and removed LECs from the interLATA subsidy pool when it appeared that the LEC no longer needed the subsidy; however, this has always been on a case by case basis. Staff believes that ALLTEL's subsidy can be reduced at the end of 1994 without any serious effect on the company's earnings or ALLTEL's ratepayers.

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Staff recommends that ALLTEL's interLATA subsidy receipts be reduced by \$443,000 annually, effective January 1, 1995. The interLATA subsidy pool receipts and payments shown on ATTACHMENT B should be approved, effective January 1, 1995.

In addition, staff also recommends that ALLTEL defer \$450,000 of 1994 subsidy revenue into 1995. This will mitigate the full year impact of the proposed rate reductions on 1995's earnings and allow the company additional time to absorb the decline in revenue.

Effective January 1, 1995, ALLTEL's subsidy will be \$100,000 annually. To the extent that ALLTEL's 1994 earnings exceed 12.5% ROE, the \$100,000 subsidy will be reduced or eliminated, effective July 1, 1995.

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ISSUE 2: How should the Commission dispose of Southern Bell's reduced subsidy payment?

RECOMMENDATION: The Commission should reserve Southern Bell's reduced subsidy payment subject to disposition by the Commission in Docket No. 920260-TL. [MAILHOT, BUTLER]

STAFF ANALYSIS: If the Commission approves Issue 1, then the amount paid into the interLATA subsidy pool by Southern Bell will decrease by \$443,000. In the past, when a company's payments into the subsidy pool have decreased, the Commission has disposed of the money by applying it to some specific purpose. Staff is not prepared to make a final recommendation on the disposition of the reduction in subsidy payments by Southern Bell. Therefore, staff recommends that the reduction in subsidy payments be held subject to disposition by the Commission in Docket No. 920260-TL.

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ISSUE 3: Should Docket 940196-TL be closed?

RECOMMENDATION: Yes. Docket 940196-TL should be closed at the expiration of the PAA period, if no timely protest is filed.
[MAILHOT]

STAFF ANALYSIS: No other action remains to be done in Docket 940196-TL. Docket 940196-TL should be closed at the expiration of the PAA period, if no timely protest is filed.

ATTACHMENT A

INTERLATA TOLL BILL AND KEEP
 CALCULATION OF SUBSIDY PAYMENTS
 October 1, 1993
 (\$000)

<u>COMPANY</u>	<u>1</u> INTERLATA BILL/KEEP IMPACT	<u>2</u> DA & COIN REVENUE	<u>3</u> REVENUE EFFECT OF PREVIOUS COMM ACTION	<u>4</u> TOTAL IMPACT (1+2+3)	<u>5</u> SUBSIDY CONTRIB	<u>6</u> SHORTFALLS REQUIRING SUBSIDY
ALLTEL	(2,110)	265	1,302 **	(543)		(543)
ST. JOSEPH	(1,674)	151	300 ***	(1,223)		(1,223)
SO. BELL	12,456	19,949	(27,481)	4,924	<u>1,766</u>	
TOTAL					<u>\$1,766</u>	<u>(\$1,766)</u>

- * EXCLUDING CENTRAL, FLORALA, GTE, GULF, INDIANTOWN, NORTHEAST, QUINCY, SOUTHLAND, UNITED AND VISTA-UNITED
- ** ALLTEL INCLUDES \$472,000 REDUCTION APPROVED IN DOCKET NO. 911108-TL, \$830,000 REDUCTION APPROVED IN DOCKET NO. 920193-TL.
- *** ST. JOSEPH INCLUDES \$300,000 REDUCTION APPROVED IN DOCKET NO. 891238-TL.

ATTACHMENT B

INTERLATA TOLL BILL AND KEEP
 CALCULATION OF SUBSIDY PAYMENTS
 January 1, 1995
 (\$000)

<u>COMPANY</u>	<u>1</u> INTERLATA BILL/KEEP IMPACT	<u>2</u> DA & COIN REVENUE	<u>3</u> REVENUE EFFECT OF PREVIOUS COMM ACTION	<u>4</u> TOTAL IMPACT (1+2+3)	<u>5</u> SUBSIDY CONTRIB	<u>6</u> SHORTFALLS REQUIRING SUBSIDY
ALLTEL	(2,110)	265	1,745 **	(100)		(100)
ST. JOSEPH	(1,674)	151	300 ***	(1,223)		(1,223)
SO. BELL	12,456	19,949	(27,481)	4,924	<u>1,323</u>	
TOTAL					<u>\$1,323</u>	<u>(\$1,323)</u>

* EXCLUDING CENTRAL, FLORALA, GTE, GULF, INDIANTOWN, NORTHEAST, QUINCY, SOUTHLAND, UNITED AND VISTA-UNITED

** ALLTEL INCLUDES \$472,000 REDUCTION APPROVED IN DOCKET NO. 911108-TL, \$830,000 REDUCTION APPROVED IN DOCKET NO. 920193-TL AND THE \$443,000 REDUCTION CURRENTLY PROPOSED.

*** ST. JOSEPH INCLUDES \$300,000 REDUCTION APPROVED IN DOCKET NO. 891238-TL.

ATTACHMENT C

PROPOSED RATE GROUP PLAN ALLTEL					
RATE GROUP	CALLING SCOPE	R-1	B-1	PBX	SEMI-PUB
1	0-5,000	\$9.10	\$22.75	\$43.25	\$26.05
2	5,001-10,000	9.35	23.40	44.55	26.75
3	10,001-20,000	9.60	24.10	45.85	27.50
4	20,001-40,000	9.75	24.40	46.50	27.85
*5	40,001-200,000	9.95	24.70	47.20	28.20
**6	200,001-320,000	10.40	26.00	49.40	29.65
**7	320,001+	11.00	27.50	52.25	31.35

* Change in rate group
** New rate group