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BST REBUTTAL
TESTIMONY

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BST REBUTTAL TESTIMONY

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SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY

REBUTTAL TESTIMONY OF WALTER S. REID

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

DECEMBER 10, 1993

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Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC.

A. MY NAME IS WALTER S. REID, AND MY BUSINESS ADDRESS IS 675 WEST PEACHTREE STREET, ATLANTA, GEORGIA. MY POSITION IS DIRECTOR-REGULATORY MATTERS FOR THE COMPTROLLERS DEPARTMENT OF BELLSOUTH TELECOMMUNICATIONS, INC. D/B/A SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY (SOUTHERN BELL OR THE COMPANY).

Q. HAVE YOU FILED DIRECT TESTIMONY IN THIS DOCKET?

A. YES. I FILED DIRECT TESTIMONY REGARDING THE COMPANY'S HISTORICAL AND GOING LEVEL EARNINGS. I ALSO QUANTIFIED THE FINANCIAL IMPACT OF THE COMPANY'S PROPOSALS IN THIS PROCEEDING.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. MY REBUTTAL TESTIMONY WILL RESPOND TO VARIOUS PROPOSALS MADE BY MR. STEPHEN ALAN STEWART, MR. THOMAS C. DE WARD, MS. KIMBERLY H. DISMUKES, AND MR. R. EARL POUCHER IN THEIR DIRECT TESTIMONIES FILED ON BEHALF OF THE OFFICE OF PUBLIC COUNSEL (OPC). THE ISSUES WHICH I ADDRESS PRIMARILY RELATE TO MATTERS THAT IMPACT THE APPROPRIATE GOING LEVEL INTRASTATE EARNINGS FOR SOUTHERN BELL'S FLORIDA OPERATIONS. I ALSO RESPOND TO ISSUES REGARDING SOUTHERN BELL'S ACHIEVED EARNINGS UNDER INCENTIVE REGULATION.

<u>REBUTTAL TO TESTIMONY OF OPC WITNESS STEPHEN ALAN STEWART AND TO OPC WITNESS R. EARL POUCHER</u>

Q. REGARDING MR. STEWART'S DIRECT TESTIMONY, TO WHICH OF HIS POSITIONS OR PROPOSALS DO YOU INTEND TO RESPOND?

A. I WILL RESPOND TO MR. STEWART'S POSITION THAT SOUTHERN BELL'S DECREASE IN INTRASTATE COST OF SERVICE OVER THE PERIOD OF THE INCENTIVE PLAN DOES

NOT PROVIDE A LOGICAL GROUND FOR EVALUATING THE IMPACT OF THE INCENTIVE PLAN. I WILL ALSO ADDRESS HIS COMPARISONS OF SOUTHERN BELL COMBINED (INTRASTATE, INTERSTATE AND NON-REGULATED) FINANCIAL DATA WITH OTHER LOCAL EXCHANGE CARRIERS (LECS) DATA. FINALLY, I WILL RESPOND TO HIS PROPOSAL THAT THE COMMISSION SHOULD IMPLEMENT STEP DECREASES IN 1995 AND 1996 TO CAPTURE THE EXPECTED SAVINGS THAT WILL RESULT FROM SOUTHERN BELL'S COST SAVINGS PROGRAMS.

Q. TO WHICH OF OPC WITNESS POUCHER'S POSITIONS ARE YOU PLANNING TO RESPOND?

A. I WILL RESPOND TO MR. POUCHER'S POSITION IN SUPPORT OF THE APPROPRIATENESS OF THE ANALYSIS MR. STEWART PERFORMED ON SOUTHERN BELL AND OTHER LECS IN FLORIDA.

Q. WHAT IS YOUR RESPONSE TO MR. STEWART'S CLAIM THAT YOUR ANALYSIS PROVIDES NO LOGICAL GROUND FOR EVALUATING THE IMPACT OF THE INCENTIVE PLAN?

A. I TOTALLY DISAGREE WITH MR. STEWART'S CLAIM. THE ANALYSIS WHICH I PRESENTED ON REID EXHIBIT WSR-1

REPORTED THE TREND FOR THE COMPANY'S INTRASTATE COST OF PROVIDING REGULATED SERVICES OVER THE NINE YEAR PERIOD 1984 THROUGH 1992. TO SAY THAT THIS PROVIDES NO LOGICAL GROUND ON WHICH TO EVALUATE THE FINANCIAL IMPACTS OF THE INCENTIVE PLAN WHICH WAS ESTABLISHED IN 1988 IS ABSURD. INTRASTATE COST OF SERVICE IS CERTAINLY AN IMPORTANT AND RELEVANT STATISTIC TO THE COMMISSION, TO THE COMPANY, AND TO THE COMPANY'S CUSTOMERS IN FLORIDA, SINCE IT REFLECTS THE TARGET UPON WHICH THE COMMISSION SETS CUSTOMER RATES.

MR. STEWART DOES NOT DENY THAT SOUTHERN BELL HAS LOWERED ITS INTRASTATE COST OF SERVICE OVER THE PERIOD OF THE INCENTIVE PLAN. HIS CRITICISM SEEMS TO BE THAT THE COMPANY CANNOT PROVE THAT INCENTIVE REGULATION WAS THE MOTIVATION FOR DECREASING ITS COSTS. THIS IS AN IMPRACTICAL REQUIREMENT SINCE IT IS OBVIOUS THAT THE COMPANY CANNOT RE-LIVE THE TIME PERIOD 1988 THROUGH 1992 UNDER A TRADITIONAL FORM OF REGULATION IN ORDER TO DETERMINE HOW IT WOULD HAVE OPERATED DIFFERENTLY.

THE COMPANY'S EVIDENCE PROVIDES REASONABLE ASSURANCE THAT THE INCENTIVE PLAN IS WORKING. THE

EXPECTATIONS THAT IT SHOULD PRODUCE BETTER RESULTS, THE FAVORABLE DECREASE IN COST OF SERVICE PER ACCESS LINE THAT HAS BEEN PRODUCED, AND THE NUMEROUS PROJECTS THAT HAVE BEEN UNDERTAKEN PROVIDE THE PRACTICAL PROOF THAT IS REQUIRED.

Q. HOW DO YOU RESPOND TO MR. STEWART'S CRITICISM THAT YOU FAILED TO MAKE ANY COMPARISON WITH OTHER TELECOMMUNICATIONS COMPANIES?

A. I HAVE THE FOLLOWING COMMENTS RELATED TO THIS STATEMENT BY MR. STEWART. FIRST, I SELECTED FINANCIAL DATA TO ANALYZE THAT WAS: 1) RELEVANT TO INTRASTATE RATEMAKING WHICH IS THE ISSUE IN THIS PROCEEDING; 2) OBTAINED FROM AN ACCURATE SOURCE WHICH HAS PREVIOUSLY BEEN REVIEWED OR AUDITED BY OPC, THE COMMISSION STAFF, THE COMPANY AND POSSIBLY OTHER PARTIES TO THIS PROCEEDING AND; 3) BASED ON THE OPERATING CONDITIONS AND FINANCIAL REPORTING CONVENTIONS OF SOUTHERN BELL IN FLORIDA FOR WHICH I HAVE CONSIDERABLE EXPERIENCE OVER THE PERIOD STUDIED.

SECOND, I DON'T BELIEVE THAT STATISTICS RELATED TO OTHER OPERATING COMPANIES NECESSARILY PROVIDE ANY

SIGNIFICANT INSIGHT INTO WHAT SOUTHERN BELL'S MOTIVATIONS WERE FOR DECREASING ITS COSTS. WHEREAS, IT MAY BE INTERESTING TO COMPARE DATA FROM DIFFERENT COMPANIES, RELIANCE ON A COMPARISON OF THIS SORT CAN EASILY MISLEAD DECISION MAKERS RATHER THAN PROVIDE RELEVANT INFORMATION FOR A SOUND DECISION. I BELIEVE MR. STEWART'S COMPARISONS HAVE MANY UNDERLYING INCONSISTENCIES WHICH COULD DISTORT THE RESULTS BEING PRESENTED. FOR EXAMPLE, HIS REVENUE AND EXPENSE TOTALS INCLUDE NON-REGULATED SERVICES WHICH CAN VARY IN AMOUNT OVER THE PERIOD DUE TO FACTORS TOTALLY UNRELATED TO EFFICIENCIES IN PROVIDING REGULATED SERVICES. I WILL ADDRESS OTHER INCONSISTENCIES IN MY MORE SPECIFIC DISCUSSION OF MR. STEWART'S COMPARISONS.

FINALLY, IT IS NO SECRET THAT THE TELECOMMUNICATIONS INDUSTRY IS IN A STATE OF RAPID CHANGE TOWARD MORE COMPETITION AND THAT COMPANIES ARE TRYING TO REDUCE THEIR COSTS. IN 1988 THE COMMISSION RECOGNIZED THIS FACT WHEN IT ESTABLISHED THE INCENTIVE PLAN. THE COMMISSION'S ORDER IN DOCKET NO. 880069-TL, ORDER NO. 20162, PAGE 6 STATED:

"THE TELECOMMUNICATIONS INDUSTRY HAS BEEN AND CONTINUES TO BE IN A STATE OF CHANGE. MORE AND MORE ASPECTS OF THE RELEVANT MARKETS ARE BECOMING COMPETITIVE. A LOCAL EXCHANGE COMPANY, SUCH AS SOUTHERN BELL, MUST ADAPT TO THE NEW COMPETITIVE WORLD IN WHICH IT FINDS ITSELF. THIS COMMISSION MUST ALSO RECOGNIZE THESE FUNDAMENTAL CHANGES IN THE INDUSTRY AND ALLOW SOUTHERN BELL TO TRANSITION ITSELF FOR THESE CHANGES. WE THUS BELIEVE THAT THE INCENTIVE ASPECTS OF THIS PLAN WILL ASSIST IN THIS TRANSITION PROCESS. WE HOPE IT WILL RESULT IN A WIDER ARRAY OF SERVICES AT THE LOWEST POSSIBLE COST TO RATEPAYERS..."

MOST OF THE OTHER COMMISSIONS ACROSS THE COUNTRY HAVE NOW RECOGNIZED THE SAME FACTS DESCRIBED BY THE FLORIDA COMMISSION IN 1988 AND HAVE IMPLEMENTED SOME FORM OF INCENTIVE PLAN. IT IS THEREFORE, SAFE TO SAY THAT MANY OF THE COMPANIES INCLUDED IN MR. STEWART'S INDUSTRY WIDE COMPARISONS WERE OPERATING UNDER AN INCENTIVE PLAN AT LEAST SOMETIME DURING THE PERIOD.

Q. WHAT IS YOUR RESPONSE TO MR. STEWART'S POINT THAT BY USING INTRASTATE DATA IN YOUR ANALYSIS, YOU ARE NOT GIVING THE FULL PICTURE IN THE EVALUATION OF THE EFFICIENCY OF THE COMPANY?

A. THE REASON I CHOSE TO USE INTRASTATE DATA IN MY ANALYSIS IS THAT INTRASTATE RESULTS AS REPORTED ON THE SURVEILLANCE REPORT REPRESENT THE MOST SCRUBBED AND AUDITED DATA AVAILABLE. BY SCRUBBED, I MEAN ADJUSTED TO PUT OUT OF PERIOD TRANSACTIONS INTO THE PROPER REPORTING PERIOD AND TO STATE THE RESULTS ON A COMMISSION BASIS. I REALIZE THAT THIS SOMEWHAT UNDERSTATES THE ACTUAL EFFICIENCIES ACHIEVED BY THE COMPANY OVER THE PERIOD. HOWEVER, I BELIEVE INTRASTATE RESULTS ARE THE MOST RELEVANT DATA FOR THIS PROCEEDING. THE MAIN REASON THAT COMBINED DATA WOULD SHOW HIGHER EFFICIENCIES FOR SOUTHERN BELL THAN INTRASTATE DATA IS THAT THERE HAVE BEEN SHIFTS IN JURISDICTIONAL ASSIGNMENT OF COSTS AND INVESTMENTS FROM THE INTERSTATE JURISDICTION TO THE INTRASTATE JURISDICTION. I EXPLAINED THIS FACT IN MY DIRECT TESTIMONY WHERE I STATED ON PAGE 3, "...THE COMPANY HAS BEEN ABLE TO ACHIEVE REDUCED LEVELS OF COST OF SERVICE IN SPITE OF

JURISDICTIONAL COST OF SERVICE SHIFTS FROM INTERSTATE TO INTRASTATE OPERATIONS...".

Q. DO YOU HAVE AN EXHIBIT WHICH WILL SHOW HOW YOUR ANALYSIS WOULD HAVE LOOKED ON A COMBINED BASIS?

A. YES. I HAVE PREPARED EXHIBIT WSR-5 TO DEMONSTRATE HOW AN ANALYSIS LIKE THE ONE I REPORTED ON WSR-1 LOOKS WHEN PREPARED ON A COMBINED BASIS. IN ORDER TO PERFORM THIS ANALYSIS, I MERELY SUBSTITUTED THE COMBINED "PER BOOKS" REGULATED DATA FROM THE ANNUAL SURVEILLANCE REPORTS FOR THE "PER BOOKS" INTRASTATE DATA ON EXHIBIT WSR-1, PAGE 1. AS EXPECTED THE RESULTS SHOW THAT THE COMPANY'S EFFICIENCY ACCOMPLISHMENTS ARE EVEN MORE DRAMATIC IF YOU LOOK AT THEM ON A COMBINED BASIS. THE COMBINED COST OF SERVICE ON THIS ANALYSIS DROPS FROM $728.73 PER ACCESS LINE IN 1988 TO $665.42 IN 1992. I HAVE PREPARED A CHART OF THE TREND IN COMBINED REGULATED RESULTS AND INCLUDED IT AS PAGE 2 OF WSR-5.

Q. DO YOU AGREE WITH MR. STEWART THAT, BY USING COMBINED DATA, THIS ALLOWS FOR COMPARISONS BETWEEN UTILITIES?

A. NO. AS I PREVIOUSLY EXPLAINED, I DON'T BELIEVE THAT SIMPLE COMPARISONS BETWEEN UTILITIES ARE USEFUL. THERE ARE TOO MANY POTENTIAL PITFALLS IN SUCH COMPARISONS WHICH CAN LEAD TO INCORRECT CONCLUSIONS.

Q. TURNING TO MR. STEWART'S COMPARISONS BETWEEN LECS, DO YOU AGREE WITH HIS USE OF TOTAL OPERATING REVENUE PER AVERAGE ACCESS LINE AS A MEASURE OF EFFICIENCY?

A. NO. MR. STEWART INCORRECTLY STATES THAT I USE OPERATING REVENUE PER AVERAGE ACCESS LINE AS A MEASURE OF EFFICIENCY. HE REFERENCES PAGES 11 THROUGH 14 OF MY TESTIMONY AS THE PLACE WHERE I USE THIS STATISTIC AS SUPPORT FOR MY CONCLUSIONS. ON THESE PAGES OF MY TESTIMONY, I CLEARLY STATE THAT MY RESULTS REPRESENT INTRASTATE COST OF SERVICE PER AVERAGE ACCESS LINE, NOT OPERATING REVENUE PER AVERAGE ACCESS LINE. THERE IS A BIG DIFFERENCE BETWEEN AN ANALYSIS OF THESE TWO STATISTICS. COMPANIES WILL NOT ALWAYS BE EARNING AT THEIR COST OF CAPITAL, THEREFORE OPERATING REVENUE MAY NOT REFLECT THE TRUE COST OF SERVICE. IN ADDITION, MR. STEWART INCLUDES NON-REGULATED

REVENUES IN HIS ANALYSIS OF OPERATING REVENUE WHICH CONFUSES HIS RESULTS EVEN MORE.

Q. CAN YOU IDENTIFY ANY SPECIFIC CIRCUMSTANCES WHICH MAKE MR. STEWART'S COMPARISON OF OPERATING REVENUE PER AVERAGE ACCESS LINE MISLEADING?

A. YES. AS I GATHERED THE SOURCE DATA TO VERIFY MR. STEWART'S CALCULATIONS, I NOTICED A FEW OBVIOUS FACTS WHICH CAUSE SIGNIFICANT DISTORTIONS IN HIS COMPARISONS. THERE COULD EASILY BE OTHER INCONSISTENCIES IN THE DATA WHICH ARE NOT OBVIOUS TO ME, SINCE I DO NOT HAVE THE SAME LEVEL OF KNOWLEDGE CONCERNING THE OTHER LECS' DATA AS I DO CONCERNING SOUTHERN BELL'S DATA.

THE FIRST DISTORTION I NOTICED WAS THAT A SIGNIFICANT PORTION OF THE REVENUE DROP FOR GTE, UNITED AND CENTEL APPEARED TO OCCUR IN THE RENT REVENUE AND CUSTOMER OPERATIONS ACCOUNTS. SINCE THESE ACCOUNTS ARE NOT TYPICALLY CREDITED WITH REVENUES DERIVED FROM CHARGES TO END USER CUSTOMERS, BUT INSTEAD COME FROM AGREEMENTS BETWEEN COMPANIES FOR USE OF PLANT OR SERVICES AND FROM INTERCOMPANY BILLINGS, THE AMOUNTS IN THESE

ACCOUNTS CAN BE INFLUENCED BY THE ORGANIZATIONAL STRUCTURE WITHIN A COMPANY OR OTHER FACTORS NOT NECESSARILY REFLECTIVE OF COST OF SERVICE. FOR EXAMPLE, GTE REPORTED A DROP OF $51,441,000 IN RENT REVENUE FROM 1988 TO 1989 OR $30 PER AVERAGE ACCESS LINE; CENTEL REPORTED A $6,889,271 DROP IN CUSTOMER OPERATIONS REVENUE FROM 1988 TO 1989 OR $27 PER AVERAGE ACCESS LINE; AND UNITED REPORTED A $8,364,780 DROP IN CUSTOMER OPERATIONS REVENUE FROM 1990 TO 1991 OR $8 PER AVERAGE ACCESS LINE.

THE NEXT DISTORTION IN MR. STEWART'S COMPARISON IS HIS CALCULATION OF THE PERCENT CHANGE COLUMN. I HAVE BEEN UNABLE TO DETERMINE HOW HE MADE THIS CALCULATION, BUT IT DOES NOT APPEAR TO BE IN THE NORMAL MANNER FOR DETERMINING THIS STATISTIC. FOR EXAMPLE, FOR SOUTHERN BELL, A DROP FROM $733 PER AVERAGE ACCESS LINE IN 1988 TO $637 IN 1992 IS A DROP OF 13.1%, NOT 9.80% AS HE REPORTS.

BASED ON THE REVENUE ACCOUNTS WHICH ARE BEING REPORTED BY THE COMPANIES ON THEIR ANNUAL REPORTS, IT ALSO APPEARS AS THOUGH SOUTHERN BELL'S AND GTE'S NON-REGULATED REVENUES ARE INCLUDED IN THE REVENUE DATA TRACKED BY MR. STEWART, BUT UNITED'S AND

CENTEL'S NON-REGULATED REVENUES ARE NOT INCLUDED.

FINALLY, IT APPEARS AS THOUGH THE SOURCE MR. STEWART USED TO DETERMINE AVERAGE ACCESS LINES IS DISTORTING THE RESULTS FOR HIS REVENUE COMPARISONS AS WELL AS HIS EXPENSE COMPARISONS. MR. STEWART APPARENTLY USED THE S-2 SCHEDULE OF THE ANNUAL REPORT TO SECURE END OF PERIOD ACCESS LINES BY CUSTOMER AND SIMPLY AVERAGED THE END OF PERIOD AMOUNTS FOR EACH YEAR. LOOKING AT SCHEDULE S-2 DATA FROM THE DIFFERENT COMPANIES OVER THE PERIOD 1988 THROUGH 1992, IT IS APPARENT THAT THE COMPANIES REFINED THEIR METHODOLOGIES FOR REPORTING END OF PERIOD ACCESS LINES ON THIS REPORT. FOR EXAMPLE, CENTEL DID NOT REPORT ANY SPECIAL ACCESS LINES (NON-SWITCHED) ON ITS 1988 THROUGH 1990 SCHEDULE S-2'S, BUT IN 1991 IT WAS ABLE TO IDENTIFY 30,140 SPECIAL ACCESS LINES. THIS CHANGE REPRESENTED AN INCREASE OF 10.5% IN ITS END OF PERIOD ACCESS LINE COUNT AND WOULD CERTAINLY AFFECT THE RESULTS REPORTED BY MR. STEWART. IF THESE ADDITIONAL ACCESS LINES WERE NOT INCLUDED IN CENTEL'S TOTALS, THEN MR. STEWART'S ANALYSIS WOULD HAVE REPORTED AN INCREASE IN (1) O&M EXPENSE PER AVERAGE ACCESS LINE AND (2) O&M EXPENSE WITHOUT

DEPRECIATION PER AVERAGE ACCESS LINE FOR THE PERIOD.

Q. WHAT ARE YOUR COMMENTS REGARDING MR. STEWART'S COMPARISONS OF O&M EXPENSE PER AVERAGE ACCESS LINE AND O&M EXPENSE LESS DEPRECIATION PER AVERAGE ACCESS LINE?

A. IN ADDITION TO THE PROBLEM WITH THE ACCESS LINES WHICH I PREVIOUSLY DISCUSSED, MR. STEWART HAS MADE AT LEAST ONE ERROR WHICH HAS DISTORTED HIS RESULTS. FOR CENTEL, HE HAS USED DATA FOR 1988 THAT APPARENTLY INCLUDES NON-REGULATED EXPENSES AND HE HAS USED DATA FOR 1989 THROUGH 1992 THAT EXCLUDES NON-REGULATED EXPENSES. I BELIEVE THIS TO BE THE CASE SINCE CENTEL CHANGED THE AMOUNTS FOR 1988 WHEN IT FILED ITS 1989 ANNUAL REPORT. THE PRIOR YEAR COLUMN ON THE 1989 REPORT SHOWS LOWER REPORTED REVENUE AND EXPENSE AMOUNTS THAN THE 1988 CENTEL ANNUAL REPORT. MR. STEWART APPARENTLY PICKED UP THE LOWER REPORTED REVENUE AMOUNTS FOR 1988 WHEN HE COMPUTED HIS OPERATING REVENUE PER AVERAGE ACCESS LINE STATISTICS, BUT HE FAILED TO USE THE LOWER EXPENSE AMOUNTS FOR 1988 WHEN HE COMPUTED HIS O&M PER AVERAGE ACCESS LINE STATISTICS. IF HE HAD

CORRECTLY PICKED UP CENTEL'S REVISED 1988 EXPENSE AMOUNTS, HE WOULD HAVE REPORTED $418 PER AVERAGE ACCESS LINE FOR CENTEL O&M EXPENSE PER AVERAGE ACCESS LINE IN 1988 INSTEAD OF $448. THIS ERROR ALONE WOULD HAVE CHANGED HIS PERCENT CHANGE FOR CENTEL ON THIS COMPARISON FROM HIS REPORTED -10.50% TO -4.07%. IF HE HAD CORRECTLY CALCULATED CENTEL'S O&M EXPENSE WITHOUT DEPRECIATION PER AVERAGE ACCESS LINE, HE WOULD HAVE REPORTED A $311 FOR 1988 INSTEAD OF A $335 AMOUNT AND HIS PERCENT CHANGE WOULD HAVE BEEN -0.96% INSTEAD OF -8.00%.

Q. DO YOU HAVE ANY COMMENTS REGARDING MR. STEWART'S COMPARISON OF O&M EXPENSE PER OPERATING REVENUE AND O&M EXPENSE LESS DEPRECIATION PER OPERATING REVENUE?

A. YES. I DON'T BELIEVE THIS COMPARISON PROVIDES ANY INFORMATION THAT IS MEANINGFUL TO AN ANALYSIS OF THE IMPACT OF THE INCENTIVE PLAN. I CANNOT SEE ANY LOGICAL CONCLUSION THAT CAN BE REACHED FROM THE COMPARISON PRESENTED.

Q. WHAT ARE YOUR COMMENTS RELATED TO MR. STEWART'S CONCLUSIONS REGARDING HIS COMPARISON OF INDUSTRY

STATISTICS TO THE STATISTICS HE COMPUTED FOR SOUTHERN BELL?

A. MR. STEWART POINTS OUT THAT THE INDUSTRY STATISTICS HE HAS CALCULATED SHOW THAT DECLINING COSTS PER ACCESS LINE HAVE BEEN AN OBVIOUS TREND IN THE TELECOMMUNICATIONS INDUSTRY OVER THE LAST FIVE YEARS. HE IMPLIES THAT SINCE THIS APPEARS TO BE THE CASE, THEN MY TESTIMONY WHICH DEMONSTRATES THE DECLINE IN COST OF SERVICE FOR SOUTHERN BELL IS AN INCOMPLETE ASSESSMENT.

IT IS DIFFICULT TO UNDERSTAND MR. STEWART'S LOGIC GIVEN THE DATA HE HAS PRESENTED. HIS CALCULATION OF PERCENT DECLINES IN O&M EXPENSE PER AVERAGE ACCESS LINE AND O&M EXPENSE WITHOUT DEPRECIATION PER AVERAGE ACCESS LINE FOR SOUTHERN BELL OVER THE FIVE YEAR PERIOD WERE -9.47% AND -9.13%, RESPECTIVELY. HIS CALCULATIONS OF PERCENT DECLINES IN THESE SAME STATISTICS FOR THE REGIONAL BELL OPERATING COMPANIES WERE -4.87% AND -2.34%, RESPECTIVELY. HIS CALCULATION OF PERCENT DECLINES IN THESE SAME STATISTICS FOR OTHER LECS WERE -4.18% AND -2.63%, RESPECTIVELY. I DON'T AGREE WITH MR. STEWART THAT THESE COMPARISONS ARE NEEDED TO PROVE

THAT SOUTHERN BELL HAS PERFORMED EFFECTIVELY UNDER THE INCENTIVE PLAN, BUT I FAIL TO SEE HOW HE CAN REPORT THAT WE ACHIEVED PERCENT COST REDUCTIONS ALMOST TWO TO FOUR TIMES THE INDUSTRY RESULTS AND AT THE SAME TIME CONCLUDE THAT THE COMPANY HAS NOT BEEN EFFECTIVE UNDER THE PLAN.

Q. HOW DO YOU RESPOND TO MR. STEWART'S CLAIM THAT SOUTHERN BELL'S PERFORMANCE DURING THE INCENTIVE PLAN DOES NOT STAND OUT FROM THE OTHER FLORIDA LECS WHO DID NOT OPERATE UNDER INCENTIVE REGULATION?

A. I HAVE EXPLAINED SOME OF THE PROBLEMS WITH MR. STEWART'S CALCULATIONS WHICH SIGNIFICANTLY CHANGE THE COMPARISONS HE IS MAKING. I BELIEVE SOUTHERN BELL'S RESULTS ARE GOOD DURING THE PERIOD OF THE INCENTIVE PLAN AND CERTAINLY SUPPORT THE CONTINUATION OF THE PLAN, NOT ITS ABANDONMENT AS PROPOSED BY MR. STEWART.

SOUTHERN BELL IS THE ONLY ONE OF THE COMPANIES SHOWN IN MR. STEWART'S COMPARISON WHICH DID NOT FILE FOR A GENERAL RATE INCREASE DURING THE PERIOD STUDIED. THIS FACT FURTHER SUPPORTS THE

CONTINUATION OF THE INCENTIVE PLAN.

Q. DOES OPC'S WITNESS POUCHER PERFORM ANY FURTHER ANALYSIS OF THE OPERATIONS OF SOUTHERN BELL, GTE, UNITED OR CENTEL THAT PROVIDES ADDITIONAL DATA OR CORRECTS THE MISTAKES MADE IN OPC WITNESS STEWART'S TESTIMONY?

A. NO. MR. POUCHER MERELY STATES THAT MR. STEWART'S RECOMMENDATION IS THE SAME AS HIS OWN. MR. POUCHER ACTUALLY NEVER ANSWERS THE FIRST PART OF THE QUESTION POSED ON PAGE 15, LINE 20 OF HIS TESTIMONY FOR DOCKET NO. 920260. THE QUESTION STARTS: "HAVE YOU REVIEWED THE ANALYSIS OF OPC WITNESS, STEVE STEWART..." IT IS NOT CLEAR FROM MR. POUCHER'S ANSWER IF HE REVIEWED THE ACCURACY OF THE DATA AND THE CALCULATIONS UNDERLYING MR. STEWART'S ANALYSIS. HIS COMMENTS IN RESPONSE TO THE QUESTION ADDRESS GENERALLY THE APPROPRIATENESS OF MAKING AN ANALYSIS SUCH AS MR. STEWART'S, BUT HIS SUPPORT FOR THE RESULTS REPORTED BY MR. STEWART APPEAR TO BE CONJECTURE.

Q. DOES MR. POUCHER PROVIDE AN ANALYSIS TO SUPPORT THE CLAIM HE MAKES ON PAGE 16 OF HIS TESTIMONY,

STARTING AT LINE 11, WHERE HE STATES: "IF SOUTHERN BELL COMPARES UNFAVORABLY TO GTE OR UNITED, THEN IT WOULD BE MY THOUGHT THAT IT IS DUE TO THE VARIANCES IN THE OVERHEADS WITHIN THE ORGANIZATIONS."?

A. NO. AGAIN, THIS STATEMENT APPEARS TO BE PURE CONJECTURE. NEITHER MR. STEWART NOR MR. POUCHER PERFORM AN ANALYSIS OF THE OVERHEADS WITHIN THE COMPANIES.

Q. ARE YOUR RESPONSES TO THE CONCLUSIONS REACHED BY MR. POUCHER REGARDING COMPARISONS BETWEEN COMPANIES THE SAME AS THE RESPONSES YOU HAVE GIVEN REGARDING MR. STEWART'S CONCLUSIONS?

A. YES.

Q. HAS SOUTHERN BELL IMPLEMENTED ANY COST SAVINGS PROGRAMS THAT WILL RESULT IN SAVINGS BEYOND 1993?

A. YES. THE COMPANY IS IN THE PROCESS OF RE-ENGINEERING MANY OF ITS PROCESSES IN ORDER TO CONTINUE IN ITS EFFORTS TO PROVIDE BETTER SERVICE AT REDUCED COST. THIS IS CONSISTENT WITH THE EXPECTATIONS OF THE INCENTIVE PLAN AND IS EVIDENCE

THAT THE COMPANY IS SERIOUS IN MOVING AGGRESSIVELY FORWARD TO COMPETE IN THE CHANGING TELECOMMUNICATIONS ENVIRONMENT. I WILL PROVIDE MORE SPECIFIC DETAIL ON THESE RE-ENGINEERING EFFORTS LATER IN MY TESTIMONY.

Q. DO YOU AGREE WITH MR. STEWART'S PROPOSAL ON BEHALF OF THE OPC THAT THE COMMISSION SHOULD IMPLEMENT STEP DECREASES IN 1995 AND 1996 TO ALLOW RATEPAYERS TO RECOVER THE SAVINGS THAT WILL OCCUR DURING THESE YEARS AS A RESULT OF THE COMPANY'S PROGRAMS?

A. NO. THIS PROPOSAL IS COUNTER TO PAST RATEMAKING TREATMENTS AND IMPOSES DISINCENTIVES INTO THE REGULATORY PROCESS RATHER THAN INCENTIVES. I AM NOT AWARE OF A TIME UNDER TRADITIONAL REGULATION WHERE THE COMMISSION GAVE THE COMPANY A STEP INCREASE IN RATES IN FUTURE YEARS TO RECOGNIZE INCREASING COSTS OF SERVICE. THE COMMISSION HAS RECOGNIZED AN ATTRITION ADJUSTMENT IN THE PAST TO MOVE AN HISTORICAL TEST YEAR TO A POINT REFLECTIVE OF THE PERIOD IN WHICH RATES WOULD BE IN EFFECT, BUT THIS DID NOT INCLUDE AN AUTOMATIC INCREASE IN RATES IN FUTURE YEARS. OPC'S PROPOSAL WOULD, THEREFORE, IMPOSE AN UNBALANCED AND UNFAIR

TREATMENT OF THE COMPANY'S INVESTORS.

UNDER THE INCENTIVE PLAN ESTABLISHED BY THE COMMISSION IN SOUTHERN BELL DOCKET NO. 880069-TL, THE COMMISSION PROVIDED INCENTIVES FOR THE COMPANY TO REDUCE ITS COSTS. THESE INCENTIVES WOULD ALLOW THE COMPANY TO SHARE IN EARNINGS PRODUCED BY ITS OWN INITIATIVES. OPC'S PROPOSAL NOT ONLY REMOVES THE INCENTIVE FOR EARNINGS SHARING, BUT ALSO TAKES AWAY COST SAVINGS THE COMPANY HASN'T YET REALIZED AND MAY NEVER REALIZE. INDEED OPC'S PROPOSAL SEEMS TO MEET THE DESCRIPTION OF A DISINCENTIVE AS STATED BY THE COMMISSION. IN ITS ORDER NO. 20162 OF DOCKET NO. 880069-TL, ON PAGE 6, THE COMMISSION STATES: "...IT IS ONLY WHEN ONE SEES NO REWARD FOR DOING WHAT WOULD OTHERWISE BE PRUDENT THAT DISINCENTIVE SETS IN..." OPC'S PROPOSED STEP DECREASES IN RATES PUT DISINCENTIVES IN THE REGULATORY PROCESS BECAUSE IT TELLS SOUTHERN BELL AND OTHER COMPANIES THAT, IF THEY PLAN COST SAVINGS PROGRAMS, THE REGULATORY PROCESS IS GOING TO TAKE THE SAVINGS AWAY FROM THE COMPANY EVEN BEFORE THEY MATERIALIZE. THE COMMISSION SHOULD NOT ACCEPT SUCH A PROPOSAL.

Q. DO THE COST SAVINGS AMOUNTS REPORTED BY MR. DE WARD AND MR. STEWART REFLECT THE LATEST FORECASTS THE COMPANY HAS RELATED TO ITS RE-ENGINEERING EFFORTS?

A. NO. MR. DE WARD AND MR. STEWART USED THE COMPANY'S RESPONSE TO CITIZEN'S 39TH SET OF INTERROGATORIES, ITEM NO. 988 FOR THE COST SAVINGS. MORE RECENTLY, THE COMPANY HAS PROVIDED REVISED ESTIMATES IN CITIZEN'S 53RD SET OF INTERROGATORIES, ITEM NO. 1336. THE LATEST AMOUNTS FOR 1994, 1995 AND 1996 ARE A NET EXPENSE OF $35 MILLION, AND NET SAVINGS OF $27 MILLION AND $99 MILLION, RESPECTIVELY.

<u>REBUTTAL OF TESTIMONY OF OPC WITNESS THOMAS C. DE WARD</u>

Q. MR. REID WILL YOU BE RESPONDING TO THE ACCOUNTING ISSUES ADDRESSED BY OPC WITNESS DE WARD IN HIS DIRECT TESTIMONY?

A. YES. I WILL ADDRESS ALL OF THE ACCOUNTING ISSUES WHICH MR. DE WARD INCLUDED IN HIS TESTIMONY. THIS SECTION OF MY TESTIMONY WILL BE STRUCTURED TO FOLLOW THE SAME SEQUENTIAL ORDER FOR THE ACCOUNTING ISSUES AS MR. DE WARD USED IN HIS TESTIMONY, SO

THAT THE ISSUES CAN BE EASILY CROSS-REFERENCED.

Q. DO YOU HAVE ANY INITIAL RESPONSE TO THE CONCLUSIONS WHICH MR. DE WARD REACHES ON PAGE 7 OF HIS TESTIMONY THAT THE COMPANY'S RATES SHOULD BE REDUCED BY AN AMOUNT IN EXCESS OF $450 MILLION AND THAT REFUNDS FOR 1993 SHOULD BE BASED ON ACTUAL RESULTS INCLUDING ADJUSTMENTS FOR MANY OF THE ITEMS HE IS PROPOSING?

A. YES. MR. DE WARD'S CONCLUSIONS ARE SO OUTLANDISH THAT HE FEELS COMPELLED TO SPEND THE NEXT FIVE PAGES OF HIS TESTIMONY TRYING TO CONVINCE THE READER THAT IT IS OKAY THAT HIS PROPOSALS WILL REDUCE THE COMPANY'S NET OPERATING INCOME BY $276,000,000 OR OVER 74% OF THE COMPANY'S REPORTED NET OPERATING INCOME OF $370,968,000 AS REPORTED ON ITS JULY 31, 1993 SURVEILLANCE REPORT. HE FAILS TO INFORM THE READER THAT ON THIS SAME SURVEILLANCE REPORT THE COMPANY REPORTS RATE BASE INVESTMENTS IN FLORIDA OF $4,076,427,000. MAKING A FEW SIMPLE CALCULATIONS FROM THE CAPITAL STRUCTURE AND INTEREST COST RATES SHOWN ON PAGE 3 OF THIS SURVEILLANCE REPORT, IT IS OBVIOUS THAT THE INTEREST COST ON THE COMPANY'S INVESTMENTS IN

FLORIDA ALONE EXCEEDS $99,500,000. SINCE THE RESIDUAL AMOUNT DERIVED FROM SUBTRACTING $276,000,000 FROM $370,968,000 OF NET OPERATING INCOME IS ONLY $94,968,000, IT IS OBVIOUS THAT THE COMPANY WOULDN'T EVEN HAVE ENOUGH MONEY LEFT TO PAY ITS INTEREST PAYMENTS. ITS STOCKHOLDERS WOULD BE LEFT WITH A LOSS OF OVER $4,532,000 ON AN EQUITY INVESTMENT OF $1,972,523,000.

IT IS ALSO IMPORTANT TO NOTE THAT THE SURVEILLANCE REPORT REPRESENTS FINANCIAL REPORTING ON THE BASIS PRESCRIBED BY THE COMMISSION, INCLUDING ADJUSTMENTS IN ACCORDANCE WITH THE COMPANY'S LAST RATE PROCEEDING AND COMMISSION RULES. MR. DE WARD IS THEREFORE REQUESTING THE COMMISSION TO CHANGE ITS REGULATORY TREATMENT OF SOUTHERN BELL TO SUCH AN EXTENT THAT HIS PROPOSED ADJUSTMENTS RIVAL THE SIZE OF THE COMPANY'S EXISTING INTRASTATE NET INCOME. THESE PROPOSALS ARE NOT RATIONAL AND COULD CAUSE SIGNIFICANT HARM TO THE COMPANY AND ITS CUSTOMERS IN FLORIDA. THE COMMISSION SHOULD REJECT SUCH IRRATIONAL PROPOSALS.

Q. PLEASE ADDRESS THE REASONING MR. DE WARD USES ON PAGES 8 THROUGH 12 OF HIS TESTIMONY TO JUSTIFY THE

SIZE OF HIS PROPOSALS?

A. MR. DE WARD ITEMIZES 9 POINTS IN HIS ATTEMPT TO RATIONALIZE HIS POSITION. HIS FIRST POINT IS THAT DUE TO THE PROPOSED $450,000,000 REDUCTION IN REVENUES, THE COMPANY WILL REALIZE TAX SAVINGS OF $173,587,500. THIS IS LIKE SAYING TO SOMEONE, YOU WON'T BE PAID A SALARY NEXT YEAR, BUT DON'T WORRY, JUST THINK OF ALL THE TAXES YOU WILL SAVE. THE BOTTOM LINE EFFECT IS STILL THE SAME, YOU DON'T HAVE ENOUGH EARNINGS LEFT AFTER TAXES TO COVER YOUR NEEDS.

HIS SECOND POINT IS THAT IT SHOULD BE TAKEN INTO ACCOUNT THAT THERE ARE EXCESSIVE EARNINGS ON THE BOOKS OF THE COMPANY'S AFFILIATES WHICH SOMEHOW SHOULD BE ATTRIBUTED TO THE REGULATED OPERATIONS IN FLORIDA. THIS IS AN UNFOUNDED ACCUSATION. THE EXAMPLE HE USES IS THE DIRECTORY ADVERTISING OPERATIONS OF BELLSOUTH ADVERTISING & PUBLISHING CORPORATION, (BAPCO). I WILL REBUT HIS PROPOSED ADJUSTMENT FOR BAPCO LATER IN MY TESTIMONY, BUT AT THIS POINT I WANT TO SHOW THAT THIS PROPOSAL IS ALSO IRRATIONAL. MR. DE WARD QUOTES HIS PROPOSED ADJUSTMENT AS OVER $ MILLION TO REDUCE THE

EXCESSIVE RETURNS EARNED BY BAPCO. IN RESPONSE TO STAFF AUDIT REQUEST ITEM NO. 3-051.0 IN THIS DOCKET, THE COMPANY PROVIDED THE BAPCO-FLORIDA FINANCIAL STATEMENT FOR 1992. THIS STATEMENT REPORTED NET INCOME FOR BAPCO IN 1992 OF $. ON DE WARD SCHEDULE 1, HE QUANTIFIES THE REVENUE REQUIREMENT VALUE FOR HIS BAPCO ADJUSTMENT AS $. TAKING THIS AMOUNT TO A NET OPERATING INCOME EQUIVALENT AFTER FEDERAL AND STATE INCOME TAXES, HIS ADJUSTMENT IS EQUAL TO $1 . HIS CLAIM OF $ IN EXCESSIVE EARNINGS ON BAPCO'S BOOKS JUST DOESN'T MAKE SENSE WHEN YOU LOOK AT THE FACT THAT BAPCO-FLORIDA'S TOTAL EARNINGS IN 1992 WERE ONLY $.

MR. DE WARD'S THIRD POINT IS THAT A NUMBER OF HIS ADJUSTMENTS MERELY SHIFT EXPENSES FROM THE INTRASTATE TO THE INTERSTATE JURISDICTION. HE IDENTIFIES HIS MOST NOTABLE OF THESE AS A SHIFT IN DIRECTORY ADVERTISING EXPENSES TO THE INTERSTATE JURISDICTION. THE COMPANY IS ALREADY ASSIGNING THE MAXIMUM AMOUNT THAT THE SEPARATIONS RULES, PART 36 OF THE FCC RULES AND REGULATIONS, WILL ALLOW FOR INTERSTATE DIRECTORY EXPENSE ASSIGNMENT. HIS PROPOSAL DOUBLE ASSIGNS SOME OF THE SAME EXPENSES

TO INTERSTATE THAT THE COMPANY IS ALREADY ASSIGNING AND IS TOTALLY INAPPROPRIATE. THE COMPANY CERTAINLY COULD NOT EXPECT TO DOUBLE RECOVER EXPENSES IN THE INTERSTATE JURISDICTION, SO ITS EARNINGS WOULD SUFFER THE CONSEQUENCES OF THIS INAPPROPRIATE ADJUSTMENT.

HIS FOURTH POINT IS THAT SOME OF HIS ADJUSTMENTS MERELY REVERSE THE COMPANY'S ATTEMPT TO INCREASE 1994 GOING FORWARD LEVEL OF EXPENSE. IN HIS TESTIMONY, MR. DE WARD SEEMS TO RECOMMEND THAT THE COMPANY'S SHAREHOLDERS SHOULD JUST SUFFER LOWER EARNINGS WHEN EVENTS SUCH AS HURRICANES OCCUR. HE REJECTS THE COMPANY'S PROPOSAL TO SET UP A CASUALTY RESERVE AND HE RECOMMENDS THAT THE COMMISSION RETROACTIVELY ABANDON ITS REGULATORY POLICY FOR TREATING CASUALTY DAMAGES. THIS IS AN UNJUSTIFIABLE POSITION IN WHICH TO PUT A COMPANY WHOSE EARNINGS ARE REGULATED, AND AMOUNTS TO CONFISCATION OF THE COMPANY'S ASSETS.

HIS FIFTH POINT IS JUST AN ASSUMPTION ON HIS PART THAT THE COMPANY CAN REVISE ITS CALCULATIONS OF PENSION EXPENSE AND THEREFORE, BOOK NO PENSION EXPENSE. THE COMPANY HAS EXPLAINED TO MR. DE WARD

IN INTERROGATORY RESPONSES THAT IT IS REVIEWING ITS ASSUMPTIONS UNDERLYING THE PENSION EXPENSE CALCULATION AND THE HEALTH BENEFITS EXPENSE CALCULATION. THERE ARE IMPACTS FROM POTENTIAL CHANGES IN ASSUMPTIONS THAT INCREASE EXPENSE AS WELL AS DECREASE EXPENSE. MR. DE WARD'S GENERAL ASSUMPTION IS INAPPROPRIATE.

MR. DE WARD'S SIXTH THROUGH NINTH POINTS MERELY IDENTIFY ADDITIONAL EXPENSE DISALLOWANCES THAT HE IS PROPOSING THE COMMISSION IMPOSE ON SOUTHERN BELL. THESE PROPOSED DISALLOWANCES DO NOT ELIMINATE THE EXPENSE, THEY SIMPLY SHIFT THEM TOTALLY ONTO THE SHAREHOLDERS OF THE COMPANY. THE COMPANY'S EARNINGS IN FLORIDA WOULD SUFFER ACCORDINGLY.

ACCOUNTING ISSUES

A. DIRECTORY ADVERTISING REVENUES

Q. WILL YOU SUMMARIZE THE ISSUE MR. DE WARD IS RAISING CONCERNING DIRECTORY ADVERTISING REVENUES?

A. YES. THE COMPANY IS GUIDED BY COMMISSION RULE 25-4.0405 REGARDING THE AMOUNT OF DIRECTORY

ADVERTISING GROSS PROFITS WHICH IT REPORTS IN REGULATED OPERATIONS. THE COMPANY HAS CONSISTENTLY FOLLOWED THIS RULE SINCE IT WAS FIRST ADOPTED IN 1985. THE PURPOSE OF THE RULE WAS TO SPELL OUT PRECISELY HOW THE PROVISIONS OF SECTION 364.037, FLORIDA STATUTES (1983) RELATING TO TELEPHONE DIRECTORY ADVERTISING WOULD BE APPLIED IN THE RATEMAKING PROCESS.

EVEN THOUGH THE COMPANY HAS CONSISTENTLY APPLIED RULE 25-4.0405 IN ITS EARNINGS CALCULATIONS, MR. DE WARD NOW BELIEVES THAT A NEW INTERPRETATION OF THE PROVISIONS OF SECTION 364.037, FLORIDA STATUTES NEEDS TO BE APPLIED. MR. DE WARD'S APPROACH WILL INCREASE THE AMOUNT OF GROSS PROFITS ATTRIBUTED TO REGULATED OPERATIONS. TO ACCOMPLISH THIS HE SUGGESTS THAT GROSS PROFITS FROM DIRECTORY ADVERTISING SHOULD NOT ONLY INCLUDE THE AMOUNT ON SOUTHERN BELL'S BOOKS BUT ALSO THE AMOUNT ON BAPCO'S BOOKS.

Q. DO YOU HAVE ANY EVIDENCE WHICH INDICATES THAT THE COMPANY HAS BEEN CORRECTLY INTERPRETING COMMISSION RULE 25-4.0405 AND THAT MR. DE WARD'S INTERPRETATION IS WRONG?

A. YES. I HAVE ATTACHED A COPY OF THE COMMISSION STAFF'S RECOMMENDATION TO THE COMMISSION IN JULY, 1985 FOR THE PROPOSED RULE. I HAVE ALSO ATTACHED A COPY OF COMMENTS FILED ON DECEMBER 27, 1985 BY THE CITIZENS OF THE STATE OF FLORIDA (PUBLIC COUNSEL) REGARDING ADOPTION OF RULE 25-4.0405 - TELEPHONE DIRECTORY ADVERTISING REVENUES. I HAVE IDENTIFIED THESE DOCUMENTS AS REID EXHIBITS WSR-6 AND WSR-7, RESPECTIVELY.

ON PAGES 8 AND 9 OF THE STAFF'S RECOMMENDATION (EXHIBIT WSR-6), THE STAFF REPORTED: "...IN THE FUTURE BELL WILL BE CONTRACTING THE DIRECTORY FUNCTION WITH THEIR ASSOCIATED COMPANY (BAPCO) AND WILL BE RECORDING COMMISSIONS PAID IN ACCOUNT 649. IN ORDER FOR THE BASE PERIOD (1982) GROSS PROFIT AND FUTURE PERIOD GROSS PROFIT CALCULATIONS TO BE COMPARABLE, WE RECOMMEND THAT THE GROSS PROFIT BASE BE SET AT $102,215,043 USING THE 40% LIMIT. THIS WILL PUT ALL TELEPHONE COMPANIES ON AN EVEN FOOTING IN THAT THEY WILL ALL BE USING A 1982 GROSS PROFIT BASE EQUAL TO 60% OF GROSS REVENUES. THIS WILL ALSO RECOGNIZE THE INDIRECT EXPENSES INCURRED BY SOUTHERN BELL FOR ADVERTISING THAT WERE PREVIOUSLY

RECORDED IN ACCOUNTS OTHER THAN ACCOUNT 649 DIRECTORY EXPENSES." SINCE THE STAFF HAD ALREADY IDENTIFIED GROSS PROFIT AS ACCOUNT 523 - DIRECTORY REVENUES LESS ACCOUNT 649 - DIRECTORY EXPENSES IN RESPONSE TO ISSUE 5 OF THEIR RECOMMENDATION, IT IS CLEAR THAT THE INTENT OF THE RULE WAS TO BASE THE GROSS PROFIT CALCULATION ON THE AMOUNT OF REVENUE AND EXPENSE RECORDED ON SOUTHERN BELL'S BOOKS.

Q. DID THE OPC OBJECT TO THE PROPOSED DIRECTORY ADVERTISING RULE?

A. NO. IN FACT OPC WAS COMPLIMENTARY OF THE STAFF AND THE COMMISSION REGARDING THE FAIRNESS OF THE RULE. ON PAGE 6 OF OPC'S COMMENTS TO THE COMMISSION REGARDING THE PROPOSED DIRECTORY ADVERTISING RULE, IT STATES:

> "IN SUM, THE STATUTE AND THE PROPOSED RULE PROVIDE THE COMPANIES WITH AN INCENTIVE TO MAXIMIZE PROFITS FROM DIRECTORY ADVERTISING SO THAT THEIR SHAREHOLDERS MAY NOW SHARE IN A SOURCE OF REVENUE WHICH PREVIOUSLY INNURED SOLELY TO THE BENEFIT OF THE RATEPAYERS. THE

STAFF OF THE COMMISSION HAS ACTED RESPONSIBLY IN PROVIDING A FAIR METHOD OF ALLOCATION OF DIRECTORY ADVERTISING PROFITS AND WE URGE THE COMMISSION TO ADOPT THE RULE ALONG WITH THE SUGGESTED AMENDMENTS."

Q. IS THERE AN INDICATION IN OPC'S COMMENTS REGARDING RULE 25-4.0405 THAT IT UNDERSTOOD THAT THE GROSS PROFIT CALCULATION WOULD BE BASED ON THE AMOUNT OF PAYMENTS MADE BY SOUTHERN BELL TO BAPCO?

YES. OPC'S PROPOSED AMENDMENTS (F) AND (H), WHICH ARE INCLUDED IN THE APPENDIX TO ITS COMMENTS, CERTAINLY INDICATE THAT OPC FULLY UNDERSTOOD THAT THE PAYMENTS MADE BY SOUTHERN BELL TO BAPCO WOULD BE USED IN DETERMINING THE GROSS PROFIT AMOUNT.

Q. HAVE RATEPAYERS BENEFITED FROM THE COMPANY'S EXPANSION OF THE DIRECTORY ADVERTISING BUSINESS SINCE THE BASE YEAR, 1982, ESTABLISHED IN THE STATUTE?

A. YES. ON PAGE 8 OF THE STAFF'S RECOMMENDATION REGARDING THE RULE (EXHIBIT WSR-6), SOME FINANCIAL

STATISTICS ARE REPORTED FOR SOUTHERN BELL'S DIRECTORY ADVERTISING OPERATIONS IN 1982. ACCORDING TO THE DATA LISTED, GROSS OPERATING REVENUES IN 1982 WERE $170,358,405, AND TOTAL DIRECTORY EXPENSES (INCLUDING ALL RELATED INDIRECT EXPENSES) WERE $78,841,914. THIS MEANS THAT $91,516,491 WOULD HAVE BEEN INCLUDED IN REGULATED NET OPERATING REVENUES IN 1982. THIS AMOUNT IS SOMEWHAT HIGH SINCE IT HAS NOT BEEN REDUCED FOR UNCOLLECTIBLE REVENUES, BUT IT WILL DEMONSTRATE MY POINT. I WOULD ALSO CLARIFY THAT IN 1982, THE INVESTMENTS REQUIRED TO OPERATE THE DIRECTORY ADVERTISING BUSINESS WERE IN SOUTHERN BELL'S RATE BASE. AS REPORTED ON ANNUAL REPORT SCHEDULE Z-9, THE ACTUAL 1992 DIRECTORY ADVERTISING GROSS PROFITS ON SOUTHERN BELL'S BOOKS WERE $223,957,880. THE 1982 AMOUNT OF $91,516,491 GROWN BY CPI AND ACCESS LINES TO 1992 WOULD ONLY BE $212,224,043. RATEPAYER BENEFITS UNDER THE PUBLISHING FEE ARRANGEMENT ARE THEREFORE, GROWING FASTER THAN THE GROWTH RATE SPECIFIED IN THE STATUTE. IN ADDITION, SINCE THE INVESTMENTS ASSOCIATED WITH THE DIRECTORY ADVERTISING OPERATION ARE ON BAPCO'S BOOKS, THE RATEPAYERS RECEIVE AN EVEN GREATER BENEFIT.

Q. ARE YOU PROPOSING THAT THE COMMISSION CHANGE THE 1982 BASE YEAR GROSS PROFIT AMOUNT OF $102,215,043 IN ORDER TO RECOGNIZE ALL OF THE DIRECT AND INDIRECT EXPENSES REQUIRED FOR THE DIRECTORY ADVERTISING BUSINESS?

A. NO. MY CALCULATIONS ARE ONLY INTENDED TO DEMONSTRATE THAT THE COMMISSION'S CURRENT RULE FOR DIRECTORY ADVERTISING, WHICH HAS BEEN CONSISTENTLY FOLLOWED BY SOUTHERN BELL, IS TREATING RATEPAYERS FAIRLY.

Q. WILL SOUTHERN BELL BE FAIRLY TREATED UNDER MR. DE WARD'S PROPOSED REVISIONS TO THE DIRECTORY ADVERTISING RULE?

A. NO. MR. DE WARD'S PROPOSAL WILL RESULT IN PRUDENTLY INCURRED DIRECTORY ADVERTISING COSTS GOING UNRECOVERED. THIS CAN EASILY BE SEEN BY JUST LOOKING AT THE SIZE OF HIS PROPOSED ADJUSTMENT. HE PROPOSES THAT THE COMMISSION IMPOSE AN ADJUSTMENT THAT WILL REDUCE THE COMPANY'S REVENUES BY $ REDUCING THIS AMOUNT FOR FEDERAL AND STATE INCOME TAXES OF $. (AT AN EFFECTIVE RATE OF 38.575%) YIELDS A NET INCOME IMPACT OF

$ . . WHICH EXCEEDS BAPCO-FLORIDA'S TOTAL NET INCOME OF $ . . FOR 1992. THIS IS AN ABSURD RESULT AND SHOULD NOT BE ACCEPTED.

B. <u>SHIFT OF ADVERTISING EXPENSE DOLLARS - INTRASTATE TO INTERSTATE</u>

Q. IS MR. DE WARD CORRECT IN HIS STATEMENT THAT THERE WAS A SHIFT IN JURISDICTIONAL EXPENSE ASSIGNMENT FOR DIRECTORY WHITE PAGE EXPENSES DUE TO THE ESTABLISHMENT OF THE PUBLISHING FEE AGREEMENT WITH BAPCO?

A. NO. THIS WAS INCORRECT SPECULATION BY MR. DE WARD. THE COMPANY STILL ASSIGNS AN APPROPRIATE AMOUNT OF WHITE PAGE EXPENSES TO THE INTERSTATE JURISDICTION AND THIS ASSIGNMENT APPROPRIATELY REDUCES INTRASTATE EXPENSES. THIS ASSIGNMENT IS EQUIVALENT TO THE PROCEDURE USED BY THE COMPANY PRIOR TO THE BAPCO AGREEMENT. SINCE MR. DE WARD'S PREMISE FOR THIS ADJUSTMENT IS TOTALLY INCORRECT, IT SHOULD BE REJECTED.

IN ADDITION TO BEING BASED ON AN INCORRECT SPECULATION, MR. DE WARD'S ADJUSTMENT IS

MATHEMATICALLY FLAWED IN THAT EVEN THOUGH HE ACKNOWLEDGES THAT EXPENSES ASSOCIATED WITH THE SALES, PRODUCTION AND DISTRIBUTION OF THE YELLOW PAGES ARE CONSIDERED TO BE INTRASTATE EXPENSES, HE STILL INCLUDES THEM IN THE BASE EXPENSES WHICH HE ALLOCATES TO INTERSTATE.

C. <u>DIRECTORY EXPENSES NOT RECORDED IN ACCOUNT 6622.1</u>

Q. IS MR. DE WARD CORRECT IN HIS PREMISE THAT CERTAIN COMPANY EXPENSES WHICH ARE ASSOCIATED WITH THE PRODUCTION OF WHITE PAGE LISTINGS OR YELLOW PAGE ADVERTISEMENTS WOULD HAVE BEEN CLASSIFIED TO ACCOUNT 649 IN 1982, BUT ARE NOT INCLUDED IN ACCOUNT 6622 TODAY DUE TO CHANGES IN THE UNIFORM SYSTEM OF ACCOUNTS (USOA)?

A. NO. THE EXPENSES WHICH THE COMPANY IDENTIFIED IN RESPONSE TO OPC INTERROGATORY NOS. 984 AND 1158 ARE EXPENSES WHICH ARE ASSOCIATED WITH DIRECTORY ADVERTISING OPERATIONS, BUT THEY WERE NOT CLASSIFIED TO ACCOUNT 649 UNDER THE PREVIOUS USOA. EXPENSES FOR BILLING AND COLLECTIONS, SUBSCRIBER LISTING DATA AND DIRECTORY DELIVERY INFORMATION

WOULD HAVE BEEN CLASSIFIED TO ACCOUNTS SUCH AS ACCOUNT 662 - ACCOUNTING DEPARTMENT AND ACCOUNT 645 - LOCAL COMMERCIAL OPERATIONS UNDER THE USOA, PART 31.

SINCE ALMOST ALL OF THE EXPENSES WHICH WOULD HAVE BEEN CHARGED TO ACCOUNT 649 UNDER THE OLD USOA RESIDED ON BAPCO'S BOOKS, THE ADOPTION OF PART 32, USOA, BY SOUTHERN BELL HAD LITTLE, IF ANY, EFFECT ON THE AMOUNTS SOUTHERN BELL RECORDED AS DIRECTORY EXPENSE FOR THE DIRECTORY GROSS PROFIT CALCULATION.

SINCE THE PREMISE UPON WHICH HE BASED THIS ADJUSTMENT IS WRONG, HIS PROPOSED ADJUSTMENT SHOULD BE REJECTED.

D. HURRICANE ANDREW

1. AMORTIZATION

Q. PLEASE SUMMARIZE THE ISSUES ASSOCIATED WITH MR. DE WARD'S RECOMMENDATION THAT THE COMPANY BE REQUIRED TO WRITE OFF THE COST OF HURRICANE ANDREW IN 1992.

A. IN HIS RECOMMENDATION ON THIS ISSUE, MR. DE WARD IS ASKING THE COMMISSION TO RETROACTIVELY REVERSE ITS PRIOR RATEMAKING TREATMENT FOR CASUALTY DAMAGES. HIS RATIONALE IS THAT (1) GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) DO NOT PROVIDE FOR THE DEFERRAL OF SUCH EXPENSES; (2) USOA, PART 32 ADOPTED GAAP; AND (3) THE COMMISSION'S CONTINUED RECOGNITION OF A CASUALTY ADJUSTMENT IN RATEMAKING SINCE PART 32 WAS ADOPTED DOES NOT SET A PRECEDENT. HE FURTHER CLAIMS THAT THE COMPANY IS ALLOWED TO FULLY RECOVER THE AMORTIZATION OF HURRICANE ANDREW EXPENSE UNDER HIS PROPOSAL. THIS CLAIM IS TOTALLY UNBELIEVABLE.

Q. IS HE CORRECT THAT GAAP DOES NOT PROVIDE FOR THE DEFERRAL OF EXPENSES SUCH AS THE AMORTIZATION OF CASUALTY DAMAGES?

A. NO. STATEMENT OF FINANCIAL ACCOUNTING STANDARDS (SFAS) NO. 71 - ACCOUNTING FOR THE EFFECTS OF CERTAIN TYPES OF REGULATION, CLEARLY PROVIDES ACCOUNTING GUIDANCE FOR SITUATIONS WHERE A REGULATOR INCLUDES COSTS IN ALLOWABLE EXPENSES IN A PERIOD OTHER THAN THE PERIOD IN WHICH THE COSTS WOULD BE CHARGED TO EXPENSE BY AN UNREGULATED

ENTERPRISE. THE FACT THAT THE COMMISSION HAS A LONG ESTABLISHED RATEMAKING POLICY TO TREAT THE COST OF CASUALTY DAMAGES OVER A FIVE YEAR AVERAGE PERIOD GIVES THE COMPANY A REGULATORY ASSET UNDER SFAS 71 AND ALLOWS THE COMPANY TO REPORT THE EFFECT OF THIS RATEMAKING TREATMENT IN ITS EXTERNAL FINANCIAL STATEMENTS. THE COMPANY CAN, THEREFORE, RECORD THE DEFERRAL AND AMORTIZATION OF HURRICANE ANDREW ON ITS FINANCIAL STATEMENTS.

Q. DOES GAAP MANDATE HOW THE COMMISSION WILL TREAT AN ISSUE SUCH AS COST RECOVERY FOR HURRICANE ANDREW DAMAGE?

A. NO. GAAP PROVIDES GUIDANCE ON HOW RATE REGULATED COMPANIES SHOULD REPORT THE ACTIONS OF REGULATORS IN THEIR EXTERNAL FINANCIAL STATEMENTS, BUT IT DOES NOT MANDATE WHAT ACTIONS THE REGULATOR SHOULD TAKE. THE COMMISSION'S RATEMAKING POLICY REGARDING CASUALTY DAMAGES IS FAIR AND APPROPRIATE FOR A RATE REGULATED COMPANY, ESPECIALLY IN A STATE THAT IS SO VULNERABLE TO HURRICANES. THE COMPANY'S RATES CERTAINLY DID NOT INCLUDE DAMAGE COSTS FOR A STORM SUCH AS HURRICANE ANDREW. IF THE COMMISSION WERE TO REQUIRE THE COMPANY TO REPORT ALL OF THE COSTS

FOR HURRICANE ANDREW IN 1992 AND THEN MONITOR EARNINGS IN FUTURE YEARS WITH NO ACKNOWLEDGMENT OF THESE INCURRED COSTS, THE SHAREHOLDER IS BEING REQUIRED TO BEAR THE FULL COST OF THE DAMAGE. UNDER THE COMMISSION'S FIVE YEAR AVERAGE POLICY, HOWEVER, THE COMPANY'S EARNINGS SURVEILLANCE REPORTS REFLECT 1/5 OF THE COST OF THE DAMAGE EACH YEAR FOR FIVE YEARS. SHAREHOLDERS STILL BEAR MUCH OF THE COST UNDER THIS APPROACH, SINCE RATES DO NOT AUTOMATICALLY GO UP, BUT DO SO ONLY WHEN JUSTIFIED BY THE COMPANY IN A RATESETTING DOCKET. AGAIN, THIS APPROACH IS FAIR AND SHOULD BE FOLLOWED WHETHER IT RESULTS IN SPECIFIC ACCOUNTING ENTRIES OR MERELY PRO FORMA ADJUSTMENTS ON EARNINGS SURVEILLANCE REPORTS.

Q. IS MR. DE WARD ENTIRELY CORRECT THAT THE USOA, PART 32 ADOPTED GAAP?

A. NO. MR. DE WARD IS ONLY PARTIALLY CORRECT IN THIS STATEMENT. THE ACTUAL PART 32 RULES STATE:

> "...ACCORDINGLY, THE USOA HAS BEEN DESIGNED TO REFLECT STABLE, RECURRING FINANCIAL DATA BASED TO THE EXTENT

REGULATORY CONSIDERATIONS PERMIT UPON THE CONSISTENCY OF THE WELL ESTABLISHED BODY OF ACCOUNTING THEORIES AND PRINCIPLES COMMONLY REFERRED TO AS GENERALLY ACCEPTED ACCOUNTING PRINCIPLES." (SECTION 32.1, FCC RULES)

MR. DE WARD HAS OBVIOUSLY OVERSTATED HIS ARGUMENT ON THIS POINT.

THE COMPANY WOULD AGREE THAT THE TELECOMMUNICATIONS INDUSTRY IS MOVING FAST TOWARD A MORE COMPETITIVE ENVIRONMENT AND THAT REPORTING IN ACCORDANCE WITH GAAP IS BECOMING MORE IMPORTANT. HOWEVER, IT WOULD BE UNFAIR TO REGULATE A COMPANY'S EARNINGS THROUGH RATESETTING WHICH REMOVES EXTRAORDINARY EVENTS SUCH AS HURRICANE ANDREW AND THEN WHEN ONE OF THESE EVENTS OCCURS ARGUE THAT GAAP REQUIRES THAT THE COSTS BE RECORDED IN THE HISTORICAL PERIOD AND THEREFORE, NO RECOGNITION CAN BE GIVEN FOR THE COSTS IN RATES.

Q. DO YOU AGREE WITH MR. DE WARD THAT THE COMMISSION DOES NOT HAVE A PRECEDENT FOR TREATING CASUALTY DAMAGES OVER A FIVE YEAR AVERAGE PERIOD?

A. NO. IN FACT ON PAGES 18 AND 19 OF MY DIRECT TESTIMONY, FILED ON JULY 2, 1993, I QUOTED THE COMMISSION'S STATEMENT IN SOUTHERN BELL DOCKET NO. 810035-TP WHICH CLEARLY DELINEATES THIS RATEMAKING POLICY. THE COMPANY HAS BEEN FOLLOWING THIS POLICY FOR REPORTING PURPOSES AND THE COMMISSION HAS BEEN MAKING RATESETTING DECISIONS BASED ON THE REPORTED RESULTS FOR WELL OVER TEN YEARS. THIS IS CLEARLY A WELL ESTABLISHED FLORIDA RATEMAKING POLICY.

Q. MR. REID, DO YOU KNOW WHAT EFFECT MR. DE WARD'S PROPOSAL, TO REQUIRE THE COMPANY TO WRITE OFF ALL OF THE COST OF HURRICANE ANDREW IN 1992, WOULD HAVE ON THE COMPANY'S RETURN ON EQUITY?

A. YES. MY UPDATED DIRECT TESTIMONY, FILED ON OCTOBER 1, 1993, HAD AN INTRASTATE ANNUAL AMORTIZATION FOR HURRICANE ANDREW OF $21,796,036. SINCE MR. DE WARD'S PROPOSAL IS TO WRITE OFF THE AMORTIZATION IN 1992, THIS WOULD MEAN RECORDING AN ADDITIONAL $87,184,144 IN 1992 INTRASTATE EXPENSE. HE ALSO PROPOSES A WRITE OFF OF EXTRAORDINARY RETIREMENTS OF COMPANY PLANT DAMAGED IN THE STORM WHICH WOULD INCREASE 1992 INTRASTATE EXPENSE BY AN

ADDITIONAL $19,852,000. BASED ON A CALCULATION THAT 100 BASIS POINTS ON EQUITY IS WORTH APPROXIMATELY $33,000,000 IN INTRASTATE REVENUE REQUIREMENTS, MR. DE WARD'S PROPOSAL WOULD HAVE THE IMPACT OF INCREASING THE COMPANY'S INTRASTATE EXPENSES BY $107,036,144 AND REDUCING ITS RETURN ON EQUITY BY APPROXIMATELY 324 BASIS POINTS. THIS IS TOTALLY INAPPROPRIATE AND A SLAP IN THE FACE TO THE COMPANY AFTER THE EXTENSIVE EFFORTS IT WENT THROUGH TO GET ITS SOUTH FLORIDA CUSTOMERS BACK IN SERVICE. MR. DE WARD'S RECOMMENDED TREATMENT SHOULD BE REJECTED.

2. REALLOCATION OF INSURANCE PROCEEDS BETWEEN FLORIDA AND LOUISIANA

Q. WHAT IS THE NATURE OF MR. DE WARD'S PROPOSED ADJUSTMENT TO REALLOCATE INSURANCE PROCEEDS BETWEEN FLORIDA AND LOUISIANA?

A. THE COMPANY ALLOCATED THE INSURANCE PROCEEDS AND THE INSURANCE DEDUCTIBLE REQUIREMENT BETWEEN FLORIDA AND LOUISIANA BASED ON THE RELATIVE AMOUNT EACH OF THESE TWO STATES HAD PAID TOWARD THE INSURANCE POLICIES. THE COMPANY BELIEVES THIS IS A

FAIR METHODOLOGY IN THAT IT PROVIDES EACH STATE WITH APPROXIMATELY THE SAME RELATIONSHIP BETWEEN POLICY PAYMENTS AND PROCEEDS RECEIVED FOR THIS SPECIFIC CASUALTY OCCURRENCE. MR. DE WARD BELIEVES THAT THE AMOUNT OF THE INSURANCE PAID BY A STATE SHOULD BE IGNORED AND THAT THE PROCEEDS SHOULD BE ALLOCATED BASED ON THE RELATIVE AMOUNT OF DAMAGE SUFFERED IN EACH JURISDICTION.

Q. WHAT SUPPORT DOES MR. DE WARD PROVIDE FOR HIS POSITION?

A. HE PROVIDES NO SUPPORT FOR HIS POSITION OTHER THAN A SIMPLE ANALOGY OF DAMAGE TO A SMALLER BUILDING VERSUS A LARGER BUILDING. HE FAILS TO RECOGNIZE, HOWEVER, THAT IF YOU ARE THE OWNER OF THE LARGER BUILDING AND YOU PAID 80% OF THE COST OF AN INSURANCE POLICY AND THE OWNER OF THE SMALLER BUILDING PAID 20% OF THE COST, YOU WOULD CONSIDER YOUR ENTITLEMENT TO THE PROCEEDS FROM A COMMON DISASTER TO BE REPRESENTATIVE OF THE 80% YOU PAID RELATIVE TO THE 20% THE OWNER OF THE SMALLER BUILDING PAID.

THE COMPANY'S ALLOCATION METHODOLOGY FOR INSURANCE

PROCEEDS ASSOCIATED WITH HURRICANE ANDREW IS REASONABLE. MR. DE WARD'S PROPOSED ADJUSTMENT IS ARBITRARY AND SHOULD BE REJECTED.

E. CORPORATE RE-ENGINEERING COST - FORCE REDUCTIONS

Q. MR. REID, WOULD YOU OUTLINE THE DETAILS OF THE COMPANY'S ANNOUNCED RE-ENGINEERING PLANS AND RELATED RESTRUCTURING CHARGE?

A. YES. BELLSOUTH TELECOMMUNICATIONS, INC., (BST), IS CURRENTLY RE-ENGINEERING 13 OF ITS MAJOR BUSINESS WORK PROCESSES IN ORDER TO PROVIDE BETTER CUSTOMER SERVICE AT LOWER COST. BASED ON BST'S EXPECTATIONS OF THE EFFICIENCIES WHICH WILL BE GAINED THROUGH THESE RE-ENGINEERING EFFORTS, BST HAS ANNOUNCED THAT IT PLANS TO DOWNSIZE ITS WORK FORCE BY APPROXIMATELY 10,200 EMPLOYEES BY THE END OF 1996. RELATED TO THESE RE-ENGINEERING EFFORTS AND THE PLANNED FORCE DOWNSIZING, THE COMPANY WILL REPORT A FOURTH QUARTER 1993 CHARGE OF $1.2 BILLION ON ITS EXTERNAL FINANCIAL STATEMENTS. THIS CHARGE IS BEING REPORTED TO INFORM INVESTORS THAT THE COMPANY ANTICIPATES IT WILL INCUR EXPENSES FROM 1993

THROUGH 1996 OF THIS AMOUNT FOR EMPLOYEE SEPARATION AND RELOCATION COSTS, CONSOLIDATION AND ELIMINATION OF CERTAIN OPERATIONS, CONCEPTUAL DESIGN AND CONSULTING FEES, COMPREHENSIVE SYSTEMS REPLACEMENT, AND OTHER MISCELLANEOUS COSTS RELATED TO THE RE-ENGINEERING EFFORTS.

THE $1.2 BILLION CHARGE WILL BE HANDLED AS AN ADJUSTMENT TO THE CONSOLIDATED RESULTS REPORTED EXTERNALLY BY BST AND BELLSOUTH CORPORATION. THE COMPONENTS OF THIS CHARGE WILL BE RECORDED BY SOUTHERN BELL ON ITS STATE BOOKS IN THE SAME MANNER AND AT THE SAME TIME THE EXPENSES NORMALLY WOULD BE RECORDED ABSENT THIS SPECIAL REQUIREMENT TO NOTIFY INVESTORS OF THE COMPANY'S PLANS. FOR EXAMPLE, EMPLOYEE SEPARATION COSTS ARE NORMALLY RECORDED WHEN THE EMPLOYEE HAS SIGNED AN ACCEPTANCE AGREEMENT UNDER ONE OF THE COMPANY'S FORCE SEPARATION PLANS. INCLUDED IN THE $1.2 BILLION CHARGE ARE ALL OF THE ANTICIPATED FORCE SEPARATIONS COSTS WHICH WILL BE INCURRED BETWEEN 1993 AND THE END OF 1996. HOWEVER, ON THE STATE BOOKS, THESE SEPARATIONS COSTS WILL BE REFLECTED AS THE EMPLOYEES SIGN AGREEMENTS IN EACH OF THE INDIVIDUAL YEARS.

AT THIS TIME, THE COMPANY ANTICIPATES THAT THE COSTS INCURRED IN 1993 AND 1994 ASSOCIATED WITH THE RE-ENGINEERING EFFORTS WILL EXCEED THE SAVINGS DERIVED IN EACH YEAR. BY 1995, AND CONTINUING ONWARD, THE ANNUAL SAVINGS ARE EXPECTED TO BE GREATER THAN THE COSTS INCURRED.

Q. WHAT IS THE DIFFERENCE IN RATEMAKING TREATMENT BETWEEN THE COMPANY'S FILING IN THIS PROCEEDING AND MR. DE WARD'S RECOMMENDATIONS ON THE ISSUE?

A. THE COMPANY IS PROPOSING THAT THE COMMISSION CONTINUE TO REGULATE SOUTHERN BELL UNDER THE INCENTIVE PLAN WHICH WAS ESTABLISHED BY THE COMMISSION IN 1988. THIS PLAN WAS DESIGNED TO GIVE SOUTHERN BELL THE INCENTIVE TO PROVIDE A WIDER ARRAY OF SERVICES AT THE LOWEST POSSIBLE COST TO RATEPAYERS. THE COMPANY HAS IN FACT IMPLEMENTED NEW SERVICES AND REDUCED ITS INTRASTATE COST OF SERVICE IN FLORIDA SINCE THE PLAN WAS ESTABLISHED. THE RE-ENGINEERING EFFORTS I JUST OUTLINED SHOW THAT THE COMPANY IS CONTINUING TO AGGRESSIVELY PURSUE IMPROVED SERVICE AT REDUCED COSTS. THE INCENTIVE PLAN WAS STRUCTURED TO ALLOW SOUTHERN

BELL TO SHARE ONLY INCREASED EARNINGS THAT RESULT FROM THE COMPANY'S EFFORTS. THE INCENTIVE PLAN STRUCTURE ADEQUATELY HANDLES THE COSTS AND SAVINGS ISSUES ASSOCIATED WITH THE COMPANY'S RE-ENGINEERING. SOUTHERN BELL WILL BE INCURRING THE COSTS IN EXPECTATION OF SHARING IN THE SAVINGS WHICH WILL BE DERIVED FROM ITS OWN EFFORTS.

MR. DE WARD ON THE OTHER HAND DISAGREES WITH THE CONCEPTS UNDERLYING THE INCENTIVE PLAN AND RECOMMENDS THAT THE COMMISSION REQUIRE RATE REDUCTIONS FOR ALL OF THE COMPANY'S EXPECTED FUTURE SAVINGS. HIS RECOMMENDATION GOES BEYOND EVEN THE EARNINGS CONSTRAINTS OF TRADITIONAL REGULATION BY SUGGESTING THAT STEP RATE REDUCTIONS BE ORDERED FOR 1995 AND 1996 IN ANTICIPATION OF THE SAVINGS WHICH THE COMPANY CURRENTLY FORECASTS FOR THOSE YEARS.

MR. DE WARD'S POSITION ON THE ISSUE IS CERTAINLY CAPTURED ON PAGE 37 ON HIS TESTIMONY BY THE FOLLOWING STATEMENTS:

> "...I STRONGLY DISAGREE WITH THE ARGUMENT THAT SOMEHOW, INCENTIVE REGULATIONS DRIVES COST SAVINGS... TO ARGUE THAT

WITHOUT INCENTIVE REGULATIONS, THE COMPANY, FOR SOME REASON, WILL NOT ATTEMPT TO KEEP ITS COST IN LINE, OR REDUCE COSTS, DOES NOT MAKE ANY SENSE."

MR. DE WARD'S POSITION FLIES IN THE FACE OF THE COMMISSION'S STATED RATIONALE FOR ESTABLISHING THE INCENTIVE PLAN IN DOCKET NO. 880069-TL. HIS POSITION ALSO DOES NOT AGREE WITH THE INDUSTRY TREND TOWARD INCENTIVE REGULATION ACROSS THE NATION.

Q. WHY DOES THE COMPANY PROPOSE THAT RATES NOT BE RESET TO AN AUTHORIZED RATE OF RETURN IN THIS PROCEEDING?

A. THE COMPANY BELIEVES THAT PROPER INCENTIVES ARE IMPORTANT IN THE REGULATORY ENVIRONMENT. IF THE COMMISSION RESETS RATES IN THIS PROCEEDING TO TAKE AWAY ALL OF THE SAVINGS WHICH HAVE BEEN ACCOMPLISHED UNDER THE INCENTIVE PLAN, AND FUTURE SAVINGS THAT ARE NOW ONLY ANTICIPATED FOR 1995 AND 1996, IT WILL BE ELIMINATING CRITICAL INCENTIVES FROM THE REGULATORY PROCESS. WHEREAS, THIS MAY BE IN LINE WITH THE LOGIC ADVOCATED BY MR. DE WARD, IT

IS CERTAINLY A STEP BACKWARD FROM THE COMMISSION'S POSITION STATED ON PAGE 6 OF ORDER NO. 20162, SOUTHERN BELL DOCKET NO. 880069-TL, WHERE IT SAID:

> "...ONE CAN REASONABLY EXPECT THAT GIVEN THE OPPORTUNITY TO EARN A HIGHER RETURN, EVEN IF IT HAS TO BE SHARED, WILL ENCOURAGE FURTHER INVESTMENTS AND EFFICIENCIES AS WELL AS NEW SERVICES."

THE COMPANY WOULD ENTREAT THE COMMISSION TO MAINTAIN THE INCENTIVES IN THE REGULATORY PROCESS NO MATTER WHAT DECISION IT REACHES IN THIS PROCEEDING. RESETTING RATES TO CAPTURE ALL OF THE COMPANY'S SAVINGS DOES NOT ACCOMPLISH THIS.

Q. IS MR. DE WARD'S PROPOSED ADJUSTMENT BASED ON THE COMPANY'S LATEST ESTIMATES OF ITS RE-ENGINEERING COSTS AND SAVINGS?

A. NO. AS I MENTIONED IN RESPONSE TO OPC WITNESS STEWART'S TESTIMONY, THE COMPANY HAS PROVIDED MORE UP TO DATE DATA REGARDING RE-ENGINEERING COST AND SAVINGS IN RESPONSE TO OPC INTERROGATORY NOS. 1318 AND 1336. BASED ON THE COMPANY'S LATEST

INFORMATION, THERE WOULD ACTUALLY BE AN INCREASE IN NET COST OVER SAVINGS IN 1994 AS COMPARED TO 1993. THE NET COST IN 1993 INCLUDED IN THE COMPANY'S TEST YEAR DATA IS ESTIMATED TO BE APPROXIMATELY $11.7 MILLION. THE CURRENT ESTIMATE OF NET COST IN 1994 FOR FLORIDA IS APPROXIMATELY $35 MILLION.

Q. HOW WOULD THIS NEW DATA IMPACT THE ADJUSTMENT MR. DE WARD IS PROPOSING FOR THIS ISSUE IN 1994?

A. MR. DE WARD WAS ANTICIPATING A REDUCTION OF COST IN 1994 WHEN HE PROPOSED HIS ADJUSTMENT. THE NEW INFORMATION INDICATES THAT INSTEAD, FLORIDA COSTS WILL ACTUALLY INCREASE BY APPROXIMATELY $23.3 MILLION ON A COMBINED BASIS FOR 1994 OVER THE TEST YEAR AMOUNT. HIS ADJUSTMENT IS, THEREFORE, INAPPROPRIATE.

F. <u>MAINTENANCE CHARGES DEFERRED TO 1993 BUDGET</u>

Q. WHAT IS THE ISSUE ASSOCIATED WITH MAINTENANCE CHARGES IN THE COMPANY'S 1993 BUDGET?

A. WHEN THE COMPANY WAS PREPARING ITS COMMITMENT VIEW FOR 1993, ONE OF THE ADJUSTMENTS TO THE VIEW BEFORE

IT WAS FINALIZED WAS AN INCREASE IN ESTIMATED MAINTENANCE EXPENSES OF APPROXIMATELY $24.9 MILLION ON A COMBINED BASIS. MR. DE WARD IS SPECULATING IN HIS TESTIMONY THAT THIS AMOUNT DOES NOT REPRESENT A GOING FORWARD LEVEL OF EXPENSE FOR THE COMPANY AND IS PROPOSING THAT THE TEST YEAR EXPENSE LEVEL BE REDUCED BY THE INTRASTATE PORTION OF THIS AMOUNT.

Q. IS MR. DE WARD CORRECT IN HIS SPECULATION REGARDING THIS ISSUE?

A. NO. THE COMPANY HAS EXPLAINED TO MR. DE WARD THAT THE ADDITION OF THE $24.9 MILLION WAS RELATED TO ONGOING WORK, NOT JUST HURRICANE WORK, AND THAT IT WAS NEEDED BECAUSE THE BUDGET DEVELOPED UP TO THAT POINT WAS OVERLY OPTIMISTIC. THE COMPANY ALSO INFORMED MR. DE WARD THAT IT INTENDED TO ADD ANOTHER 120 EMPLOYEES IN FLORIDA THAT WAS NOT EVEN RECOGNIZED IN THE COMPANY'S ADDITION TO THE BUDGET.

IN ADDITION, I WOULD LIKE TO POINT OUT THAT MR. DE WARD DID NOT INCLUDE THE COMPANY'S COMPLETE RESPONSE TO OPC INTERROGATORY 850 IN HIS TESTIMONY. HE EXTRACTED ONLY PART OF A PARAGRAPH AND THE PART HE OMITTED CONTAINED FURTHER EXPLANATION. THE FULL

PARAGRAPH READS:

"THE 1993 PLANNING BUDGET FOR PLANT LABOR ASSUMED AGGRESSIVE FORCE AND TECHNOLOGICAL SAVINGS WHICH DID NOT MATERIALIZE. AS A RESULT OF HURRICANE ANDREW, WORK ACTIVITIES PLANNED IN 1992 TO IMPROVE THE TROUBLE REPORT RATE WERE DEFERRED; THEREFORE NOT ACHIEVING THE FORCE AND TECHNOLOGICAL SAVINGS FOR 1993 AND BEYOND. IN REVIEWING THE 1993 BUDGET, IT WAS DETERMINED THAT AN ADDITIONAL $24.9M WAS REQUIRED FOR PLANT LABOR. IN FACT, SERVICE REQUIREMENTS HAVE NECESSITATED AN INCREASE IN THE PERMANENT WORK FORCE DURING 1993 ABOVE THAT FUNDED BY THE $24.9M, WHICH IS NOT IN THE SAME FORECAST. ACCOUNT 6421 RECEIVED $3.3M OF THE $24.9M" (RESPONSE TO OPC INTERROGATORY 850, PAGE 3 OF 5)

IT IS CLEAR THAT THE COMPANY HAS EXPLAINED THAT ITS 1993 LEVEL OF FORECASTED COSTS REPRESENTS AN ONGOING LEVEL OF EXPENSE APPROPRIATE FOR THE TEST YEAR. THE COMPANY HAS INCLUDED AN ADJUSTMENT FOR

COST SAVINGS IN THE STUDY PERFORMED BY COMPANY WITNESS JOHN MCCLELLAN BASED ON THE COMPANY'S HISTORICAL ACHIEVEMENTS FOR 1989 THROUGH 1992. IT IS, THEREFORE, INAPPROPRIATE TO REMOVE THIS COMPONENT OF THE COMPANY'S 1993 FORECASTED EXPENSE LEVEL.

Q. MR. DE WARD LEAVES THE IMPRESSION IN HIS TESTIMONY THAT THERE MAY BE SOMETHING SINISTER IN THE COMPANY'S TIMING OF FORCE REDUCTIONS FOLLOWING RATE PROCEEDINGS. WHAT IS THE COMPANY'S RESPONSE TO THIS?

A. COMPANY WITNESS JERRY SANDERS ADDRESSES THIS ISSUE IN HIS TESTIMONY, BUT I WOULD LIKE TO POINT OUT THAT IT IS JUST ANOTHER EXAMPLE OF MR. DE WARD INACCURATELY SPECULATING ON ISSUES AND DRAWING INVALID CONCLUSIONS. AS MR. SANDERS POINTS OUT, THE FLUCTUATIONS IN THE DATA FOR REPAIR FORCES IS DUE TO RECLASSIFICATIONS OF PERSONNEL JOB FUNCTION CODES AND NOT DUE TO ANY SINISTER PLOT ON THE PART OF THE COMPANY.

G. INCENTIVE COMPENSATION

Q. DOES THE COMPANY HAVE INCENTIVE COMPENSATION PLANS FOR ITS EMPLOYEES?

A. YES. A PORTION OF THE SALARIES FOR MOST OF THE COMPANY'S EMPLOYEES ARE "AT RISK" UNDER INCENTIVE COMPENSATION PLANS. THE PRIMARY INCENTIVE COMPENSATION PLANS ARE THE TEAM EXCELLENCE AWARD FOR MANAGERS (TEAM) AND THE NON-MANAGEMENT TEAM INCENTIVE AWARD PLAN (NTIA).

Q. HOW DOES MR. DE WARD'S TREATMENT OF THE COST FOR THESE PLANS IN THE TEST YEAR DIFFER FROM YOUR PROPOSED TREATMENT?

A. SINCE I HAVE USED THE COMPANY'S COMMITMENT VIEW FORECAST FOR 1993 AS THE STARTING POINT FOR MY ADJUSTED TEST YEAR DATA, TEST YEAR EXPENSES INHERENTLY CONTAIN AMOUNTS FOR INCENTIVE COMPENSATION PAYMENTS. MR. DE WARD PROPOSES TO REDUCE THE LEVEL OF ALLOWABLE INCENTIVE COMPENSATION EXPENSE BY 50%. HE ATTRIBUTES HALF OF HIS PROPOSED DISALLOWANCE TO AN OVERSTATED BUDGET LEVEL AND THE OTHER HALF TO SOME FORM OF SHARING HE WANTS TO INSTITUTE BETWEEN THE RATEPAYER AND THE SHAREHOLDER.

Q. HOW DOES THE COMPANY BUDGET FOR COSTS SUCH AS THOSE FOR EMPLOYEE INCENTIVE COMPENSATION PAYMENTS?

A. IN THE COMPANY'S ASSUMPTION LETTER FOR THE BUDGET, IT INSTRUCTS THE VARIOUS DEPARTMENTAL ORGANIZATIONS REGARDING THE APPROPRIATE INCENTIVE COMPENSATION PAYOUT ASSUMPTION TO MAKE WHEN THEY ARE PREPARING THEIR DEPARTMENT'S BUDGET. AFTER THE BUDGETS ARE PREPARED ON A BOTTOMS UP BASIS BY THE VARIOUS DEPARTMENTS, THE COMPANY GOES THROUGH A PROCESS OF "TOPS DOWN, BOTTOMS UP" BUDGET NEGOTIATION BEFORE THE FINAL COMMITMENT BUDGET IS RESOLVED. BUDGET TOTALS FOR DEPARTMENTAL ORGANIZATIONS ARE ESTABLISHED IN THIS PROCESS AND FINANCIAL STATEMENTS BY FUNCTIONAL CATEGORY ARE PREPARED, BUT DETAILS, SUCH AS THE AMOUNT OF INCENTIVE COMPENSATION PAYMENTS INCLUDED IN THE FINAL NUMBERS, ARE NOT MAINTAINED.

Q. HOW DOES THE COMPANY KNOW IT HAS THE RIGHT LEVEL OF INCENTIVE COMPENSATION IN THE BUDGET IF IT DOESN'T SPECIFICALLY TRACK THE AMOUNT THROUGH THE PROCESS?

A. THE COMPANY'S FOCUS IN THE PROCESS OF ESTABLISHING

ITS BUDGET IS TO SET DEPARTMENTAL AND COMPANY EXPENSE TARGETS THAT ARE CHALLENGING TO ITS EMPLOYEES YET REASONABLE IN LIGHT OF ANTICIPATED WORK VOLUMES. THE ASSUMPTIONS WHICH INITIATE THE COMPANY'S VIEW ARE A TOOL TOWARD REACHING THE FINAL PRODUCT, BUT THE FINAL EXPENSE LEVELS ARE DETERMINED BASED ON THE NEGOTIATED TOPS DOWN, BOTTOMS UP PROCESS AND MANAGERS ARE EXPECTED TO STRIVE TOWARD MEETING THEIR SERVICE OBJECTIVES WITHIN THE BUDGETARY CONSTRAINTS. AS LONG AS THE OVERALL EXPENSE OBJECTIVES ARE REASONABLE, DETAILS SUCH AS THE THEORETICAL AMOUNT OF INCENTIVE COMPENSATION EMBEDDED IN THE BUDGET ARE NOT TRACKED. HOWEVER, EXPENSE MISSES BY ORGANIZATION ARE TRACKED AND EXPLAINED EACH MONTH. AS I NOTED IN MY DIRECT TESTIMONY UPDATE FILED ON OCTOBER 1, 1993, THE COMPANY IS ON TARGET WITH ITS EXPENSE FORECAST THROUGH JUNE CONSIDERING THE KNOWN REASONS FOR EXPENSE OVERRUNS.

Q. WHAT JUSTIFICATION DOES MR. DE WARD GIVE FOR HIS RECOMMENDATION TO DISALLOW 25% OF THE COMPANY'S INCENTIVE COMPENSATION AS A WAY OF SHARING THE COST BETWEEN THE RATEPAYER AND THE SHAREHOLDER?

A. HIS PROPOSED DISALLOWANCE APPEARS TO BE BASED ON HIS OPINION THAT THE COMPANY COULD FILL ITS EMPLOYEE POSITIONS AT LOWER COMPENSATION LEVELS BY HIRING INDIVIDUALS FROM A QUALIFIED POOL OF UNEMPLOYED PEOPLE WHICH HE SPECULATES EXISTS IN THE MARKETPLACE.

Q. DID MR. DE WARD PROVIDE ANY STUDIES TO SUPPORT HIS SPECULATIONS?

A. NO.

Q. ARE THERE ANY STUDIES WHICH INDICATE THAT THE COMPANY'S LEVEL OF COMPENSATION IS REASONABLE?

A. YES. THE FLORIDA PUBLIC SERVICE COMMISSION'S BUREAU OF REGULATORY REVIEW RELEASED A REPORT ON NOVEMBER 16, 1993 ENTITLED "EXECUTIVE COMPENSATION REVIEW OF EIGHT FLORIDA UTILITIES". THIS REVIEW INCLUDED SOUTHERN BELL AMONG THE COMPANIES STUDIED. THE OVERALL OPINION OF THE REVIEW IS STATED AS FOLLOWS:

> "IT IS OUR OVERALL OPINION THAT THE DIFFERENT POLICIES, PROCEDURES, AND

PROCESSES USED TO SET EXECUTIVE COMPENSATION BY EACH OF THE UTILITIES INCLUDED IN THIS REVIEW ARE APPROPRIATE GIVEN THE UTILITY'S SIZE AND CORPORATE CULTURE. IN ADDITION, WHILE EACH OF THE COMPENSATION PROCESSES WERE SIMILAR AND VARIED ONLY IN GENERAL STRATEGY AND DESIGN, IT IS OUR OPINION THAT EACH SYSTEM SHOULD LEAD TO THE OFFERING OF COMPENSATION PACKAGES AND SALARY LEVELS WHICH ARE REASONABLE. REASONABLENESS, AS USED IN THIS OPINION, MEANS A PROCESS OR SYSTEM SUPPORTED BY CURRENT MARKET INFORMATION THAT PRODUCES COMPENSATION PACKAGES AND SALARIES WHICH ARE COMPARABLE TO THOSE OFFERED OR RECEIVED BY OTHER EXECUTIVES IN SIMILAR CIRCUMSTANCES AND JOB RESPONSIBILITIES."

IN ADDITION, MR. EDWARD L. DELAHANTY OF HEWITT ASSOCIATES HAS PRESENTED TESTIMONY IN THIS PROCEEDING WHICH SUPPORTS THE REASONABLENESS OF THE COMPANY'S COMPENSATION PACKAGES. MR. DE WARD IS INCORRECT ON THIS ISSUE AND HIS RECOMMENDATION SHOULD BE REJECTED.

H. PENSION EXPENSE

Q. IS THE COMPANY FOLLOWING APPROPRIATE ACCOUNTING PROCEDURES AND COMMISSION ORDERS RELATED TO ITS RECORDING OF PENSION EXPENSE FOR THE TEST YEAR?

A. YES. THE COMPANY IS FOLLOWING THE GUIDELINES OF SFAS 87, EMPLOYERS' ACCOUNTING FOR PENSIONS, TO RECORD ITS PENSION EXPENSE. SFAS 87 IS THE APPLICABLE GAAP FOR RECORDING THE FINANCIAL IMPACTS ASSOCIATED WITH BELLSOUTH'S PENSION PLAN AND THE FLORIDA COMMISSION HAS RECOGNIZED THE APPROPRIATENESS OF SFAS 87 IN ITS ORDER NO. 23005 OF DOCKET NO. 881170-PU, ISSUED MAY 30, 1990.

Q. WHY THEN, IS MR. DE WARD PROPOSING A DISALLOWANCE OF THE COMPANY'S PENSION EXPENSE?

A. MR. DE WARD SPECULATES THAT THE COMPANY CAN CHANGE THE ASSUMPTIONS UNDERLYING ITS PENSION EXPENSE CALCULATIONS UNDER SFAS 87 AND EFFECTIVELY ELIMINATE ANY RECORDING OF PENSION EXPENSE. HE IS AWARE THROUGH PRODUCTION OF DOCUMENT REQUESTS THAT THE COMPANY HAS BEEN COMMUNICATING WITH ITS ACTUARY

CONCERNING THE IMPACTS ON THE PENSION PLAN RESULTING FROM THE COMPANY'S DOWNSIZING EFFORTS AND POSSIBLE CHANGES IN SFAS 87 RELATED ASSUMPTIONS. HIS CONCLUSION, HOWEVER, IS NOT BASED ON SPECIFIC PLANS OF THE COMPANY TO CHANGE ASSUMPTIONS AND RECORD ZERO PENSION EXPENSE. HE PROVIDES NO SPECIFIC ASSUMPTION CHANGES OR CALCULATIONS WHICH WOULD JUSTIFY A DISALLOWANCE OF THE COMPANY'S PENSION EXPENSE WHICH IS CALCULATED IN ACCORDANCE WITH SFAS 87. HE MERELY SPECULATES THAT ZERO EXPENSE IS APPROPRIATE.

Q. IS MR. DE WARD CORRECT THAT AS OF THE END OF 1992, THE ASSETS IN THE COMPANY'S PENSION TRUST EXCEEDED THE ACCUMULATED BENEFIT OBLIGATION (ABO) BY OVER $1.63 BILLION?

A. YES. THE NOTES TO THE 1992 CONSOLIDATED FINANCIAL STATEMENTS OF BELLSOUTH INDICATE THIS FACT. HOWEVER, I WOULD CAUTION ANYONE FROM DRAWING ANY FINAL CONCLUSIONS FROM THIS STATISTIC. A REVIEW OF THE NOTES TO BELLSOUTH'S FINANCIAL STATEMENTS FROM 1988 THROUGH 1992 SHOW THAT IN 1989 THE ASSETS IN THE TRUST EXCEEDED THE ABO BY APPROXIMATELY $2.1 BILLION AND A YEAR LATER IN 1990 THIS AMOUNT

DROPPED TO ONLY $1.1 BILLION. OBVIOUSLY, THE VOLATILITY OF MARKET VALUE OF THE ASSETS IN THE TRUST CAN CAUSE A DRAMATIC CHANGE IN THIS AMOUNT.

Q. DO SOME OF THE SCENARIOS OF PENSION PLAN EXPENSE, WHICH HAVE BEEN RUN BY THE COMPANY'S ACTUARY, SHOW NEGATIVE PENSION PLAN EXPENSE IN THE NEAR FUTURE AS REPORTED BY MR. DE WARD?

A. NO. UNDER CERTAIN SCENARIOS THE MANAGEMENT PENSION PLAN CALCULATIONS DID INDICATE A NEGATIVE EXPENSE POSITION, BUT NONE OF THE SCENARIOS SHOW NEGATIVE OR ZERO PENSION EXPENSE FOR THE TOTAL OF BOTH MANAGEMENT AND NON-MANAGEMENT PENSION PLANS. IT IS ALSO IMPORTANT TO NOTE THAT THESE SCENARIOS WERE RUN WITHOUT FULL CONSIDERATION OF THE SECURITIES AND EXCHANGE COMMISSION'S (SEC) RECENT REMARKS CONCERNING THEIR INTERPRETATION OF THE APPROPRIATE DISCOUNT RATES FOR PURPOSES OF MEASURING PENSION EXPENSE.

THE SEC STAFF HAS RECENTLY QUESTIONED A REGISTRANT CONCERNING THAT REGISTRANT'S SELECTION OF DISCOUNT RATES FOR PURPOSES OF MEASURING ITS DEFINED BENEFIT PENSION OBLIGATION UNDER SFAS 87. THE SEC STAFF

HAS INDICATED THAT IT EXPECTS REGISTRANTS TO USE DISCOUNT RATES TO MEASURE OBLIGATIONS FOR PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (OPRB) THAT REFLECT THE CURRENT LEVEL OF INTEREST RATES AT THE NEXT MEASUREMENT DATE. IF BELLSOUTH DETERMINES THAT LOWER DISCOUNT RATES FOR PENSIONS AND OPRB ARE NECESSARY, THIS WILL SIGNIFICANTLY INCREASE THE LEVEL OF PENSION AND OPRB EXPENSE IT MUST RECORD.

Q. WHAT FACTORS ARE BEING CONSIDERED BY THE COMPANY TO DETERMINE THE APPROPRIATE ASSUMPTIONS FOR USE IN CALCULATING ITS PENSION EXPENSE UNDER SFAS 87 AND ITS OPRB EXPENSE UNDER SFAS 106?

A. THE COMPANY RECEIVES SIGNIFICANT GUIDANCE IN ITS CHOICE OF ASSUMPTIONS FROM VARIOUS AUTHORITATIVE SOURCES. AS I MENTIONED, THE SEC HAS RECENTLY EXERCISED ITS AUTHORITY IN REGARDS TO THE DISCOUNT RATE ASSUMPTION SELECTED BY COMPANIES. IN ADDITION THE COMPANY MUST SATISFY ITS EXTERNAL AUDITORS THAT ITS SELECTION OF ASSUMPTIONS IS CONSISTENT WITH THE GUIDANCE PROVIDED BY SFAS 87 AND GAAP. FURTHER, THE COMPANY'S OUTSIDE ACTUARIAL FIRM PROVIDES SIGNIFICANT INPUT AS TO THE APPROPRIATE ASSUMPTIONS

TO USE BASED ON STUDIES PERFORMED BY THIS FIRM. THE COMPANY IS OBVIOUSLY NOT ALLOWED TO SIMPLY CHOOSE A SET OF ASSUMPTIONS THAT WILL YIELD ZERO EXPENSE AS MIGHT BE IMPLIED BY MR. DE WARD'S PROPOSAL.

Q. HAS THE COMPANY REACHED DEFINITIVE PLANS REGARDING ANY CHANGES TO ITS ASSUMPTIONS UNDERLYING SFAS 87 OR SFAS 106?

A. NO. AT THIS TIME THE COMPANY IS STILL RECEIVING ADVICE FROM ITS EXTERNAL AUDITOR AND ACTUARIAL FIRM REGARDING THE APPROPRIATE SELECTION OF ASSUMPTIONS.

Q. SHOULD MR. DE WARD'S RECOMMENDATION ON PENSION EXPENSE BE ACCEPTED?

A. NO. THE COMMISSION HAS APPROPRIATELY ADOPTED SFAS 87 FOR RATEMAKING PURPOSES. THE COMPANY IS COMPLYING WITH SFAS 87 TO RECORD ITS PENSION EXPENSES. MR. DE WARD'S CONJECTURE THAT ZERO PENSION EXPENSE CAN SOMEHOW BE ACHIEVED IS NOT BASED ON FACTS AND SHOULD BE REJECTED.

I. EMPLOYEE BENEFITS

1. <u>CONCESSION REVENUES</u>

Q. DOES THE COMPANY PROVIDE ITS EMPLOYEES CERTAIN CONCESSION BENEFITS ON THE SERVICES IT PROVIDES?

A. YES. THE PROVISION OF EMPLOYEE CONCESSION BENEFITS IS A LONG STANDING PRACTICE IN THE TELEPHONE INDUSTRY. IN FACT, THE COMMUNICATIONS ACT OF 1934, SECTION 210 INCLUDED THE FOLLOWING STATEMENT RELATED TO CONCESSION:

> "NOTHING IN THIS ACT OR IN ANY OTHER PROVISION OF LAW SHALL BE CONSTRUED TO PROHIBIT COMMON CARRIERS FROM ISSUING OR GIVING FRANKS TO, OR EXCHANGING FRANKS WITH EACH OTHER FOR THE USE OF, THEIR OFFICERS, AGENTS, EMPLOYEES, AND THEIR FAMILIES, OR SUBJECT TO SUCH RULES AS THE COMMISSION MAY PRESCRIBE, FROM ISSUING, GIVING, OR EXCHANGING FRANKS AND PASSES TO OR WITH OTHER COMMON CARRIERS NOT SUBJECT TO THE PROVISIONS OF THIS ACT, FOR THE USE OF THEIR OFFICERS, AGENTS, EMPLOYEES, AND THEIR FAMILIES. THE

TERM "EMPLOYEES", AS USED IN THIS SECTION, SHALL INCLUDE FURLOUGHED, PENSIONED, AND SUPERANNUATED EMPLOYEES."

Q. HAS THIS COMMISSION PREVIOUSLY ALLOWED THE COMPANY'S EMPLOYEE CONCESSIONS?

A. YES. TO MY KNOWLEDGE THE COMMISSION HAS ALWAYS ALLOWED THE COMPANY TO PROVIDE ITS EMPLOYEES WITH CONCESSIONS. SOUTHERN BELL'S GENERAL SUBSCRIBER SERVICE TARIFF SECTION A2.3.20 SPECIFICALLY PROVIDES FOR THE EMPLOYEE CONCESSIONS WHICH ARE PROVIDED. NO PREVIOUS DISALLOWANCE HAS BEEN MADE.

Q. WHAT IS THE BASIS MR. DE WARD GIVES FOR HIS RECOMMENDATION THAT THE COMMISSION SHOULD CHANGE ITS PAST PRACTICE REGARDING CONCESSIONS?

A. MR. DE WARD IS BASING HIS RECOMMENDATION ON HIS OPINION THAT THE COMPANY'S BENEFITS ARE ADEQUATE, IF NOT EXCESSIVE, WITHOUT THE EMPLOYEE CONCESSIONS. HE GOES ON IN HIS TESTIMONY TO QUESTION THE COMPANY'S TREATMENT OF ITS CONCESSIONS AS A NON-TAXABLE BENEFIT, PRESUMABLY BECAUSE THE TAX TREATMENT IS ONE OF THE ECONOMICAL ADVANTAGES TO

THIS BENEFIT.

Q. DOES THE COMPANY HAVE EVIDENCE THAT MR. DE WARD'S OPINIONS ARE INACCURATE?

A. YES. AS I STATED PREVIOUSLY, MR. DELAHANTY OF HEWITT ASSOCIATES HAS PRESENTED TESTIMONY IN THIS DOCKET WHICH SUPPORTS THE REASONABLENESS OF THE COMPANY'S EMPLOYEE COMPENSATION.

REGARDING THE TAX TREATMENT OF CONCESSIONS, THE COMPANY BELIEVES IT HAS A SOUND BASIS FOR TREATING THIS AS NON-TAXABLE. THE COMPANY HAS CONSISTENTLY APPLIED THIS TAX TREATMENT FOR MANY YEARS.

Q. WHAT IS YOUR RESPONSE TO HIS ALTERNATIVE RECOMMENDATION TO ALLOCATE A PORTION OF THE CONCESSION BENEFIT TO THE INTERSTATE JURISDICTION?

A. I DO NOT BELIEVE THAT HIS PROPOSED ALTERNATIVE RECOMMENDATION IS APPROPRIATE. IN ESSENCE IT IS A PROPOSAL TO DISALLOW A PORTION OF THE CONCESSION AMOUNT, SINCE THE COMPANY WOULD HAVE NO WAY OF RECOVERING THE AMOUNT ASSIGNED TO THE INTERSTATE JURISDICTION. HOWEVER, IF THE COMMISSION FOLLOWED

THIS APPROACH, THEORETICAL CONSISTENCY WOULD REQUIRE THAT A PORTION OF THE INTERSTATE CONCESSIONS WHICH ARE ALLOWED BY THE FCC ON THE INTERSTATE CALC SHOULD BE ASSIGNED TO THE INTRASTATE JURISDICTION. MR. DE WARD DID NOT INCLUDE THIS CONSIDERATION IN HIS PROPOSED ALTERNATIVE DISALLOWANCE.

2. <u>SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN (SERP)</u>

Q. WHAT IS YOUR RESPONSE TO MR. DE WARD'S PROPOSED DISALLOWANCE FOR THE COMPANY'S SERP EXPENSES?

A. MR. DE WARD'S REASONING FOR THIS DISALLOWANCE AGAIN SEEMS TO BE HIS OPINION THAT THE COMPANY'S BENEFITS, IN THIS CASE PENSION BENEFITS, ARE ADEQUATE WITHOUT SERP. CONTRARY TO HIS ASSERTION, THE COMPANY HAS PRESENTED TESTIMONY OF THE HEWITT COMPANY IN THIS PROCEEDING SUPPORTING THE REASONABLENESS OF ITS COMPENSATION, AND AS I MENTIONED IN RESPONSE TO HIS PROPOSED DISALLOWANCE OF THE COMPANY'S INCENTIVE COMPENSATION PAYMENTS, THE COMMISSION'S BUREAU OF REGULATORY REVIEW HAS RECENTLY RELEASED A REPORT FINDING THAT THE COMPANY'S COMPENSATION SYSTEM SHOULD LEAD TO A

REASONABLE RESULT.

MR. DE WARD'S PROPOSED DISALLOWANCE OF SERP COST SHOULD BE REJECTED.

J. <u>SFAS 106</u>

Q. WHAT IS MR. DE WARD ADVOCATING IN REGARD TO SOUTHERN BELL'S TREATMENT OF POSTRETIREMENT BENEFITS UNDER SFAS 106?

A. MR. DE WARD IS RECOMMENDING THAT THE COMMISSION REQUIRE THE COMPANY TO RECALCULATE THE TRANSITION BENEFIT OBLIGATION (TBO) TO INCLUDE THE REIMBURSEMENTS WHICH THE COMPANY RECEIVES FROM AT&T FOR THOSE EMPLOYEES WHO RETIRED PRIOR TO DIVESTITURE. HE CLAIMS THAT THE COMPANY'S COSTS WOULD BE LESS IF THIS HAD BEEN TAKEN INTO ACCOUNT.

Q. DO YOU AGREE WITH MR. DE WARD'S RECOMMENDATION?

A. NO. IN THE COMPANY'S RESPONSE TO OPC 44TH INTERROGATORIES ITEM NO. 1130, THE COMPANY POINTED OUT THAT THE RECEIVABLE THAT WOULD BE CREATED BY THE CALCULATION HE PROPOSES DOES NOT MEET THE

DEFINITION OF AN ASSET UNDER SFAS 106. IN ADDITION, THE COMPANY BELIEVES THAT THE OBLIGATION FOR BENEFIT REIMBURSEMENT TO THE EMPLOYEES WHO RETIRED FROM SOUTHERN BELL OR SOUTH CENTRAL BELL PRIOR TO DIVESTITURE IS THE DIRECT OBLIGATION OF THE COMPANY. UNDER DIVESTITURE AGREEMENTS CERTAIN AMOUNTS ARE PAID TO THE COMPANY BY AT&T, BUT THE OBLIGATION TO THE RETIREE REMAINS WITH BELLSOUTH. THEREFORE, IT WOULD NOT BE APPROPRIATE UNDER GAAP TO RECALCULATE SFAS 106 AMOUNTS IN THE MANNER HE PROPOSES.

THE COMPANY'S CALCULATION OF SFAS 106 EXPENSE ACCURATELY REPORTS THE EFFECTS OF THE COMPANY'S OBLIGATIONS FOR EMPLOYEE OR RETIREE POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND THE EFFECTS OF THE COMPANY'S ASSETS WHICH HAVE BEEN SPECIFICALLY DESIGNATED FOR MEETING THESE OBLIGATIONS. THE COMPANY APPROPRIATELY RECOGNIZES PAYMENTS MADE BY AT&T TO BELLSOUTH PER THE DIVESTITURE AGREEMENTS IN THE CALENDAR YEAR TO WHICH THE PAYMENTS ARE APPLICABLE AND INCLUDES AMOUNTS FOR THIS IN ITS FORECASTS.

K. <u>COMPANY PROPOSED PRO FORMA ADJUSTMENTS</u>

1. BOND REFINANCING COSTS

Q. IS MR. DE WARD CORRECT THAT RATEPAYERS WILL RECEIVE NONE OF THE BENEFITS FROM THE COMPANY'S REFINANCINGS IF THE COMPANY'S PROPOSED TREATMENT FOR BOND REFINANCING COSTS IS ACCEPTED?

A. NO. THE COMPANY'S PROPOSAL REGARDING BOND REFINANCING COST IS TO INCLUDE THEM IN THE INCENTIVE PLAN "BOX" CALCULATION AS DISCUSSED IN MY DIRECT TESTIMONY. THIS PROCEDURE HAS BEEN FOLLOWED FOR SEVERAL ISSUES DURING THE COURSE OF THE INCENTIVE PLAN AND IT EQUITABLY BALANCES THE INTEREST OF THE RATEPAYER AND THE COMPANY. BASICALLY, THE BOX CALCULATION QUANTIFIES BOTH POSITIVE AND NEGATIVE IMPACTS TO THE COMPANY'S COST OF SERVICE WHICH ARE ORIGINATING FROM EXOGENOUS SOURCES AND NETS THE AMOUNTS. IF THE EXOGENOUS EFFECTS NET TO A LOWER COST OF SERVICE IMPACT, THE COMMISSION DETERMINES THE APPROPRIATE MANNER TO RETURN THIS NET BENEFIT TO CUSTOMERS.

IN THE CASE OF THE BOND REFINANCINGS, THE COMPANY HAS INCURRED SIGNIFICANT UP FRONT CASH EXPENSES IN

ORDER TO ACHIEVE THE LOWER DEBT COSTS WHICH ARE CURRENTLY AVAILABLE. THE COMPANY IS INCLUDING THE INTEREST SAVINGS IN THE BOX CALCULATION AND IS PROPOSING THAT THE UP FRONT CASH REQUIREMENTS TO ACHIEVE THESE INTEREST SAVINGS ALSO BE INCLUDED SO THAT THE COMPANY CAN RECOVER THESE COSTS IN A REASONABLE PERIOD OF TIME. SINCE THE COMPANY IS NOT RECEIVING A RATE OF RETURN ON ANY UNRECOVERED BALANCE OF BOND REFINANCING COSTS, TO SPREAD THE RECOVERY OVER A LONG PERIOD, SUCH AS 30 YEARS, IS A DISINCENTIVE FOR THE COMPANY TO ENTER INTO SUCH REFINANCINGS AND IS NOT EQUITABLE TREATMENT. AFTER THE BOND REFINANCING COSTS ARE RECOVERED, THE INTEREST SAVINGS WILL STILL BE IN THE BOX, REFLECTING A SAVINGS IN COST OF SERVICE WHICH WILL EITHER BE RETURNED TO THE RATEPAYERS AS DEEMED APPROPRIATE BY THE COMMISSION OR WILL BE USED TO OFFSET YET UNKNOWN EXOGENOUS COST OF SERVICE INCREASES WHICH MAY ARISE.

THE COMPANY'S PROPOSED TREATMENT FOR BOND REFINANCING COSTS IS EQUITABLE. MR. DE WARD'S PROPOSAL IS NOT EQUITABLE AND SHOULD BE REJECTED.

2. <u>CASUALTY DAMAGE RESERVE ACCRUAL</u>

Q. MR. REID, REGARDING THE COMPANY'S PROPOSAL TO ESTABLISH A CASUALTY DAMAGE RESERVE FOR FLORIDA, HOW DO YOU RESPOND TO MR. DE WARD'S CONTENTION THAT GAAP DOES NOT PROVIDE FOR SUCH AN ACCRUAL?

A. AS I HAVE PREVIOUSLY STATED, SFAS 71 PROVIDES GUIDANCE FOR SITUATIONS WHERE A REGULATOR INCLUDES COSTS IN A PERIOD OTHER THAN THE PERIOD IN WHICH THE COSTS ARE INCURRED. THIS COMMISSION CERTAINLY HAS THE AUTHORITY TO ESTABLISH A CASUALTY DAMAGE RESERVE FOR FLORIDA RATEMAKING. IN FACT, THE COMMISSION HAS ALREADY ORDERED SUCH A RESERVE IN THE CASE OF FLORIDA POWER & LIGHT IN ORDER NO. PSC-93-0918-FOF-EI OF DOCKET NO. 930405-EI DATED JUNE 17, 1993. THE COMMISSION'S DECISION ON THIS ISSUE SHOULD BE MADE BASED ON THE MERITS OF PROPER PLANNING FOR CATASTROPHIC EVENTS SUCH AS HURRICANE ANDREW, NOT ON THE EXCUSE THAT IT MAY NOT BE PROVIDED FOR BY A SPECIFIC GAAP PROVISION.

Q. WHAT IS YOUR RESPONSE TO MR. DE WARD'S CRITICISM THAT THE ESTABLISHMENT OF A CASUALTY RESERVE LEAVES MANY UNANSWERED QUESTIONS?

A. THE COMPANY'S INTENT IN PROPOSING THE CASUALTY DAMAGE RESERVE IS TO COVER CATASTROPHIC LOSSES, PRIMARILY TO ITS OUTSIDE PLANT INVESTMENTS. THE INSURANCE MARKET FOR COVERAGE OF DAMAGE LOSSES TO THIS TYPE OF PLANT HAS VIRTUALLY DRIED UP AT THE PRESENT TIME DUE TO THE SIGNIFICANT CALAMITIES WHICH HAVE OCCURRED AROUND THE WORLD. THE INSURANCE WHICH THE COMPANY CAN OBTAIN FOR OUTSIDE PLANT INVESTMENTS PROVIDES VERY LIMITED PROTECTION AT A RATHER STEEP PRICE. BEFORE HURRICANE ANDREW, THE COMPANY HAD $70 MILLION OF INSURANCE, (WHICH COVERED OUTSIDE PLANT INVESTMENTS), WITH A $10 MILLION DEDUCTIBLE AND AN ANNUAL COST OF APPROXIMATELY $3 MILLION. AFTER HURRICANE ANDREW, THE COMPANY WAS ONLY ABLE TO NEGOTIATE $20 MILLION OF THIS TYPE INSURANCE WITH A $20 MILLION DEDUCTIBLE AND AN ANNUAL COST OF $5 MILLION. THIS POLICY HAS TO BE RENEWED IN EARLY 1994 AND THE MARKET FOR THIS TYPE OF INSURANCE IS NOT IMPROVING.

THE COMPANY BELIEVES THAT GIVEN THE CIRCUMSTANCES, IT MAKES COMMON SENSE TO SET ASIDE AMOUNTS FOR THE EVENTUALITY OF HURRICANES OR OTHER CATASTROPHES IN FLORIDA. THE COMPANY IS CERTAINLY WILLING TO WORK WITH THE COMMISSION TO ESTABLISH GUIDELINES WHICH

WILL BALANCE THE RATEPAYERS' AND SHAREHOLDERS' INTERESTS REGARDING THIS ISSUE. SINCE THE COMMISSION HAS ALREADY ESTABLISHED CASUALTY DAMAGE RESERVES FOR OTHER COMPANIES, THIS SHOULD NOT BE A PROBLEM.

MR. DE WARD'S RESERVATIONS CONCERNING A CASUALTY DAMAGE RESERVE ARE NOT A SOUND BASIS FOR REJECTING THE COMPANY'S PROPOSAL ON THIS ISSUE.

3. EXTRAORDINARY RETIREMENT EXPENSE

Q. WHAT CLAIMS DOES MR. DE WARD MAKE IN HIS RECOMMENDATION THAT THE COMMISSION REJECT THE COMPANY'S PROPOSED TREATMENT FOR HURRICANE ANDREW RELATED EXTRAORDINARY RETIREMENTS?

A. MR. DE WARD CLAIMS THE FOLLOWING: 1) THE COMPANY'S PROPOSAL TREATS THE EXPENSE AS A PERMANENT ADDITION TO RATES EVEN THOUGH THE RETIREMENT IS A ONE-TIME EVENT; 2) UNDER GAAP, THE COMPANY SHOULD HAVE WRITTEN OFF THE EXPENSE IN 1992; 3) HIS PROPOSAL IS NOT RETROACTIVE RATEMAKING; AND 4) THE COMPANY WOULD HAVE EARNED NEAR ITS FLOOR IN 1992 EVEN WITH THIS CHARGE.

Q. HOW DO YOU RESPOND TO THESE CLAIMS?

A. THE COMPANY'S PROPOSAL IN NO WAY ATTEMPTS TO MAKE THE RECOVERY OF THIS EXPENSE A PERMANENT ADDITION TO RATES. I HAVE PREVIOUSLY EXPLAINED, IN RESPONDING TO MR. DE WARD'S RECOMMENDATION FOR BOND REFINANCING EXPENSES, HOW THE "BOX" CALCULATIONS HAVE BEEN USED UNDER THE INCENTIVE PLAN TO BALANCE THE EFFECTS OF POSITIVE AND NEGATIVE IMPACTS ON THE COMPANY'S COST OF SERVICE. THE COMPANY'S PROPOSAL IS THAT THE DEPRECIATION EXPENSE REQUIRED TO OFFSET THE EXTRAORDINARY RETIREMENTS FROM HURRICANE ANDREW BE RECORDED IN 1994 AND INCLUDED IN THE BOX CALCULATIONS. SINCE THE COMMISSION HAS PREVIOUSLY APPROVED A REDUCTION IN DEPRECIATION EXPENSE IN ORDER NO. PSC-93-0462-FOF-TL OF DOCKET NO. 920385-TL, THIS TREATMENT WOULD NET FOR THE YEAR 1994, THE DEPRECIATION EXPENSE INCREASE REQUIRED BECAUSE OF HURRICANE ANDREW AGAINST THE DEPRECIATION EXPENSE DECREASE ORDERED BY THE COMMISSION IN ITS REPRESCRIPTION ORDER. IN 1995 AND BEYOND, THE DEPRECIATION EXPENSE DECREASES WOULD CONTINUE TO BE RECOGNIZED IN THE BOX CALCULATIONS UNTIL THE COMMISSION ADDRESSES HOW TO

PERMANENTLY RESOLVE THEIR IMPACT. IN THIS PROCEEDING THE COMPANY HAS PROPOSED RATE REDUCTIONS WHICH WOULD EFFECTIVELY PASS THE IMPACT OF LOWER DEPRECIATION EXPENSE ON TO RATEPAYERS IN 1995 AND BEYOND. THE COMMISSION ALSO HAS THE DADE/BROWARD 25 CENT PLAN PENDING AND THE FINAL DECISION ON THAT ISSUE COULD BE USED TO OFFSET THE LOWER DEPRECIATION.

MR. DE WARD'S CLAIM THAT THE COMPANY SHOULD HAVE WRITTEN OFF THE EXPENSE IN 1992 UNDER GAAP IS INCORRECT. SOUTHERN BELL IS STILL A RATE REGULATED COMPANY OPERATING UNDER THE PROVISIONS OF SFAS 71. THE COMPANY'S DEPRECIATION EXPENSE DETERMINED BY THE ORDERS OF ITS REGULATORS IS GAAP UNDER THESE CIRCUMSTANCES.

MR. DEWARD'S RECOMMENDATION IS RETROACTIVE RATEMAKING. THE COMPANY IS NOT AUTHORIZED TO RECORD DEPRECIATION EXPENSE AMOUNTS ON ITS REGULATED BOOKS WITHOUT THE APPROVAL OF ITS REGULATORS. THAT IS THE BASIC REASON THAT THE COMPANY AND THE COMMISSION GO THROUGH PERIODIC DEPRECIATION REPRESCRIPTIONS. IF THE COMMISSION MADE A RETROACTIVE DECISION, AS MR. DE WARD

PROPOSES, TO INCREASE THIS EXPENSE WITHOUT PROVIDING A REVENUE SOURCE TO RECOVER IT, I BELIEVE THAT DECISION WOULD BE RETROACTIVE RATEMAKING.

FINALLY, MR. DE WARD'S CLAIMS REGARDING THE COMPANY'S 1992 SURVEILLANCE REPORT ARE NEITHER ACCURATE NOR RELEVANT. HE HAS PREPARED A SCHEDULE WHICH ANALYZES THE COMPANY'S 1992 EARNINGS RESULTS ON THE ASSUMPTION THAT HIS MANY PROPOSED DISALLOWANCES ARE PROPER. AS I HAVE EXPLAINED, THEY ARE NOT. HE ALSO SEEMS TO TAKE FOR GRANTED THAT THE COMPANY'S EARNINGS FOR 1992 SHOULD BE RETROACTIVELY FORCED TO THE ALLOWABLE FLOOR. THERE IS NO BASIS FOR THIS AND IT SHOULD BE REJECTED.

4. <u>ACCOUNTING FOR POST-EMPLOYMENT BENEFITS - SFAS 112</u>

Q. DO THE COMPANY AND MR. DE WARD BOTH RECOMMEND THAT THE COMMISSION ADOPT SFAS 112 FOR RATEMAKING PURPOSES?

A. YES.

Q. HOW DOES THE COMPANY'S RECOMMENDATION DIFFER FROM

MR. DE WARD'S?

A. MR. DE WARD RECOMMENDS THAT THE COMMISSION REQUIRE THE COMPANY TO WRITE OFF THE COST OF IMPLEMENTING SFAS 112 OVER THE PERIOD 1992 AND 1993. THE COMPANY'S PROPOSAL IS THAT THE COMMISSION ALLOW IT TO RECORD THE COST OF IMPLEMENTING SFAS 112 IN 1993 AND RECOGNIZE IT IN THE BOX CALCULATIONS AS AN OFFSET AGAINST DEPRECIATION EXPENSE REDUCTIONS OR OTHER EXOGENOUS ITEMS WHICH HAVE THE OPPOSITE EFFECT ON COST OF SERVICE. THIS EQUITABLY NETS EXOGENOUS EXPENSE INCREASES AGAINST EXOGENOUS EXPENSE DECREASES.

MR. DE WARD'S RECOMMENDATION IS SIMILAR TO SEVERAL OF HIS OTHER PROPOSALS WHICH BASICALLY CALL FOR RETROACTIVELY PENALIZING THE COMPANY BY ORDERING EXPENSE WRITEOFFS IN HISTORICAL PERIODS TO DRIVE EARNINGS TO A LEVEL NEAR THE ALLOWABLE FLOOR. THIS IS RETROACTIVE RATEMAKING AND IS CERTAINLY NOT AN EQUITABLE TREATMENT OF SHAREHOLDERS. THE COMMISSION SHOULD NOT ACCEPT HIS ATTEMPT TO PENALIZE THE COMPANY BY RETROACTIVELY REDUCING 1992 EARNINGS.

L. COMPENSATED ABSENCES

Q. HOW DO YOU CHARACTERIZE MR. DE WARD'S PROPOSAL REGARDING THE TREATMENT OF COMPENSATED ABSENCES EXPENSE AND UNAMORTIZED BALANCES?

A. MR. DE WARD IS PROPOSING THAT THE COMPANY NOT BE ALLOWED TO RECOVER PRUDENT COSTS INCURRED BY THE COMPANY AND REQUIRED BY GAAP, THIS COMMISSION, AND THE FCC TO BE REFLECTED ON ITS BOOKS. HIS REASONING IS THAT THE COMPANY SHOULD HAVE INITIATED SOME ALTERNATE RATE TREATMENT WITH THIS COMMISSION BACK IN 1980 WHEN SFAS 43 WAS ADOPTED. THIS REASONING IS ABSURD AND COMPLETELY IGNORES THE FACTS IN EXCHANGE FOR SOME HYPOTHETICAL FICTION.

Q. IS MR. DE WARD'S CHARACTERIZATION OF TELEPHONE COMPANY ACCOUNTING PRIOR TO ADOPTION OF PART 32 A FAIR ONE IN YOUR OPINION?

A. NO, IT IS NOT. HE STATES THAT PRIOR TO THE ADOPTION OF PART 32 OF THE UNIFORM SYSTEM OF ACCOUNTS, TELEPHONE COMPANIES DID NOT ALWAYS FOLLOW GAAP. THIS SEEMS TO IMPLY THAT TELEPHONE COMPANIES HAD A CHOICE OF ACCOUNTING METHODS, GAAP AND

NON-GAAP. THIS WAS CERTAINLY NOT THE CASE. PRIOR TO PART 32, THE COMPANY ACCOUNTED FOR ITS OPERATIONS BASED ON PART 31 OF THE USOA, AS DID ALL OTHER TIER 1 TELEPHONE COMPANIES.

Q. ARE THERE ANY OTHER STATEMENTS MADE BY MR. DE WARD ON THIS ISSUE WITH WHICH YOU DISAGREE?

A. YES. HE STATES ON PAGE 68 OF HIS DIRECT TESTIMONY THAT PART 32 DID NOT PROVIDE FOR THE AMORTIZATION OF THE COMPENSATED ABSENCE ACCRUAL OVER A 10 YEAR PERIOD. THIS IS OBVIOUSLY WRONG. PARAGRAPH 32.24 (ORIGINALLY 32.01(14)) OF THE FCC'S PART 32 RULES WHICH HAVE BEEN ADOPTED BY THIS COMMISSION STATES PLAINLY:

> "WITH RESPECT TO THE LIABILITY THAT EXISTS FOR COMPENSATED ABSENCES WHICH IS NOT YET RECORDED ON THE BOOKS AS OF THE EFFECTIVE DATE OF THIS PART, THE LIABILITY SHALL BE RECORDED IN ACCOUNT 4120, OTHER ACCRUED LIABILITIES, WITH A CORRESPONDING ENTRY TO ACCOUNT 1439, DEFERRED CHARGES. THIS DEFERRED CHARGE SHALL BE AMORTIZED ON A STRAIGHT LINE

BASIS OVER A PERIOD OF 10 YEARS."

MR. DE WARD IS APPARENTLY UNINFORMED ON THIS ISSUE.

Q. IS IT THE COMPANY'S POSITION THAT THIS COMMISSION ADOPTED THIS 10 YEAR AMORTIZATION WHEN IT ADOPTED PART 32?

A. YES. WHEN THIS COMMISSION ADOPTED PART 32 ON APRIL 11, 1988 IN ORDER NO. 19127, AND SUBSEQUENTLY AMENDED IT IN ORDER NO. 19127-A ON APRIL 22, 1988, IT ADOPTED THESE REPORTING REQUIREMENTS EXCEPT AS SPECIFICALLY MODIFIED BY THE FLORIDA PUBLIC SERVICE COMMISSION. THIS COMMISSION MADE NO SPECIAL MODIFICATION TO THE FCC'S TREATMENT FOR COMPENSATED ABSENCES. THEREFORE, MR. DE WARD'S PROPOSAL ON THIS ISSUE SHOULD BE REJECTED.

M. <u>INSIDE WIRE NET INCOME</u>

Q. MR. REID, WHAT ARE YOUR COMMENTS RELATED TO MR. DE WARD'S RECOMMENDATION FOR TREATMENT OF INSIDE WIRE OPERATIONS.

A. MR. DE WARD'S RECOMMENDATION IS TOTALLY

INAPPROPRIATE. HE IS PROPOSING THAT THE COMMISSION MAKE AN UNSUPPORTED $1 MILLION EARNINGS IMPUTATION TO THE COMPANY'S REGULATED OPERATIONS BASED ON HIS OPINION, BUT WITH NO REASONS GIVEN FOR THE MERITS OF HIS POSITION. HE MAKES THIS RECOMMENDATION WHILE AT THE SAME TIME ACKNOWLEDGING THE FOLLOWING:

1) THE TREATMENT OF EARNINGS FROM INSIDE WIRE SERVICES IS THE SUBJECT OF A GENERIC HEARING.

2) THE COMPANY LOST MONEY ON ITS INSIDE WIRE OPERATIONS FOR 1992 AND THE FIRST SIX MONTHS OF 1993.

EQUALLY IMPORTANT FACTS WHICH HE DID NOT ACKNOWLEDGE ARE:

1) FLORIDA COMMISSION RULE 25-4.0345(2)(A), FLORIDA ADMINISTRATIVE CODE DEREGULATED INSIDE WIRE MAINTENANCE AND INSTALLATION FOR ALL FLORIDA TELEPHONE COMPANIES.

2) THE COMMISSION ADDRESSED SIMILAR ISSUES IN RATE PROCEEDINGS INVOLVING GTE AND UNITED AND DECIDED NOT TO REQUIRE THESE COMPANIES TO

CHANGE ACCOUNTING FOR INSIDE WIRE OPERATIONS WITHOUT THE COMMISSION FIRST MAKING A POLICY CHANGE.

3) A STIPULATION BETWEEN THE COMPANY, THE OPC, THE COMMISSION STAFF, AND AT&T WHICH WAS SIGNED ON DECEMBER 16, 1986 AND APPROVED BY THE COMMISSION ON DECEMBER 31, 1986 SPECIFICALLY PROVIDES THAT SOUTHERN BELL WILL BE ALLOWED TO PROVIDE UNREGULATED INSIDE WIRE INSTALLATION AND MAINTENANCE SERVICES ON AN UNSEPARATED BASIS.

HIS INSIDE WIRE PROPOSAL HAS NO BASIS AND SHOULD BE REJECTED.

N. <u>GROSS RECEIPTS TAX</u>

Q. WHAT IS MR. DE WARD'S PROPOSAL REGARDING GROSS RECEIPTS TAXES?

A. HE IS PROPOSING TWO SEPARATE ADJUSTMENTS. ONE ADJUSTMENT IS TO INCREASE TEST YEAR REVENUES BY $17,617,819 BECAUSE HE IS NOT SURE THAT THE PASS ON TAX IS INCLUDED IN TEST YEAR REVENUES. THE OTHER

ADJUSTMENT IS TO REDUCE INTRASTATE EXPENSE BY $3,161,942 BECAUSE HE CALCULATES A DIFFERENT INTERSTATE PASS ON TAX THAN THE COMPANY PROVIDED IN RESPONSE TO AN INTERROGATORY. HIS FIRST ADJUSTMENT IS BASED ON INCORRECT SPECULATION. THE COMPANY'S REVENUE FORECASTING PROCEDURE ENSURES THAT THE PROPER LEVEL OF REVENUE, INCLUDING THE IMPACT OF REVENUES DUE TO GROSS RECEIPTS TAX PASS ON REQUIREMENTS, ARE FORECASTED. HISTORICAL BOOK REVENUE AMOUNTS ARE USED IN THE FORECASTING PROCESS TO DERIVE THE ESTIMATES OF FUTURE REVENUE STREAMS. SINCE THE BOOK REVENUES INCLUDE THE PASS ON TAX IMPACTS, THE RESULTING FORECASTS ALSO REFLECT THESE IMPACTS. IN ITS PREPARATION OF REVENUE FORECASTS, THE COMPANY ANALYZES HISTORICAL RELATIONSHIPS BETWEEN BOOK REVENUE AND CERTAIN REVENUE DRIVERS, SUCH AS ACCESS LINES, INWARD MOVEMENT, MESSAGES, ETC. TRENDS IN REVENUES PER UNIT OF THE VARIOUS REVENUE DRIVERS ARE ANTICIPATED IN THE FORECASTS FOR FUTURE PERIODS BASED ON HOW THESE RELATIONSHIPS HAVE CHANGED OVER HISTORICAL PERIODS.

THE FACT THAT THE COMPANY'S FORECASTING PROCESS DOES NOT DOCUMENT THE FINITE DETAILS OF HOW MUCH PASS ON TAX IS THEORETICALLY IN REVENUES IS NO

JUSTIFICATION FOR IMPUTING ADDITIONAL AMOUNTS OF REVENUE. IN MY UPDATED DIRECT TESTIMONY FILED ON OCTOBER 1, 1993, I COMMENTED ON HOW CLOSE THE REVENUE FORECAST WAS TO ACTUALS FOR THE FIRST SIX MONTHS OF 1993. MR. DE WARD'S SPECULATIONS CERTAINLY DON'T MAKE SENSE CONSIDERING THE ACCURACY OF THE REVENUE FORECAST SO FAR AND THE COMPANY'S EXPLANATION THAT THE FORECAST METHODOLOGY INCLUDES THE PASS ON TAX IMPACT.

HIS SECOND IS BASED ON INCORRECT CALCULATIONS. HOWEVER, AFTER REVIEWING THE LEVEL OF GROSS RECEIPTS TAX ASSIGNED TO INTERSTATE IN THE BUDGET, THE COMPANY FOUND THAT AN INCORRECT FACTOR HAD BEEN USED IN THE BUDGET AND COULD HAVE LED TO MR. DE WARD'S CONCERN IN THIS AREA. WITH THE CORRECTION OF THIS FACTOR, THE COMPANY AGREES THAT INTRASTATE GROSS RECEIPTS TAX IN THE TEST YEAR SHOULD BE REDUCED BY $2,819,000.

Q. CAN YOU EXPLAIN HOW YOU ARRIVED AT THE $2,819,000 CORRECTION THAT IS NEEDED FOR INTRASTATE GROSS RECEIPTS TAX?

A. YES. THE COMPANY USED AN INCORRECT SEPARATIONS

FACTOR FOR ITS BUDGETED LEVEL OF GROSS RECEIPTS TAX. THIS RESULTED IN A FORECASTED AMOUNT OF INTERSTATE GROSS RECEIPTS TAX OF $3,881,000. ON AN ACTUAL BASIS, THE COMPANY'S TAX OFFICE NOTIFIES THE SEPARATIONS ORGANIZATION OF THE APPROPRIATE TAX AMOUNT ON INTERSTATE REVENUES. BASED ON ANALYSIS OF THE REVENUES SUBJECT TO THE TAX, THE TAX OFFICE HAS DETERMINED THAT AN INTERSTATE ASSIGNMENT OF $6,700,000 IS APPROPRIATE FOR 1993. THIS AMOUNT IS EQUIVALENT TO 2.5% GROSS RECEIPTS TAX ON AN ESTIMATED $268,000,000 OF TAXABLE INTERSTATE REVENUES. THE TAXABLE INTERSTATE REVENUES PRIMARILY RELATE TO THE INTERSTATE CALC CHARGE, BUT ALSO INCLUDE SOME AMOUNTS FOR SPECIAL ACCESS CHARGES TO END USERS, AND OTHER MISCELLANEOUS TAXABLE AMOUNTS. THE $9,197,168 AMOUNT THAT THE COMPANY INCLUDED IN RESPONSE TO OPC 1141 WAS MISALLOCATED BETWEEN INTRASTATE PASS ON AND INTERSTATE PASS ON. THE COMPANY HAS SUBMITTED A REVISED OPC 1141 RESPONSE THAT CORRECTS THIS ERROR. MR. DE WARD'S ADJUSTMENT SHOULD BE REJECTED SINCE IT USED THE WRONG AMOUNT IN COMING UP WITH THE ADJUSTMENT REQUIRED.

O. INTRACOMPANY INVESTMENT COMPENSATION

Q. WHAT IS INTRACOMPANY INVESTMENT COMPENSATION (ICIC)?

A. ICIC IS A PROCESS WHERE A STATE JURISDICTION RECEIVES COMPENSATION BASED ON THE AMOUNT OF INVESTMENT RELATED COSTS WHICH THAT STATE HAS THAT BENEFITS OTHER STATES. FOR EXAMPLE, THE COMPANY HAS CORPORATE DATA CENTERS IN A NUMBER OF STATES, INCLUDING FLORIDA, WHICH SERVE MULTIPLE STATE JURISDICTIONS. THE JURISDICTION IN WHICH THE ASSETS ARE LOCATED SHOULD NOT HAVE TO EARN A RETURN ON THE TOTAL INVESTMENT. THEREFORE, THE OWNING STATE BILLS A CHARGE TO EACH BENEFITING STATE JURISDICTION AND IS CREDITED WITH THE AMOUNT OF THESE CHARGES TO MAKE WHOLE THE OWNING STATE. INVESTMENTS INCLUDE OWNED ASSETS, CAPITAL LEASE ASSETS AND LEASEHOLD IMPROVEMENTS.

Q. DID MR. DE WARD UNDERSTAND THE NATURE OF ICIC WHEN HE INITIALLY ASKED THE COMPANY TO RESPOND TO HIS INTERROGATORY REQUESTS?

A. APPARENTLY NOT. HE INSISTED ON PORTRAYING ICIC AS AN AFFILIATE TRANSACTION. WE RESPONDED IN OPC

INTERROGATORY NO. 1175 THAT ICIC IS NOT AN AFFILIATE TRANSACTION. I AM GLAD TO SEE IN HIS TESTIMONY THAT HE SEEMS TO HAVE ACCEPTED THAT FACT.

Q. WHAT IS YOUR RESPONSE TO HIS CONCERNS ABOUT WHAT ITEMS ARE BEING CHARGED AND WHETHER THEY ARE NECESSARY IN THE PROVISION OF SERVICE?

A. THE COMPANY RESPONDED TO MR. DE WARD'S REQUEST INDICATING THAT IT WAS WILLING TO PRODUCE THE RELEVANT ICIC DATA. WE REGRET THAT MR. DE WARD DID NOT HAVE THE TIME TO SCHEDULE A DATE FOR REVIEW OF THIS DATA. HOWEVER, WE CERTAINLY DISAGREE THAT, AS A RESULT OF THIS, THE COMMISSION SHOULD ALLOW AN ARBITRARY REDUCTION TO ITS EXPENSE LEVEL.

Q. HOW WAS THE BUDGETED ICIC CHARGE FOR 1993 CALCULATED?

A. THE DECEMBER ACTUAL 1992 ICIC CHARGES FOR FLORIDA WERE ANALYZED TO DETERMINE WHETHER THE INDIVIDUAL CASES WOULD BE APPROPRIATE TO INCLUDE IN THE FORECAST OF 1993. THIS WOULD CONSIST OF THE NET OF CHARGES TO FLORIDA FROM OTHER STATES AND FROM FLORIDA TO OTHER STATES. A GROWTH FACTOR OF

APPROXIMATELY 3 PER CENT WAS APPLIED TO THE 1992 FIGURE AND THIS RESULTED IN THE BUDGET AMOUNT OF $43,567,859.

Q. ARE THE COMPANY'S FORECASTING PROCEDURES APPROPRIATE?

A. YES. USING 1992 ACTUAL DATA IS A REASONABLE METHODOLOGY FOR FORECASTING THIS TYPE OF EXPENSE. IN ADDITION, THE COMMISSION STAFF REVIEWED THE COMPANY'S PROCEDURES FOR ICIC IN THE AUDIT OF 1992 RESULTS. ONE OF THE ITEMS IN THE STAFF'S SAMPLE WAS IDENTIFIED AS AN ICIC CHARGE. AS A RESULT, STAFF REQUESTED AND RECEIVED BACKUP FOR THAT ITEM AND WE ALSO PROVIDED OUR DOCUMENTATION FOR ICIC.

MR. DE WARD'S PROPOSED DISALLOWANCE IS ARBITRARY AND NOT SUPPORTED BY FACT. THEREFORE, IT SHOULD NOT BE ACCEPTED.

P. UNCOLLECTIBLE ACCOUNTS EXPENSE

Q. IS MR. DE WARD CORRECT THAT THE COMPANY'S CURRENT FORECAST OF UNCOLLECTIBLE REVENUES FOR 1993 IS BELOW THE AMOUNT OF $39,973,000 WHICH IS INCLUDED

IN THE TEST YEAR RESULTS?

A. YES. HOWEVER, UNCOLLECTIBLE REVENUE IS JUST ONE COMPONENT OF THE OVERALL REVENUES INCLUDED IN THE TEST YEAR. AS I MENTIONED IN MY UPDATED DIRECT TESTIMONY FILED ON OCTOBER 1, 1993, I ANALYZED THE FIRST SIX MONTHS OF ACTUAL REVENUES AND EXPENSES FOR 1993 AS COMPARED TO THE FORECASTED AMOUNTS AND FOUND THAT THE TEST YEAR RESULTS WERE ON TARGET. THE UNDERRUN IN FORECASTED UNCOLLECTIBLE REVENUES, WHICH IS BEING EXPERIENCED IN 1993, IS BEING OFFSET BY AN UNDERRUN IN OTHER INTRASTATE REVENUES OF APPROXIMATELY THE SAME AMOUNT. IT IS THEREFORE INAPPROPRIATE TO MAKE AN ADJUSTMENT TO TEST YEAR UNCOLLECTIBLE REVENUES WITHOUT MAKING AN OFFSETTING ADJUSTMENT TO FORECASTED INTRASTATE REVENUES. SINCE THE TWO ADJUSTMENTS WOULD OFFSET EACH OTHER, IT DOES NOT CHANGE THE COMPANY'S EXPECTED EARNINGS FOR THE TEST YEAR.

Q. <u>RIGHT-TO-USE (RTU) FEES</u>

Q. HAS THE COMPANY INFORMED THE OPC THAT IT ANTICIPATES AN UNDERRUN IN CERTAIN RTU FEES BUDGETED FOR 1993?

A. YES. HOWEVER, AS HE DID WITH THE FORECAST OF UNCOLLECTIBLE REVENUES, MR. DE WARD IS ONLY RECOGNIZING PART OF THE FACTS. THE COMPANY EXPLAINED THAT IT WAS INCURRING EXPENSE OVERRUNS IN OTHER AREAS SUCH AS OVERTIME WORK AND THAT LOWER 1993 RTU FEES ARE BEING USED TO OFFSET THESE EXPENSE OVERRUNS. THE OPC WAS ALSO TOLD AT A DEPOSITION ON OCTOBER 14, 1993 THAT THE COMPANY WAS HAVING TO ADD APPROXIMATELY 120 PEOPLE TO THE NETWORK DEPARTMENT IN FLORIDA THAT HAVE NOT BEEN FUNDED IN THE BUDGET. IF MR. DE WARD WAS BEING EQUITABLE IN HIS APPROACH, HE WOULD HAVE PROPOSED TO ADD EXPENSE TO THE TEST YEAR TO FUND THESE FORCE ADDITIONS. HE IS OBVIOUSLY JUST PICKING ITEMS THAT REDUCE EXPENSE IN ORDER TO MAXIMIZE HIS PROPOSED EXPENSE DISALLOWANCES. HIS PROPOSAL SHOULD BE REJECTED.

R. <u>DEPRECIATION AND AMORTIZATION EXPENSE</u>

1. <u>AMORTIZATION EXPENSE</u>

Q. DOES THE COMPANY AGREE THAT THE AMOUNT OF INTRASTATE AMORTIZATION EXPENSE IN THE TEST YEAR

NEEDS TO BE REDUCED?

A. YES. HOWEVER, THE AMOUNT CALCULATED BY MR. DE WARD IS INCORRECT.

Q. BY HOW MUCH SHOULD TEST YEAR INTRASTATE AMORTIZATION BE REDUCED?

A. MY EXHIBIT WSR-8 SHOWS A CALCULATION OF THE AMOUNT OF AMORTIZATION EXPENSE THAT NEEDS TO BE ADJUSTED OUT OF THE TEST YEAR DATA I FILED ON OCTOBER 1, 1993. AS SHOWN ON THIS EXHIBIT, THE ADJUSTMENT AMOUNT SHOULD BE A DECREASE OF $3,829,000 IN AMORTIZATION EXPENSE, NOT THE $7,614,000 ALLEGED BY MR. DE WARD. THE ADJUSTMENT IS NEEDED BECAUSE THE COMPANY DISCOVERED THAT ITS FORECAST METHODOLOGY INCLUDED ONE MONTH OF AMORTIZATION EXPENSE IN 1993 FOR CERTAIN SCHEDULES THAT ENDED WITH DECEMBER 1992, AND BECAUSE THE COMPANY INADVERTENTLY OMITTED THE DROP-OFF IN AMORTIZATION EXPENSES FOR OPERATOR SYSTEMS - CROSSBAR WHEN IT COMPUTED THE TEST YEAR PRO FORMA ADJUSTMENT ENTITLED "EXPIRING AMORTIZATIONS - 1994".

Q. DO YOU KNOW WHY MR. DE WARD'S CALCULATIONS ARE

INCORRECT?

A. I BELIEVE SO. IT APPEARS AS THOUGH MR. DE WARD IS COMPARING REPORTS SUCH AS MFR SCHEDULE C-22b, WHICH ARE STATED ON A PSC COMBINED BASIS, WITH COMPANY INTERROGATORY RESPONSES WHICH REPORT INTRASTATE AMORTIZATION EXPENSE AMOUNTS. SCHEDULE C-22b HAS A NOTE AT THE BOTTOM THAT INDICATES THE DATA IS ON A PSC COMBINED BASIS. SOME OF THE COMPANY'S INTERROGATORY RESPONSES TO QUESTIONS ABOUT PRO FORMA ADJUSTMENTS, HOWEVER, REPORTED INTRASTATE AMORTIZATION EXPENSE, ALTHOUGH IT MAY NOT HAVE BEEN CLEARLY IDENTIFIED ON THE RESPONSE.

MR. DE WARD MAKES THE ASSUMPTION ON HIS SCHEDULE 25, "AS THESE ARE AMORTIZATION AMOUNTS, I HAVE ASSUMED 100% INTRASTATE." THIS WAS AN INCORRECT ASSUMPTION. MY EXHIBIT WSR-9 SHOULD CORRECT THIS CONFUSION.

2. <u>AMORTIZATION OF OFFICE EQUIPMENT/OFFICIAL COMMUNICATION EQUIPMENT</u>

Q. HOW DO YOU RESPOND TO MR. DE WARD'S OBSERVATIONS CONCERNING THE INVESTMENT AND RESERVE RELATIONSHIPS

FOR OFFICE EQUIPMENT/OFFICIAL COMMUNICATION EQUIPMENT?

A. AFTER FURTHER REVIEW OF THIS SITUATION, THE COMPANY HAS IDENTIFIED A BOOKING PROBLEM WITH 1988 THROUGH 1992 AMORTIZATION EXPENSE THAT MAY HAVE LED TO THE INVESTMENT AND RESERVE RELATIONSHIP WHICH HAS CAUSED THE CONCERNS. THE COMPANY IS VERIFYING ITS CALCULATIONS OF AMORTIZATION EXPENSE FOR THE PERIOD THIS EQUIPMENT HAS BEEN UNDER AMORTIZATION SCHEDULES TO IDENTIFY THE MAGNITUDE OF THE PROBLEM.

THE PROBLEM WHICH THE COMPANY HAS DISCOVERED RELATES TO THE TREATMENT OF THE PRE-1988 VINTAGE PLANT BALANCES AND NOT TO PLANT ADDITIONS FOR 1988 THROUGH 1992. FOR THIS REASON THE FORECAST OF 1993 AMORTIZATION EXPENSE IS NOT IMPACTED AND IS STATED AT THE CORRECT LEVEL. THE PRE-1988 VINTAGE PLANT COMPLETED ITS AMORTIZATION AT THE END OF 1992 AND THEREFORE WAS NOT AN ISSUE IN THE 1993 FORECAST.

MR. DE WARD'S PROPOSED REDUCTION OF $4,037,000 IN TEST YEAR AMORTIZATION EXPENSE SHOULD BE REJECTED SINCE THE AMOUNT OF THE EXPENSE IS CORRECTLY CALCULATED BASED ON THE COMMISSION'S RULES.

HOWEVER, IT DOES APPEAR AS THOUGH THE COMPANY WILL HAVE TO MAKE SOME CORRECTIONS FOR PRIOR CALCULATIONS OF AMORTIZATION EXPENSE.

Q. HOW DO YOU PROPOSE TO CORRECT THE PAST ERRORS IN AMORTIZATION EXPENSE?

A. AFTER IT HAS DETERMINED THE FULL EXTENT OF THE PROBLEM, THE COMPANY WILL NOTIFY THE COMMISSION OF THE AMOUNTS INVOLVED AND ITS PROPOSED CORRECTIVE ACTION.

3. DEPRECIATION EXPENSE

Q. IS MR. DE WARD'S PROPOSED ADJUSTMENT TO DEPRECIATION EXPENSE ASSOCIATED WITH DIGITAL CIRCUIT EQUIPMENT APPROPRIATE?

A. NO. THE COMPANY HAS CORRECTLY CALCULATED ITS 1993 TEST YEAR DEPRECIATION EXPENSE FOR DIGITAL CIRCUIT EQUIPMENT IN ACCORDANCE WITH THE COMMISSION'S ORDER NO. PSC-93-0462-FOF-TL IN DOCKET NO. 920385-TL RELEASED ON MARCH 25, 1993. I EXPLAIN ON PAGE 15 OF MY DIRECT TESTIMONY FILED ON JULY 2, 1993 THAT I CALCULATED MONTHLY BALANCES FOR PLANT IN SERVICE

ACCOUNTS BY USING THE 1993 BEGINNING OF YEAR BALANCES, THEN ADDING CONSTRUCTION AMOUNTS FROM THE COMMITMENT VIEW AND SUBTRACTING THE PLANT RETIREMENTS AS APPROPRIATE. I THEN APPLIED THE COMMISSION APPROVED DEPRECIATION RATES TO THE FORECASTED MONTHLY AVERAGE DEPRECIABLE PLANT BALANCES. SINCE I BEGAN THE CALCULATION WITH ACTUAL 1993 BEGINNING PLANT BALANCES, ANY 1992 RETIREMENTS OF DIGITAL CIRCUIT EQUIPMENT WOULD HAVE ALREADY BEEN REMOVED FROM THE BEGINNING PLANT IN SERVICE ACCOUNT TOTAL.

MR. DE WARD INDICATES HE IS UNCLEAR ON THIS ISSUE AND MAKES THE ADJUSTMENT IN THE EVENT THE COMPANY HAS INCORRECTLY CALCULATED ITS DEPRECIATION. THIS IS NOT THE CASE. THEREFORE, HIS ADJUSTMENT SHOULD BE REJECTED.

S. <u>FEDERAL AND STATE INCOME TAX EXPENSE</u>

1. <u>FEDERAL AND STATE INCOME TAXES</u>

Q. MR. REID, ARE THE COMPANY'S FORECASTED AMOUNTS OF INTRASTATE FEDERAL AND STATE INCOME TAXES FOR THE TEST YEAR REASONABLE?

A. YES. THE COMPANY'S BUDGET PROCESS TO DETERMINE AN APPROPRIATE LEVEL OF INTRASTATE FEDERAL AND STATE INCOME TAXES IS REASONABLE, EVEN THOUGH IT MAY NOT BE PERFORMED AT THE LEVEL OF DETAIL WHICH MR. DE WARD IS SEEKING.

Q. IS THE COMPANY'S CALCULATION OF ACTUAL INTRASTATE FEDERAL AND STATE INCOME TAXES CORRECT FOR 1992?

A. YES. THE COMPANY FOLLOWS APPLICABLE PROCEDURES TO RECORD THE VARIOUS ITEMS OF TAXABLE INCOME AND TO COMPUTE THE APPROPRIATE AMOUNT OF INTRASTATE INCOME TAX EXPENSE. THE JURISDICTIONAL SEPARATIONS PROCESS DOES NOT PERFORM AN INDIVIDUAL SEPARATIONS CALCULATION ON EACH PERMANENT AND TEMPORARY TIMING DIFFERENCE, HOWEVER, AND WHEN THIS DETAIL IS REQUESTED, IT REQUIRES EXTENSIVE ANALYSIS BY THE COMPANY TO ATTEMPT THE DISPLAY OF THE CALCULATIONS IN THIS MANNER.

Q. HOW DO YOU RESPOND TO MR. DE WARD'S PROPOSED ADJUSTMENTS TO INCOME TAX EXPENSE, WHICH RESULT FROM HIS CALCULATIONS ON SCHEDULE 28 OF HIS TESTIMONY?

A. ON SCHEDULE 28 OF HIS TESTIMONY, MR. DE WARD MAKES A FEW CONCEPTUAL MISTAKES WHICH RESULT IN THE DIFFERENCES WHICH HE IS PROPOSING TO ADJUST. I HAVE ATTACHED EXHIBIT WSR-9, WHICH IS THE COMPANY'S CORRECTION OF MR. DE WARD'S SCHEDULE 28, AS EVIDENCE THAT THE COMPANY'S INCOME TAX EXPENSE IS REASONABLE.

THE MAJOR CONCEPTUAL MISTAKES WHICH THE COMPANY IS CORRECTING ARE: 1) MR. DE WARD FAILED TO CONSIDER PERMANENT TAXABLE INCOME DIFFERENCES; 2) HE FAILED TO CONSIDER FLOW-THROUGH ON NON-DEPRECIATION RELATED ITEMS; 3) HE USED A SIMPLE CALCULATION OF STATE INCOME TAX EXPENSE AT 5.5% OF FLORIDA TAXABLE INCOME, EVEN THOUGH THE STATE TAX IS APPLICABLE TO ALLOCATED COMPANY INCOME PER STATE TAX STATUTES; AND 4) HE FAILED TO CONSIDER THE AMOUNT OF ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION IN THE TAXABLE INCOME.

AS SHOWN ON EXHIBIT WSR-9, THE COMPANY'S CALCULATION OF INTRASTATE INCOME TAX EXPENSE FOR THE 1993 TEST YEAR IS REASONABLE. MR. DE WARD'S PROPOSED ADJUSTMENTS SHOULD BE REJECTED.

2. EMPLOYEE STOCK OWNERSHIP PLAN - SPECIAL TAX BENEFIT

Q. DOES BELLSOUTH CORPORATION RECEIVE A TAX DEDUCTION ASSOCIATED WITH DIVIDEND PAYMENTS IT MAKES ON COMPANY SHARES HELD IN A LEVERAGED EMPLOYEE STOCK OWNERSHIP (LESOP) TRUST AND ALSO ON DIVIDENDS PAID ASSOCIATED WITH SHARES HELD UNDER A PAYSOP PLAN?

A. YES. UNDER THE INTERNAL REVENUE CODE, A CORPORATION WHICH PAYS DIVIDENDS IN CASH TO THE PARTICIPANTS OF AN EMPLOYEE STOCK OWNERSHIP PLAN IS ALLOWED A TAX DEDUCTION ON THOSE DIVIDENDS UNDER CERTAIN CONDITIONS.

Q. DOES BELLSOUTH ALLOCATE TO ITS SUBSIDIARIES THE TAX SAVINGS DERIVED FROM THESE DIVIDEND PAYMENTS?

A. NO. THE DIVIDEND PAYMENTS, WHICH RESULT IN THE TAX SAVINGS, ARE MADE BY THE PARENT COMPANY FROM EQUITY EARNINGS. THESE TAX SAVINGS DO NOT RESULT FROM EXPENSES CHARGED TO SUBSIDIARIES AND, THEREFORE, THEY ARE NOT ALLOCATED TO THE SUBSIDIARIES.

Q. HAS BELLSOUTH REFLECTED ALL OF THE TAX SAVINGS AS INCREASED INCOME ON ITS FINANCIAL STATEMENTS?

A. NO, THE MAJORITY OF THE TAX SAVINGS HAVE NOT BEEN TREATED AS AN INCOME ITEM. GAAP, PRIOR TO 1993, REQUIRED BELLSOUTH TO RECORD THE TAX SAVINGS ASSOCIATED WITH THE DIVIDEND PAYMENTS ON ITS LESOP AND PAYSOP AS A DIRECT EQUITY ENTRY AND NOT REFLECT IT ON THE INCOME STATEMENT. WITH THE ADOPTION OF SFAS 109 IN 1993, GAAP NOW REQUIRES BELLSOUTH TO RECORD THE TAX SAVINGS FOR DIVIDEND PAYMENTS ON UNALLOCATED SHARES IN ITS LESOP AS A DIRECT EQUITY ENTRY, BUT TAX SAVINGS ASSOCIATED WITH SHARES WHICH HAVE ALREADY BEEN ALLOCATED TO EMPLOYEE ACCOUNTS ARE REFLECTED AS REDUCED TAX EXPENSE ON THE INCOME STATEMENT.

Q. DO YOU AGREE WITH MR. DE WARD THAT THE COMMISSION SHOULD ADJUST SOUTHERN BELL-FLORIDA'S EARNINGS TO INCLUDE AN ALLOCATED SHARE OF THESE BELLSOUTH TAX SAVINGS?

A. NO. MR. DE WARD ARGUES THAT EVEN THOUGH THE COMPANY IS CHARGED AN EXPENSE ASSOCIATED WITH THE LESOP, THE COMPANY DOES NOT RECEIVE ANY OF THE

BENEFITS FROM THE DEDUCTIBILITY OF THE DIVIDENDS. THE DIVIDEND PAYMENTS, HOWEVER, DON'T INCREASE THE EXPENSE OF THE LESOP, THEY REDUCE IT.

WHEN THE COMPANY INSTITUTED THE LESOP, IT ANTICIPATED THAT THE GROWTH IN STOCK PRICE AND DIVIDENDS ASSOCIATED WITH THE COMPANY'S SHARES WOULD CONTINUE TO REDUCE THE COSTS OF THE LESOP, AND OVER THE LIFE OF THE PLAN WOULD RESULT IN LOWER EXPENSES FOR THE COMPANY AND RATEPAYERS. THE TAX SAVINGS WERE VIEWED AS A BENEFIT DESIGNED TO ENCOURAGE CORPORATIONS SUCH AS BELLSOUTH TO ESTABLISH A LESOP. IF THE TAX SAVINGS ARE ALLOCATED TO SOUTHERN BELL-FLORIDA AS REGULATED INCOME, THIS WILL LEAD TO AN OVERALL REDUCTION IN BELLSOUTH INCOME ASSOCIATED WITH THIS ITEM SINCE GAAP DOES NOT ALLOW ALL OF THE TAX SAVINGS TO BE REFLECTED IN THE INCOME STATEMENT.

T. SEPARATIONS

1. CORPORATE OPERATIONS SEPARATIONS FACTOR

Q. IS MR. DE WARD'S PROPOSED ADJUSTMENT TO REDUCE INTRASTATE EXPENSE FOR A REVISED CORPORATE

OPERATIONS SEPARATIONS FACTOR APPROPRIATE?

A. NO. MR. DE WARD SEEMS VERY CONFUSED ON THIS SUBJECT AND HAS NOT CORRECTLY INTERPRETED THE FACTS. FIRST OF ALL, HE CONFUSES THE ISSUE BY ANALYZING THE COMPANY'S CUSTOMER OPERATIONS EXPENSE SEPARATIONS AND THEN CALLS HIS PROPOSED ADJUSTMENT "CORPORATE" OPERATIONS SEPARATIONS FACTOR. HOWEVER, THIS IS JUST A MINOR PART OF THE CONFUSION. HIS MAJOR CONFUSION APPEARS TO BE A LACK OF UNDERSTANDING OF HOW THE COMPANY ASSIGNS DIRECTORY WHITE PAGE EXPENSES TO THE INTERSTATE JURISDICTION.

EARLIER IN MY REBUTTAL TESTIMONY, I RESPONDED TO MR. DE WARD'S PROPOSAL THAT THE COMPANY SHOULD ASSIGN A PORTION OF THE DIRECTORY WHITE PAGE COSTS TO THE INTERSTATE JURISDICTION BY SAYING THAT THE COMPANY ALREADY MAKES THIS ASSIGNMENT. HIS ANALYSIS OF CUSTOMER OPERATIONS SEPARATIONS HAS HIGHLIGHTED HOW THE COMPANY ACCOMPLISHES THIS ASSIGNMENT. IN RESPONSE TO OPC INTERROGATORY 887, THE COMPANY REPORTED THAT THE UNSEPARATED DOLLARS FOR ACCOUNT 6622.1, DIRECTORY EXPENSES, FOR 1992 WAS $43,119,438 INSTEAD OF THE AMOUNT WHICH MR. DE

WARD PULLED FROM THE TRIAL BALANCE FOR THIS ACCOUNT. THE REASON FOR THE DIFFERENCE IS THAT AN ADJUSTMENT IS MADE TO ADD THE DIRECTORY WHITE PAGE COST INTO THE AMOUNT OF UNSEPARATED DOLLARS PRIOR TO THE APPLICATION OF THE APPROPRIATE SEPARATIONS FACTOR. THIS ACCOMPLISHES THE ASSIGNMENT OF WHITE PAGE COSTS TO INTERSTATE.

SINCE THE COMPANY'S INTRASTATE EXPENSE AMOUNTS ARE DETERMINED BY SUBTRACTING ASSIGNED INTERSTATE TOTALS FROM THE TOTAL EXPENSE AMOUNTS, THE INTRASTATE JURISDICTION IS RECEIVING A CREDIT EXPENSE IMPACT FROM THIS PROCEDURE. MR. DE WARD INCORRECTLY INTERPRETS THIS AS AN ERROR AND ATTEMPTS A REVISED CALCULATION. HE FAILS TO NOTICE, HOWEVER, THAT HIS COMPUTED INTERSTATE ASSIGNMENT FACTOR OF 18.0694% FOR CUSTOMER OPERATIONS IS ACTUALLY LOWER THAN THE INTERSTATE RELATIONSHIP OF 19.1301% WHICH IS INCLUDED IN THE TEST YEAR RESULTS.

Q. HAS THE COMPANY PROVIDED ANY DETAILS OF THE SEPARATIONS CALCULATIONS WHICH IT PERFORMED IN DEVELOPING ITS INTRASTATE OPERATING EXPENSE AMOUNTS?

A. YES. IN RESPONSE TO OPC INTERROGATORY 1304, THE COMPANY PROVIDED SCHEDULES FROM ITS 1993 COMMITMENT VIEW WHICH DEMONSTRATED THE CALCULATION OF THE INTRASTATE EXPENSE AMOUNTS FROM THE RELATED COMBINED EXPENSE TOTALS. THE DETAIL OF THIS CALCULATIONS ALSO SHOWED THE REMOVAL OF NON-REGULATED AMOUNTS. THESE SCHEDULES SHOW THE ADJUSTMENT MADE TO THE CUSTOMER OPERATIONS EXPENSE ACCOUNTS FOR THE DIRECTORY WHITE PAGE AMOUNT. THE TOTAL OF THIS ADJUSTMENT APPEARS IN THE COLUMN HEADED "MR ADJS."

THE COMPANY'S SEPARATIONS FACTORS ARE REASONABLE AND CALCULATED CORRECTLY. MR. DE WARD'S ADJUSTMENT IS INCORRECT AND SHOULD BE REJECTED.

2. TAXES, OTHER THAN INCOME - SEPARATION FACTORS

Q. DOES MR. DE WARD'S ATTEMPT TO RECONCILE THE COMPANY'S INTRASTATE ASSIGNMENT OF TAXES, OTHER THAN INCOME, PROPERLY ACCOUNT FOR HIS PREVIOUS ADJUSTMENT TO SHIFT $3,161,942 OF GROSS RECEIPTS TAXES TO INTERSTATE FROM INTRASTATE?

A. NO. I BELIEVE MR. DE WARD IS BASICALLY DOUBLE COUNTING THE SAME ADJUSTMENT. ON HIS SCHEDULE 31, HE CALCULATES AN AMOUNT OF $138,184,165, OF INTRASTATE TAXES, OTHER THAN INCOME, WHICH HE THEN COMPARES TO THE AMOUNT OF $140,265,000 THAT THE COMPANY HAS IN THE TEST YEAR RESULTS. HOWEVER, ASSUMING THE COMMISSION HAD ACCEPTED HIS EARLIER ADJUSTMENT FOR INCREASING THE INTERSTATE ASSIGNMENT OF GROSS RECEIPTS TAXES AND REDUCING THE INTRASTATE ASSIGNMENT BY $3,161,942, THERE WOULD BE ONLY $137,103,058 (THE ORIGINAL $140,265,000 LESS THE $3,161,942 ADJUSTMENT) LEFT IN THE TEST YEAR EXPENSES. SINCE HIS CALCULATION, WHICH IS PRESUMABLY THE AMOUNT HE IS CLAIMING IS REASONABLE, EXCEEDS THE NET AMOUNT LEFT IN TEST YEAR EXPENSE, HE SHOULD HAVE CONCLUDED THAT IF ANYTHING, INTRASTATE OTHER TAXES NEEDS TO BE INCREASED.

IN MY RESPONSE TO MR. DE WARD'S ADJUSTMENT FOR GROSS RECEIPTS TAX, INTRASTATE VERSUS INTERSTATE, I AGREED THAT THE BUDGET ASSIGNMENT TO INTERSTATE SHOULD HAVE BEEN $2,819,000 HIGHER. USING THIS AMOUNT TO ADJUST THE ORIGINAL TEST YEAR TOTAL FOR INTRASTATE OTHER TAXES OF $140,265,000 WOULD YIELD A REVISED AMOUNT IN THE TEST YEAR OF $137,446,000.

THIS TOTAL WOULD ALSO SUPPORT THE FACT THAT NO FURTHER ADJUSTMENT TO INTRASTATE OTHER TAXES IS JUSTIFIED.

3. <u>UNIVERSAL SERVICE FUND</u>

Q. DO YOU AGREE WITH THE ADJUSTMENT WHICH MR. DE WARD CALCULATES ON HIS SCHEDULE 43 FOR UNIVERSAL SERVICE FUND (USF) REVENUES?

A. NO. MR. DE WARD PRESENTS A VERY CONFUSING AND INCORRECT PICTURE WITH THIS ADJUSTMENT. IN THE NARRATIVE SECTION OF HIS SCHEDULE, HE STATES THAT "BASED ON THESE RESPONSES IT WOULD APPEAR THAT INTRASTATE EXPENSES ARE UNDERSTATED BY $1,518,000." MR. DE WARD THEN UNDERTAKES A CALCULATION OF HIS OWN, WHICH INCORRECTLY USES ONLY PART OF THE INFORMATION WHICH THE COMPANY PROVIDED TO HIM. HE THEN REACHES AN INVALID CONCLUSION THAT INTRASTATE EXPENSES ARE OVERSTATED.

THE COMPANY PROVIDED HIM WITH THE PRECISE CALCULATION OF THE INTERSTATE CORPORATE OPERATIONS EXPENSE, BUT BECAUSE HE CLAIMS HE DIDN'T UNDERSTAND THE OFFBOOKS ADJUSTMENTS, HE CHOSE TO IGNORE THEM

AND MAKE HIS OWN CALCULATION. THE RESULT IS THAT HE APPLIED AN INTERSTATE SEPARATIONS FACTOR TO AN AMOUNT WHICH IS TOTALLY INTRASTATE IN NATURE. INCLUDED IN THE $16,397,000 OF OFFBOOK ADJUSTMENTS WAS THE $13,954,000 THE COMPANY HAD BUDGETED FOR INTRASTATE HURRICANE ANDREW AMORTIZATION IN 1993. IN RESPONSE TO OPC INTERROGATORY NO. 1302, THE COMPANY ADVISED MR. DE WARD THAT THE HURRICANE AMORTIZATION HAD BEEN TRANSFERRED TO ACCOUNT 6728, WHICH IS WITHIN THE CORPORATE OPERATIONS EXPENSE SUMMARY LEVEL.

MR. DE WARD'S CALCULATION HAS AN IDENTIFIABLE ERROR AND DOES NOT SUPPORT A REDUCTION IN INTRASTATE EXPENSE. IF ANY ADJUSTMENT WERE TO BE MADE TO THE USF AMOUNT, IT WOULD BE TO INCREASE INTRASTATE EXPENSE BY $1,518,000, DUE TO THE FORECAST MISS FOR THE USF. THE COMPANY IS NOT MAKING THIS RECOMMENDATION HOWEVER, SINCE IT BELIEVES THE BUDGET OVERALL IS ON TARGET.

U. <u>DEFERRED INCOME TAXES</u>

Q. IS MR. DE WARD CORRECT THAT TEST YEAR DEFERRED INCOME TAXES SHOULD BE INCREASED BY $28,828,000?

A. IN REFERENCE TO MY TESTIMONY, I AGREE THAT I INADVERTENTLY USED THE WRONG SIGN ON THE ADJUSTMENT MADE TO DEFERRED INCOME TAXES ASSOCIATED WITH HURRICANE ANDREW WHEN I FILED MY UPDATED TESTIMONY ON OCTOBER 1, 1993. THIS CAN BE CORRECTED BY ADDING $28,828,000 TO DEFERRED INCOME TAXES IN THE CAPITAL STRUCTURE OR BY COMPUTING AN APPROPRIATE NET OPERATING INCOME AMOUNT TO OFFSET THE EFFECT OF THE MISTAKE. THE NET OPERATING INCOME OFFSET WOULD BE APPROXIMATELY $2,488,000.

IN REFERENCE TO MR. DE WARD'S TESTIMONY, HE IS ALSO INCORRECT SINCE HIS PROPOSAL REGARDING HURRICANE ANDREW DAMAGE WAS TO FORCE THE COMPANY TO SUFFER ALL THE LOSSES IN HISTORICAL EARNINGS. UNDER HIS APPROACH, THERE WOULD BE NO DEFERRED HURRICANE EXPENSES AND, THEREFORE, NO RELATED DEFERRED INCOME TAXES. FOR HIS TESTIMONY TO BE CONSISTENT, HE SHOULD HAVE PROPOSED AN ADJUSTMENT TO REVERSE THE DEFERRED INCOME TAXES THE COMPANY HAD IN THE FORECASTED TEST YEAR. COINCIDENTALLY, THE AMOUNT OF DEFERRED INCOME TAXES INCLUDED IN THE FORECASTED TEST YEAR BEFORE PRO FORMA ADJUSTMENTS IS $14,292,000. THE PRO FORMA ADJUSTMENT I HAVE

PROPOSED INCREASED THIS AMOUNT BY AN ADDITIONAL $14,414,000.

V. <u>INAPPROPRIATE EXPENSES FOR RATEMAKING PURPOSES</u>

1. <u>MISCELLANEOUS EXPENSES</u>

Q. WHAT ARE YOUR COMMENTS RELATED TO MR. DE WARD'S PROPOSAL TO DISALLOW $1,000,000 OF MISCELLANEOUS EXPENSES?

A. BY HIS OWN ADMISSION, MR. DE WARD HAS TAKEN INFORMATION ON VARIOUS TYPES OF EXPENSES WHICH THE COMPANY SUPPLIED AND LISTED IT UNDER THE CATEGORIES OF INAPPROPRIATE EXPENSES, EXTERNAL RELATIONS EXPENSE AND ADVERTISING EXPENSE. WITHOUT ANY SUPPORTING DATA, HE HAS REQUESTED DISALLOWANCE OF AN ARBITRARY AMOUNT OF $1,000,000. HE OFFERS NO SUBSTANTIATION FOR THE AMOUNT AND ASKS THIS COMMISSION TO ACCEPT IT UNTIL HE PROVIDES ADDITIONAL INFORMATION. IN ADDITION, MR. DE WARD HAS COMBINED BOTH 1992 AND 1993 EXPENSES, GIVING THE IMPRESSION THAT HIS TOTAL AMOUNTS FOR ADJUSTMENT TO THE TEST YEAR ARE MUCH LARGER THAN WOULD BE THE CASE IF HE TREATED CALENDAR YEARS

SEPARATELY. THIS PROVIDES A MISLEADING RECOMMENDATION FOR A TEST YEAR ADJUSTMENT.

Q. HOW DO YOU RESPOND TO MR. DE WARD'S RECOMMENDATION THAT THE ITEMS ON HIS SCHEDULE SHOULD BE CAREFULLY REVIEWED?

A. I HAVE CAREFULLY REVIEWED THE ITEMS ON HIS SCHEDULE 34. I BELIEVE THAT THE MAJORITY OF THE ITEMS ON THIS SCHEDULE SHOULD BE INCLUDED IN TEST YEAR EXPENSES. I ALSO BELIEVE THAT ALL OF THE ITEMS WERE INCURRED WITH THE INTENT OF FURTHERING LEGITIMATE BUSINESS INTERESTS OF BST. HOWEVER, SINCE CERTAIN OF THESE EXPENSES FALL INTO CATEGORIES WHICH HAVE BEEN EXCLUDED IN PAST SOUTHERN BELL CASES, I HAVE ALREADY EXCLUDED THEM AND THEY ARE NOT IN TEST YEAR EXPENSES.

IN ADDITION TO THE EXPENSES WHICH HAVE ALREADY BEEN EXCLUDED, I WILL NOT CONTEST THE REMOVAL OF THE SPECIFIC EXPENSES WHICH I HAVE LISTED ON REID EXHIBIT WSR-10. THIS EXHIBIT IS PREPARED TO SHOW A BRIEF DESCRIPTION, THE ACCOUNT NUMBER CHARGED, AND THE FLORIDA INTRASTATE AMOUNT SEPARATELY FOR 1992 AND 1993. I PROPOSE TO ADJUST 1992 FINANCIAL

RESULTS BY THE AMOUNT OF $126,900 AND TO ADJUST THE 1993 TEST YEAR EXPENSE BY $99,398.

2. <u>LEGAL FEES AND OUTSIDE CONSULTING SERVICES</u>

Q. IS MR. DE WARD CORRECT THAT AN ADJUSTMENT OF $595,278 IS REQUIRED TO ENSURE THAT ALL EXPENSES ASSOCIATED WITH THE ATTORNEY GENERAL INVESTIGATION AND THE DAVIS ANTITRUST LITIGATION IS RECORDED BELOW THE LINE?

A. NO. THE COMPANY HAS REMOVED THESE EXPENSES FROM REGULATION. MR. DE WARD IS APPARENTLY CONFUSED BECAUSE THE COMPANY RESPONDED TO OPC 1199 THAT A PORTION OF THE LEGAL FEES FOR THE ATTORNEY GENERAL INVESTIGATION WERE ALLOCATED TO A NONREGULATED FUNCTION CODE UNDER ACCOUNT 6725. THE COMPANY WORDED THE RESPONSE THIS WAY BECAUSE THE QUESTION ASKED SPECIFICALLY ABOUT ACCOUNT 6725.
MR. DE WARD'S APPARENT ASSUMPTION THAT THE OTHER PORTION OF THE WHOLE WAS LEFT IN REGULATED ACCOUNTS IS INCORRECT. THE OTHER PORTION OF THESE LEGAL FEES WAS CHARGED TO ACCOUNT 7370, A BELOW THE LINE ACCOUNT. IN RESPONSE TO OPC INTERROGATORY 841, THE COMPANY LISTED ITS LEGAL EXPENSES AS REQUESTED AND

NOTED THAT THE ACCOUNTS CHARGED WERE ACCOUNT 6725 AND ACCOUNT 7370.

MR. DE WARD'S REMOVAL OF EXPENSES ASSOCIATED WITH AN ARTHUR ANDERSON INVOICE FOR $174,900 IS ALSO INCORRECT. HE IS MERELY SPECULATING THAT $116,600 OF THIS INVOICE WAS CHARGED TO REGULATED ACCOUNTS. AGAIN, HIS SPECULATIONS ARE WRONG. IN RESPONSE TO OPC 841, PAGE 15, THE COMPANY LISTED THIS EXPENSE AS RELATED TO THE FLORIDA ATTORNEY GENERAL INVESTIGATION AND REPORTED THE ACCOUNTS CHARGED AS ACCOUNT 6725 AND ACCOUNT 7370. AS STATED ABOVE, THE AMOUNTS CHARGED TO ACCOUNT 6725 ARE ASSIGNED TO NON-REGULATED CATEGORIES AND THE AMOUNTS CHARGED TO ACCOUNT 7370 ARE BELOW THE LINE.

3. <u>OTHER MISCELLANEOUS ADJUSTMENTS</u>

Q. UNDER THE HEADING OF "OTHER MISCELLANEOUS ADJUSTMENTS", MR. DE WARD ITEMIZES A NUMBER OF SMALL EXPENSE DISALLOWANCES. DO YOU AGREE WITH THE REMOVAL OF THESE AMOUNTS FROM TEST YEAR EXPENSES?

A. NO. I DISAGREE WITH HIS PROPOSED DISALLOWANCES FOR USTA AND FTA DUES AND FOR LEGAL AND ACCOUNTING

SERVICES FOR EXECUTIVES. FOR THE OTHER MISCELLANEOUS ITEMS HE DISALLOWS, I AGREE THAT IF THESE SMALL AMOUNTS HAD BEEN IDENTIFIED, THE COMPANY WOULD HAVE ADJUSTED THEM OUT OF THE TEST YEAR SINCE THE COMMISSION HAS NOT TRADITIONALLY ALLOWED ITEMS OF THIS NATURE. THE SIZE OF THESE ADJUSTMENTS ALSO DOES NOT WARRANT RE-ARGUING THE ISSUE BEFORE THE COMMISSION.

MEMBERSHIP IN THE USTA AND THE FTA ARE PRUDENT ACTIVITIES AND DUES FOR BELONGING TO THE USTA AND FTA ARE REASONABLE BUSINESS EXPENSES FOR A TELEPHONE COMPANY. INDEED IT IS NOT SUBSTANTIALLY DIFFERENT FROM THE FACT THAT THE OPC BELONGS TO THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES (NASUCA) AND THAT THE COMMISSION STAFF BELONGS TO THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS (NARUC). SOUTHERN BELL SHOULD NOT INCUR DISALLOWANCES FOR REASONABLE BUSINESS EXPENSES SUCH AS THESE. MR. DE WARD'S PROPOSED DISALLOWANCE OF $109,550 SHOULD BE REJECTED.

HIS PROPOSED DISALLOWANCE OF LEGAL FEES AND ACCOUNTING SERVICES FOR EXECUTIVES SHOULD ALSO BE

REJECTED. AS I HAVE POINTED OUT IN RESPONSE TO OTHER BENEFIT EXPENSES WHICH MR. DE WARD HAS PROPOSED TO DISALLOW, THE COMMISSION'S BUREAU OF REGULATORY REVIEW HAS LOOKED AT THE ISSUE OF EXECUTIVE COMPENSATION FOR FLORIDA UTILITIES, INCLUDING SOUTHERN BELL, AND FOUND THAT IT IS REASONABLE. THIS STUDY RECOGNIZED THAT THESE LEGAL FEES AND ACCOUNTING SERVICES WERE PART OF SOUTHERN BELL'S OVERALL EXECUTIVE COMPENSATION PACKAGE. MR. DE WARD'S PROPOSED DISALLOWANCE OF $30,199 SHOULD BE REJECTED.

<u>REBUTTAL TO TESTIMONY OF OPC WITNESS KIMBERLY H. DISMUKES</u>

Q. REGARDING MS. DISMUKES DIRECT TESTIMONY, TO WHICH OF HER RECOMMENDATIONS DO YOU INTEND TO RESPOND?

A. I WILL RESPOND TO TWO RECOMMENDATIONS MADE BY MS. DISMUKES. THE FIRST IS THAT THE COMPANY'S 1993 INTRASTATE REVENUES BE INCREASED BY $341,481 DUE TO THE FACT THAT THE COMPANY DID NOT INCLUDE AN AMOUNT IN ITS BUDGET FOR COMMISSIONS RECEIVED FROM BELLSOUTH TRAVEL SERVICES. THE SECOND RELATES TO HER RECOMMENDATION THAT $100,000 BE DISALLOWED FOR

CERTAIN BELLSOUTH CORPORATION EXPENSES RELATED TO VARIOUS EXPENSE VOUCHERS WHICH SHE REVIEWED.

Q. CAN YOU EXPLAIN UNDER WHAT CONDITIONS COMMISSIONS WOULD BE RECEIVED FROM BELLSOUTH TRAVEL SERVICES?

A. YES. BELLSOUTH TRAVEL SERVICES IS A DEDICATED TRAVEL OFFICE OWNED AND OPERATED BY CARLSON TRAVEL NETWORK IN ACCORDANCE WITH CARLSON'S CONTRACT WITH THE COMPANY. THIS CONTRACT STATES THAT ALL COMMISSIONS AND OVERRIDES EARNED BY CARLSON THROUGH THIS DEDICATED OFFICE SHALL COVER ALL OPERATING EXPENSES AND A MANAGEMENT FEE FOR HANDLING THE COMPANY'S CONTRACT. THE COMMISSIONS AND OVERRIDES ARE DOLLARS CARLSON TRAVEL NETWORK RECEIVES FROM AIRLINES, CAR RENTAL AGENCIES AND HOTELS FOR SELLING THEIR SERVICES TO THE COMPANY. IF THE COMMISSIONS AND OVERRIDES EXCEED THE AMOUNTS DUE CARLSON UNDER THE CONTRACT, PROVISIONS CALL FOR THE REMAINING AMOUNTS TO BE RETURNED TO THE COMPANY. IF THE COMMISSIONS AND OVERRIDES DO NOT COVER THE AMOUNTS DUE CARLSON, THE COMPANY IS REQUIRED TO REIMBURSE CARLSON FOR THE SHORTFALL.

Q. DOES THE COMPANY BUDGET AN AMOUNT ASSOCIATED WITH

THE NET EFFECT OF THE CARLSON CONTRACT?

A. NO. THE COMPANY DOES NOT ANTICIPATE THE NET EFFECT OF THE CARLSON CONTRACT EITHER POSITIVE OR NEGATIVE IN ITS BUDGET.

Q. DO YOU AGREE WITH MS. DISMUKES THAT AN AMOUNT SHOULD BE ADDED TO 1993 REVENUES FOR THIS ISSUE?

A. NO. AS I HAVE PREVIOUSLY DISCUSSED, THE REVENUE AND EXPENSE AMOUNTS IN THE TEST YEAR FORECAST ARE ON TARGET FOR THE YEAR. THIS ISSUE IS SMALL WHEN COMPARED TO THE BUDGETED REVENUE AMOUNT OF APPROXIMATELY $2.4 BILLION. THERE WILL CERTAINLY BE NUMEROUS ITEMS WHICH UNDERRUN OR OVERRUN THE BUDGET, BUT IN TOTAL THE AMOUNTS INCLUDED IN THE TEST YEAR ARE REASONABLE. NO ADJUSTMENT IS APPROPRIATE FOR THIS ISSUE.

Q. WHAT DO YOU PROPOSE TO ADJUST RELATED TO THE BELLSOUTH CORPORATION EXPENSES IN MS. DISMUKES' TESTIMONY?

A. I HAVE BEEN PROVIDED WITH AN AMOUNT TO ADJUST FOR CERTAIN BELLSOUTH CORPORATION EXPENSE VOUCHERS

WHICH MS. DISMUKES REVIEWED. THE FLORIDA INTRASTATE AMOUNT OF THAT ADJUSTMENT IS $23,033. THIS IS IN ADDITION TO THE $73,000 IN RELATED BELLSOUTH CORPORATION COSTS WHICH WE AGREED TO ADJUST IN OPC 1071 AND OPC 1269 AND FOR CERTAIN BCI CONTRIBUTIONS. NO ADDITIONAL ADJUSTMENTS ARE NECESSARY FOR THE 1993 TEST YEAR BECAUSE THIS ADJUSTMENT USED A HIGHER BASE AS A STARTING POINT. THE 1993 ADJUSTMENT IS $967,000 OR 56% HIGHER THAN THE 1992 ADJUSTMENT.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. YES, IT DOES.

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COMBINED "PER BOOKS" AMOUNTS

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY
TRENDS IN FLORIDA REVENUE REQUIREMENTS 1984 - 1992

(000)

ITEM	1984	1985	1986	1987	1988	1989	1990	1991	1992
COMBINED REVENUE	$2,418,988	$2,587,602	$2,721,505	$2,822,233	$2,945,763	$2,920,069	$2,987,381	$3,008,453	$3,086,849
DEPRECIATION EXPENSE	373,193	401,492	474,433	587,433	671,367	670,417	701,016	723,697	726,129
OTHER EXPENSE & TAX	1,294,744	1,363,281	1,395,464	1,410,669	1,532,240	1,519,712	1,562,776	1,592,878	1,694,289
TOTAL EXPENSES	1,667,937	1,764,773	1,869,897	1,998,102	2,203,607	2,190,129	2,263,792	2,316,575	2,420,418
INCOME TAXES	255,883	294,145	315,676	265,734	181,460	158,083	160,936	153,522	162,949
NET OPERATING INCOME	495,168	528,684	535,932	558,397	560,696	571,857	562,653	538,356	503,482
PLANT IN SERVICE	5,855,971	6,312,383	6,785,501	7,271,095	7,827,252	8,310,088	8,719,460	8,762,002	9,065,973
DEPRECIATION RESERVE	937,257	1,152,533	1,427,490	1,816,730	2,242,609	2,732,927	3,164,702	3,207,528	3,598,992
NET PLANT	4,918,714	5,159,850	5,358,011	5,454,365	5,584,643	5,577,161	5,554,758	5,554,474	5,466,981
OTHER INVESTMENTS	132,587	239,422	148,830	87,039	72,447	66,261	91,516	36,172	(46,513)
RATE BASE	5,051,301	5,399,272	5,506,841	5,541,404	5,657,090	5,643,422	5,646,274	5,590,646	5,420,468
AVERAGE ACCESS LINES	3,329,379	3,480,215	3,653,951	3,882,952	4,096,329	4,310,989	4,511,804	4,663,857	4,823,234

PER AVERAGE ACCESS LINE

COMBINED REVENUE	$726.56	$743.52	$744.81	$726.83	$719.12	$677.35	$662.13	$645.06	$640.00
DEPRECIATION EXPENSE	112.09	115.36	129.84	151.29	163.89	155.51	155.37	155.17	150.55
OTHER EXPENSE & TAX	388.88	391.72	381.91	363.30	374.05	352.52	346.37	341.54	351.28
TOTAL EXPENSES	500.98	507.09	511.75	514.58	537.95	508.03	501.75	496.71	501.82
INCOME TAXES	76.86	84.52	86.39	68.44	44.30	36.67	35.67	32.92	33.78
NET OPERATING INCOME	148.73	151.91	146.67	143.81	136.88	132.65	124.71	115.43	104.39
PLANT IN SERVICE	1758.88	1813.79	1857.03	1872.57	1910.80	1927.65	1932.59	1878.70	1879.65
DEPRECIATION RESERVE	281.51	331.17	390.67	467.87	547.47	633.94	701.43	687.74	746.18
NET PLANT	1477.37	1482.62	1466.36	1404.70	1363.33	1293.71	1231.16	1190.96	1133.47
OTHER INVESTMENTS	39.82	68.80	40.73	22.42	17.69	15.37	20.28	7.76	-9.64
RATE BASE	1517.19	1551.42	1507.09	1427.11	1381.01	1309.08	1251.44	1198.72	1123.82

REVENUE REQUIREMENTS PER AVERAGE ACCESS LINE

RETURN REQUIRED	$525,335	$556,125	$556,742	$550,261	$569,669	$572,243	$575,355	$568,569	$552,888
ACTUAL RETURN	495,168	528,684	535,932	558,397	560,696	571,857	562,653	538,356	503,482
DIFFERENCE	30,167	27,441	20,810	(8,136)	8,973	386	12,702	30,213	49,406
EXPANSION FACTOR	0.50308	0.49835	0.49941	0.55546	0.6093	0.60798	0.60889	0.605084	0.6048263
ADDITIONAL REVENUE	59,965	55,064	41,668	(14,647)	14,727	635	20,861	49,931	81,686
REVENUE REQUIREMENT	2,492,805	2,659,410	2,779,215	2,832,078	2,985,134	2,953,031	3,038,879	3,100,488	3,209,486
REVENUE REQ./ACC.LN.	748.67	764.15	760.61	729.36	728.73	685.00	673.54	664.79	665.42

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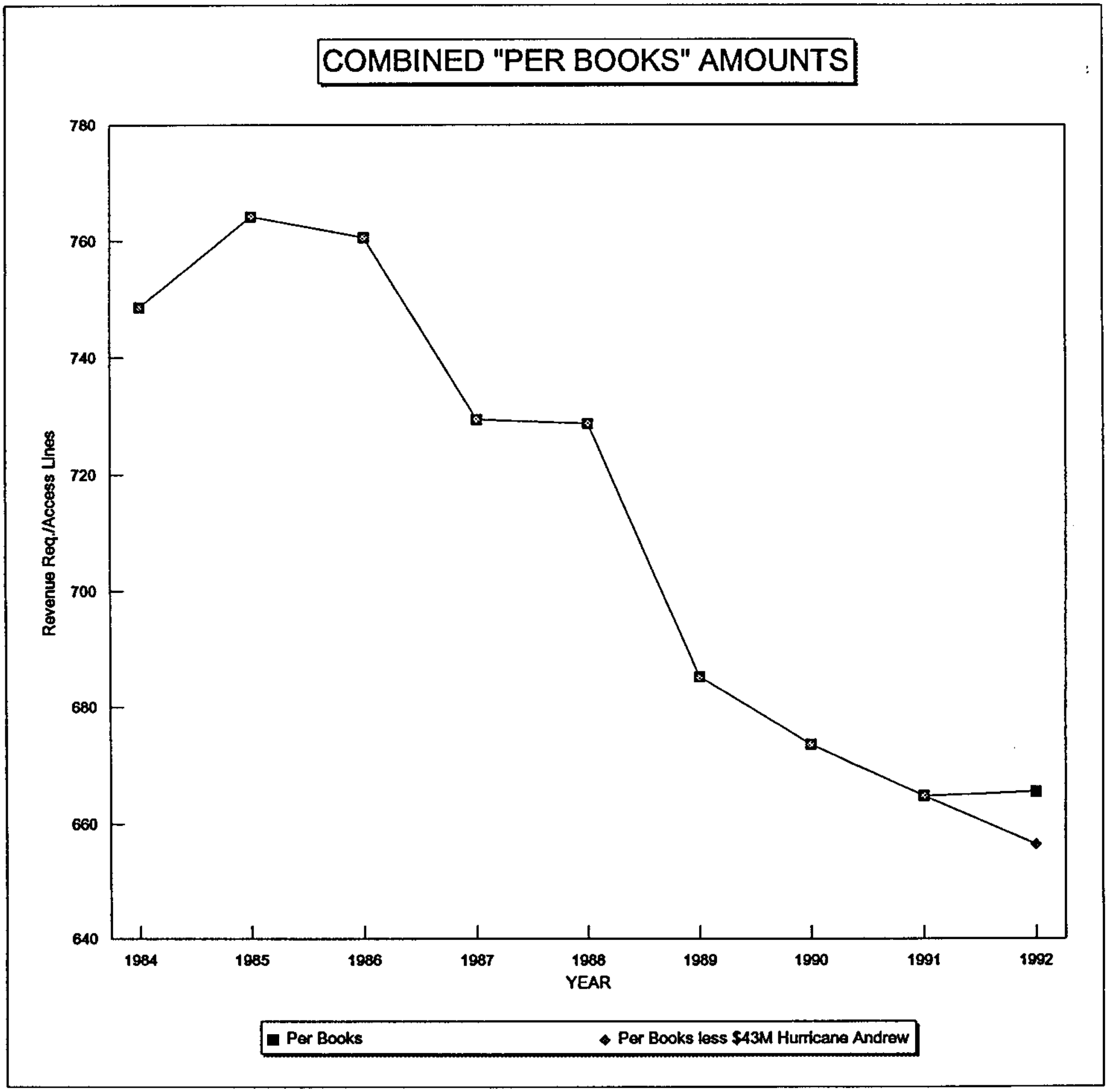
FLORIDA COMBINED REVENUE REQUIREMENT PER AVG ACCESS LINE



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M E M O R A N D U M

July 25, 1985

[redacted]

TO: COMMISSION CLERK

FROM: GENERAL COUNSEL (SEXTON PS)
COMMUNICATIONS DEPARTMENT (BAILEY, LIVINGSTON RCL)

RE: DOCKET NUMBER 840128-TL DIRECTORY ADVERTISING RULE

AGENDA: PLEASE PLACE ON THE AUGUST 6, 1985 AGENDA

ISSUE SUMMARY

ISSUE 1: Should National Yellow Page and foreign advertising revenues be included when computing the 1982 Gross Profit Base and for subsequent year calculations?

RECOMMENDATION: Yes.

ISSUE 2: Should Southern Bell's gross profit base be set at the actual achieved per books amount of $107,076,637 or should the company's requested amount of $102,215,043 (60% of Revenues) be approved?

RECOMMENDATION: Southern Bell's gross profit base should be set at $102,215,043.

ISSUE 3: What consumer price index should be used?

RECOMMENDATION: The Consumer Price Index-All Urban (CPI-U) should be used.

ISSUE 4: Should the rule require that the customer growth factor and the CPI-U index be additive or should it be compounded?

RECOMMENDATION: The factors should be compounded.

ISSUE 5: Should Account 523 - Directory Revenues less Account 649 - Directory Expenses including white page costs be used to calculate gross profit?

RECOMMENDATION: Yes.

ISSUE 6: Should the attached rule governing the ratemaking treatment for telephone directory advertising revenues and expenses be proposed?

RECOMMENDATION: Yes.

INTRODUCTION

This rule is proposed for the purpose of spelling out precisely how the provisions of Section 364.037, Florida Statutes (1983) relating to telephone Directory Advertising shall be applied in the ratemaking process. Subsection 364.037(1) provides that for ratemaking purposes the 1982 gross profit from directory advertising, adjusted for customer growth and for the Consumer Price Index, shall be included as regulated profit. The actual gross profit shall be used if less than the 1982 adjusted amount. Subsection 364.037(3) provides that the 1982 gross profit base shall be actual gross profit for 1982 but that directory expenses in excess of 40% of the directory revenues will be excluded; and Subsection 364.037(5) provides that no less than two-thirds of the test year gross profit shall be included in the regulated operations for the test year. The rule, which will be described section-by-section under Issue 6, is designed to fully implement Section 364.037. It incorporates a complete formula for calculating customer growth and CPI growth and incorporates accounting and reporting requirements. In addition it fixes the 1982 base data for CPI, 1982 gross profits and 1982 customers (using access lines). In this manner, the rule becomes a one-stop process for ratemaking and relieves the Commission of the need to repeatedly review 1982 base data for each Company.

Since the law was passed in 1983 the Staff has audited the 1982 base year gross profits and average access lines reported by the companies, held meetings with the companies to discuss the proposed rule and polled their opinion on various items such as use of CPI-U (all urban) and definition of access lines, etc. The following is an example of a rate case adjustment calculation:

> ABC Telephone Company had directory revenue (a/c 523) of $1,000,000 Directory expenses (a/c 649) of $450,000, average access lines of 3000, and the CPI-U index was 289.1 for <u>CY 1982</u>.
>
> The company files for increased rates based on a <u>CY 1984</u> test-year. Their directory revenues (a/c 523) are $1,300,000, directory expenses (a/c 649) are $500,000, average access lines are 3,300 and the CPI-U index is 311.1 for the year.
>
> <u>Question 1:</u> What is the base period (1982) gross profit amount?

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Answer: Gross Profit (base) = Directory Revenues less Directory Expense (Directory expenses may not exceed 40% of Revenues) $600,000 (1,000,000 - 400,000)

Question 2: What is the rate case adjustment for directory advertising profit?

Answer:

Test year gross profit (1,3000,00 - 500,000)		$800,000
Regulated profit (See calculation below)		$710,160
Rate Case Adjustment to move a portion of gross profit below the line. (Unregulated Profit)		($ 89,840)

Regulated profit is calculated as follows:

Gross Profit Base		$600,000	
Access Line Growth Factor (3300/3000)	x	1.10	
GP adjusted for growth	=	$660,000	
CPI Factor (311.1/2.89.1)	x	1.076	
Regulated Gross Profit	=	$710,160	or $533,333 (2/3 of $800,000) whichever is greater.

Since both the Statute and the rule involve new policies, the Staff has submitted the rule for initial Commission review before preparing an Economic Impact Statement. Upon approval of the Staff's draft or a decision on an alternative, the Staff will return with an Economic Impact Statement for your review.

DISCUSSION

ISSUE 1: Should National Yellow Page and foreign advertising revenues be included when computing the 1982 Gross Profit Base and for subsequent year calculations.

RECOMMENDATION: Yes.

Position of Parties:

Central Telephone Company: Central contends that the statute terminology "outside the Company's franchise area" should be interpreted to exclude National Yellow Page and foreign advertising revenues. They argue that these two types of advertising are a service provided to advertisers outside the company's local franchised area and that the gross profit from this advertising is not derived from the local customers.

General Telephone Company: GTFL excluded the national yellow page revenue and expense from their proposed base period gross profit amount without explanation.

Vista-United Telecommunications: Vista-United argues as follows. "Vista-United does not believe the gross revenue as reported by National Yellow Pages (NYP) to be revenue to us nor is the related Commission expense part of our directory advertising expense. It is Vista-United's directory subcontractor's settlement with Vista-United that Vista-United uses for purposes of determining gross revenue."

Other Companies: The other companies have not taken issue with staff's position on this issue.

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STAFF ANALYSIS

Our understanding of National Yellow Page Service (NYPS) is that a company (non-telco) with statewide or nationwide operations (e.g., DuPont) can contract with their headquarters area telephone company or directory company to place advertising in all of the directories published in the non-telco's operating territory. They pay the headquarters area telco or directory company for the national yellow page advertising who in turn remits the gross revenues less commissions to the other telephone companies who publish the directories.

Foreign advertising is advertising by businesses from outside the telephone company's service area such as a business in Jacksonville with an FX line to Tallahassee advertising in the Tallahassee directory. The business in Jacksonville deals directly with Centel rather than going the NYPS route.

We contend that all revenue derived from directories published by the telephone company for the benefit of their subscribers in their franchised territory should be included in the gross profit base and the subsequent year calculations. We interpret the "outside the company's franchise area" statute language to mean revenues derived from directories published for use in areas outside the franchised area. Thus National Yellow Page and foreign advertising revenues should be included in calculating both the base amount and in subsequent year calculations.

ISSUE 2: Should Southern Bell's gross profit base should be set at the actual achieved per books amount of $107,076,637 or should the

Company's requested amount of $102,215,043 (60% of revenues) be approved?

RECOMMENDATION: Southern Bell's gross profit base should be set at $102,215,043.

Position of Parties:

Southern Bell: Southern Bell contends that the gross profit base for 1982 should be $102,215,043 in recognition of the fact that in 1982 the Company carried on its books all revenues and expenses associated with directory operations. However, starting in 1984, a separate subsidiary of BellSouth Corporation, BellSouth Advertising And Publishing Company (BAPCO) was formed and this subsidiary has the responsibility for the directory advertising operations. Southern Bell contracts with BAPCO much the same as another telco might contract with L.M. Berry. The formation of BAPCO places Southern Bell-Florida operations on the same basis as other telephone companies in Florida who contract for directory sales and publishing work.

STAFF ANALYSIS

The gross profit base amount is very significant because it, with adjustments for growth and price increases, will be the basis for determining the regulated directory advertising profit to be included in future rate proceedings. The higher the base, the greater the regulated profit.

Audited results show that all companies except Southern Bell will be using 60% of 1982 revenues as their gross profit base if we use audited per books Account 523 Directory Revenues less Account 649 Directory Expenses.

This is due to the fact that during 1982 Bell was operating with their own employees while the other companies were contracting out the directory advertising function. As a result, the companies using contractors recorded the commissions paid in Account 649 Directory Expenses while Bell recorded only direct costs (salaries and printing costs) in this account. Other indirect expenses such as pensions, payroll taxes, group insurance, etc. were recorded in other accounts by Southern Bell. The audited amount of expenses recorded in Account 649 for Southern Bell for 1982 was $63,281,768 whereas the total directory expenses (including all related indirect expenses) was $78,841,914. Under the law, expenses are limited up to 40% of revenues which is $68,143,362 ($170,358,405 x 40%). Thus, the $78,841,914 total expense cannot be used. It appears therefore, that we have two choices. We can either use actual direct expenses of $63,281,768 which produces a gross profit of $107,076,637 ($170,358,405 - $63,281,768) or a gross profit of $102,215,043 ($170,358,405 - $68,143,362) based on 40% expense limit taking into consideration Southern Bell's indirect directory expenses. In the future Bell will be contracting the directory function with their associated company (BAPCO) and will be recording commissions paid in Account 649. In order that the base period (1982) gross profit and future period gross profit calculations be compatable we recommend that the gross profit base be set at $102,215,043 using the 40% limit. This will put all telephone companies on an even footing in that they will all be using a 1982 gross profit base equal to 60% of gross revenues. This will also recognize the indirect expenses incurred by Southern Bell for advertising that were previously recorded in accounts other than account 649 Directory Expenses.

ISSUE 3: What consumer price index should be used?

RECOMMENDATION: The Consumer Price Index-All Urban (CPI-U) should be used.

Postion of parties:

CONTINENTAL TELEPHONE COMPANY: Contel recommends use of the Gross National Product Implicit Price Deflator (GNPIPD). They point out that this index is used by the New York Public Service Commission in projected test year rate cases. They contend that the GNPIPD index is a more appropriate measure of the effect of inflation on the economy.

QUINCY TELEPHONE COMPANY: Quincy comments as follows; "We suggest the use of an index which would subtract housing prices. This suggestion is based on the fact that moving activity in our service area is not very high; also, we have very few apartment dwellings."

SOUTHERN BELL: Southern Bell recommends use of CPI-W because this index is based on wages earned which would correlate to labor costs associated with directory operations. They point out that CPI-W has been used by the Commission in analyzing expense growth in rate cases.

UNITED TELEPHONE COMPANY: United favors the use of CPI-U (All Urban) stating that it is the most appropriate index for use in this case because it covers all sectors of the economy and all areas of the country, it is least susceptible to temporary statistical abberations in specific industries or specific geographical areas. Concern that the CPI-U has become distorted due to housing costs has become somewhat mitigated since in January, 1983, the Bureau of Labor Statistics modified the CPI-U to incorporate a rental equivalence measure of housing costs. The old method calculated homeowner costs as home purchase, mortgage interest costs, property taxes, property insurance and maintenance and repair. Distortion sometimes resulted from fluctuating mortgage rates. We believe the new methodlogy virtually eliminates the possibility of CPI-U distortion due to the housing component.

OTHER COMPANIES: The other companies either agreed, had no objection or no comment on the use of the CPI-U (All Urban) index as a measure of inflation.

STAFF ANALYSIS

Our reasons for selecting the CPI-U (All Urban) index over the other CPI indexes is that we felt a broad measure of price increases was called for in this case. The use of a broad gauge of overall inflation for determining the portion of gross profit from directory advertising to be used in setting local telepone rates seems appropriate. We believe that CPI-U is a better indication of the overall inflation being-experienced by the telco's directory operations than CPI-W - (Urban Wage Earners and Clerical Workers) or some of the other indices. The Commission uses CPI-U in testing operating and maintenance (O&M) expense increases and therefore using it in this rule would be consistent with the O&M check calculation.

ISSUE 4: Should the rule require that the customer growth factor and the CPI-U index factor be additive or should it be compounded.

RECOMMENDATION: The factors should be compounded.

Position of Parties:

ALLTEL Florida, Inc.: ALLTEL contends that the factors should be added because "both the customer growth and the CPI factors individually are compounded. To multiply these factors would overstate the growth in gross profits".

Central Telephone Company: Central contends that compounding is not consistent with the law and quotes the Florida Statute 364.037(1) as follows:

> The gross profit from directory advertising to be included in the calculation of earnings for ratemaking purposes shall be the amount of gross profit derived from directory advertising during the year 1982 adjusted for each subsequent year, by the Consumer Price Index published by the United States Department of Commerce and by customer growth".

Their position is that the use of the words and by indicates that the factor should be applied in an additive fashion.

General Telephone Company: General's position is that the formula should be additive for the following reason. "The compounded formula suggests a relationship exists between CPI growth and access line growth. However, there is no interdependence between CPI and customer growth making the compounded formula proposed in the rule improper".

Southern Bell: Southern Bell's position is that compounding is incorrect. "In this particular use of access lines and a CPI index, which are at best broad measurements of change, it would appear that compounding may simply magnify any degree of error produced by their use".

United Telephone Company: United recommends use of the compounding formula stating that it is theoretically correct. "The process of reflecting both growth and changes in price level is inherently a multiplicative function, which argues for the compound formula. For example suppose the base, as measured by access lines were to double in size, a factor of 100%. Suppose also that the price level according to CPI were to double. The result would be an entity four times as large in nominal (inflated) dollars. However the additive approach would only call for a tripling effect (base + 100% + 100%)".

St Joseph Telephone & Telegraph Company and Southland Telephone Company: These two companies did not take a position on the formula.

All Other Parties: The others were unanimous in their position that the compounding formula was incorrect.

STAFF ANALYSIS

We contend that it is appropriate to compound the growth factor and the CPI factor because the price increases would apply to the total units including the units added due to growth and not just to the base period units. The Commission has used a similar application of growth and CPI index factors in testing the reasonableness of increases in operation and maintenance expenses over time (i.e., O & M expense check calculation). The factors used in those calculations are compounded. Therefore Staff is of the opinion that the methodology used for the Directory Advertising rule and the

O & M expense check should be consistent.

ISSUE 5: Should we use Account 523 - Directory Revenues less Account 649 - Directory Expenses including white page costs to calculate gross profit.

RECOMMENDATION: Yes.

Position of Parties:

General Telephone: Staff proposed a base period gross profit for General in the amount of $22,371,496 which was derived by subtracting expenses of $14,914,331 ($37,285,827 x 40%) from audited revenues in Account 523 of $37,285,827. The Company proposed the use of an amount of $22,981,401 which was derived by subtracting expenses of $14,312,741 (actual $19,025,371 less white page cost of $4,712,630) from revenues of $37,294,142. The white page costs are estimated at about 25% of directory expenses.

United Telephone: Staff proposed a base period gross profit for United in the amount of $13,459,664 which was derived by subtracting expenses of $8,973,110 ($22,432,774 x 40%) from audited revenues in Account 523 of $22,432,774. The Company proposes to use an amount of $13,733,955 which is derived by subtracting expenses of $8,698,819 (actual $10,455,815 less white page costs of $1,756,996) from revenues of $22,432,774. The following notation is the company's description of the white page costs which they propose to exclude.

> Expenses associated with white pages represents amounts on the Company's books for "alpha" related expenses as well as a portion of agency commissions for their

> white pages expenses and an allocation of the Company's booked expenses not directly associated with either white or yellow pages based on the number of white pages as a percentage of total pages."

<u>All Other Companies</u>: The other telephone companies did not propose excluding white page costs.

STAFF ANALYSIS

For purposes of this rule we have proposed to include the white page costs because the allocations between white and yellow are arbitrary in our opinion Staff does not believe including the white page costs will have a material effect on the amounts included for ratemaking purposes, as long as we are consistent in including these costs in the base period amount and in the future rate case test period amounts. Staff proposes to keep the calculation of gross profit simple by using directory revenues less directory expenses (Account 523 Directory Revenues less Account 649 Directory Expenses) and make execution of the rule as straightforward and free of questionable interpretations as possible.

<u>ISSUE 6</u>: Should the attached rule governing the rate making treatment for telephone directory advertising revenues and expenses be adopted?

<u>RECOMMENDATION</u>: Yes.

STAFF ANALYSIS

The purpose of this rule (Attachment I) is to define as clearly as possible the rate making treatment that is to be afforded under section 364.037, Florida Statutes (1983) (Attachment II). The rule defines the revenues and expenses to be included, defines the growth factor, the CPI factor and spells out precisely how the test period gross profit is to be calculated. Staff believes the adoption of this rule will remove all doubt as to how the gross profit from directory advertising shall be calculated and be treated for rate making purposes.

Following is a section by section analysis of proposed rule 25-4.405.

Section	Analysis
(1)	This subsection defines the purpose of the rule in conjunction with the provisions of Section 364.037 Florida Statutes (1983) to govern the ratemaking treatment for telephone directory advertising revenues and expenses.
(2)(a)	This paragraph sets out the formula used to determine test year regulated gross profit.
(2)(b)	This paragraph sets out the formula to determine customer growth.
(2)(c)	This paragraph sets out the formula for CPI adjustments.
(2)(d)	This paragraph defines access lines for use in (2)(b).
(2)(e)	This paragraph states the exceptions to the calculated amount of test year regulated gross profit.
(2)(f)	This paragraph defines the accounts that are to be used for calculating the actual gross profit for the test period.
(2)(g)	This paragraph defines the revenues that are to be included for the test period.
(3)	This subsection delineates the 1982 gross profit base for each of the local exchange telephone companies.
(4)	This subsection delineates the number of base period (1982) average access lines for each of the local exchange companies.

(5) This subsection requires the filing of annual financial results for the directory advertising operations as part of the annual report Form M.

JB/bg
6940C3
cc: Commissioners
Bill Talbott
Legal Department

25-4.405 Telephone Directory Advertising Revenues.

(1) The provisions of this rule, in conjunction with the provisions of Section 364.037, Florida Statutes (1983), shall govern the ratemaking treatment for telephone directory advertising revenues and expenses.

(2) Adjustments under Section 364.037(1) for customer growth and Consumer Price Index shall be calculated in accordance with paragraph (a), producing a Test Year Regulated Gross Profit. Except as provided in paragraph (e), the Test Year Regulated Gross Profit shall be used to establish the test year gross profit from directory advertising in the local franchise area to be considered in setting rates for telecommunications service.

(a) The Test Year Regulated Gross Profit is determined as follows: Test Year Regulated Gross Profit = 1982 Gross Profit Base x Customer Growth Factor x CPI factor.

(b) The Customer Growth Factor is determined as follows:

$$\text{Customer Growth Factor} = \frac{\text{Average test year access lines}}{\text{Average 1982 access lines.}}$$

(c) The CPI Factor reflects CPI adjustments made using the annual average Consumer Price Index - All Urban (CPI-U) as follows:

$$\text{CPI Factor} = \frac{\text{Annual average CPI-U for test year}}{289.1}$$

(d) An access line is any exchange line that provides residential or business service as follows:

1. Residential lines (R1, 2, 4, etc.);
2. Business lines (B1, 2, 4, etc.);
3. Centrex lines;
4. PBX trunks; or
5. Key system lines.

(e) When the Test Year Regulated Gross Profit is less than two thirds of the actual test year gross profit from directory

CODING: Words underlined are additions; words in ~~struck-through type~~ are deletions from existing law.

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advertising, two thirds of the actual test year gross profit shall be used. When the Test Year Regulated Gross Profit is greater than the actual test year gross profit from directory advertising, the actual test year gross profit shall be used.

(f) Each local exchange company shall record its directory advertising revenues in revenue account 523 (Directory Revenues) and shall record its directory advertising expenses in expense account 649 (Directory Expense). The actual test year gross profit from telephone directory advertising shall be determined by subtracting the amount recorded in expense account 649 from the amount recorded in revenue account 523, with such adjustments as the Commission deems appropriate.

(g) Directory advertising revenues and expenses, as used in this rule, shall include revenue and expenses from both yellow page advertising, including national advertising, and any boldface or other highlighted white page listings for directories within the franchised area of the exchange telephone company.

(3) The dollar amount of the 1982 Gross Profit Base for each local exchange telephone company is established pursuant to Section 364.037(3) as follows:

Local Exchange Company	1982 Gross Profit Base
ALLTEL Florida, Inc.	$ 299,380
Central Telephone Company of Florida	$ 3,091,181
Continental Telephone Company of the South - Florida	$ 173,872
Florala Telephone Company, Inc.	$ 1,780
General Telephone Company of Florida	$22,371,496
Gulf Telephone Company	$ 54,794
Indiantown Telephone System, Inc.	$ 28,319
Northeast Florida Telephone Company, Inc.	$ 20,676
Quincy Telephone Company	$ 68,580

CODING: Words underlined are additions; words in ~~struck-through~~ type are deletions from existing law.

St. Joseph Telephone and Telegraph Company	$ 148,538
Southern Bell Telephone & Telegraph Company-Fla.	$102,215,043
Southland Telephone Company	$ 8,630
United Telephone Company of Florida	$13,459,664
Vista-United Telecommunications	$ 161,840

(4) The Average 1982 Access Lines for each local exchange telephone company is as follows:

<u>Local Exchange Company</u>	<u>1982 Average Access Lines</u>
ALLTEL Florida, Inc.	56,435
Central Telephone Company of Florida	142,628
Continental Telephone Company of the South - Florida	20,832
Florala Telephone Company, Inc.	1,417
General Telephone Company of Florida	1,157,203
Gulf Telephone Company	5,934
Indiantown Telephone System, Inc.	1,501
Northeast Florida Telephone Company, Inc.	3,874
Quincy Telephone Company	7,089
St. Joseph Telephone and Telegraph Company	16,229
Southern Bell Telephone & Telegraph Company - Florida.	2,993,084
Southland Telephone Company	2,279
United Telephone Company of Florida	574,150
Vista-United Telecommunications	1,706

(5) As part of its annual report required by Rule 25-4.18, each local exchange telephone company shall submit the audited financial results of directory advertising operations during the prior calendar year.

Specific Authority: 350.127(2), F.S.

Law Implemented: 364.037, F.S.

History: New

CODING: Words <u>underlined</u> are additions; words in ~~struck-through type~~ are deletions from existing law.

4699G

ser and the facilities, instrumentalities, and equipment furnished by it shall be safe and kept in good condition and repair and its appliances, instrumentalities, and service shall be modern, adequate, sufficient, and efficient.

(2) Every telephone company operating in this state shall provide and maintain suitable and adequate buildings and facilities therein, or connected therewith, for the accommodation, comfort, and convenience of its patrons and employees.

(3) Every telephone company shall, upon reasonable notice, furnish to all persons who may apply therefor and be reasonably entitled thereto suitable and proper facilities and connections for telephonic communications and furnish telephone service as demanded upon terms to be approved by the commission.

History.—s. 3, ch. 6525, 1913; RGS 4396; CGL 6360; s. 3, ch. 76-168; s. 1, ch. 77-457; ss. 3, 32, ch. 80-36; s. 2, ch. 81-318.

[1]Note.—Repealed effective October 1, 1989, by s. 2, ch. 81-318, and scheduled for review pursuant to s. 11.61 in advance of that date.

[1]364.035 Rate fixing; criteria service complaints.—

(1) In fixing the just, reasonable, and compensatory rates, charges, fares, tolls, or rentals to be observed and charged for service within the state by any and all telephone companies under its jurisdiction, the commission is authorized to give consideration, among other things, to the efficiency, sufficiency, and adequacy of the facilities provided and the services rendered, including energy conservation and the efficient use of alternative energy resources; the value of such service to the public; and the ability of the telephone company to improve such service and facilities; except that no telephone company shall be denied a reasonable rate of return upon its rate base in any order entered pursuant to such proceedings. In its consideration thereof, the commission shall have authority, and it shall be the commission's duty, to hear service complaints, if any, that may be presented by subscribers and the public during any proceedings involving such rates, charges, fares, tolls, or rentals; however, no service complaints shall be taken up or considered by the commission at any proceedings involving rates, charges, fares, tolls, or rentals unless the telephone company has been given at least 30 days' written notice thereof, and any proceeding may be extended, prior to final determination, for such period; and, further, no order hereunder shall be made effective until a reasonable time, considering the factor of growth in the community and availability of necessary equipment, has been given the telephone company involved to correct the cause of service complaints.

(2) The power and authority herein conferred upon the commission shall not cancel or amend any existing punitive powers of the commission but shall be supplementary thereto and shall be construed liberally to further the legislative intent that adequate service be rendered by telephone companies in the state in consideration for the rates, charges, fares, tolls, and rentals fixed by the commission and observed by the telephone companies under its jurisdiction.

History.—s. 25, ch. 80-36; s. 2, ch. 81-318.

[1]Note.—Repealed effective October 1, 1989, by s. 2, ch. 81-318, and scheduled for review pursuant to s. 11.61 in advance of that date.

[1]364.037 Telephone directory advertising revenues.—The commission shall consider revenues derived from advertising in telephone directories when establishing rates for telecommunication services. When establishing such rates, the gross profit from all directory advertising in the local franchise area of a telephone company shall be allocated between the regulated portion and the nonregulated portion of its operation as provided in this section.

(1) The gross profit derived from directory advertising to be included in the calculation of earnings for ratemaking purposes shall be the amount of gross profit derived from directory advertising during the year 1982 adjusted, for each subsequent year, by the Consumer Price Index published by the United States Department of Commerce and by customer growth or, if lesser, the amount of gross profit actually derived from directory advertising in the local franchise area for the year.

(2) The gross profit derived from directory advertising to be allocated to the nonregulated operation of a company shall be the gross profit which is in excess of the adjusted 1982 amount determined in accordance with subsection (1).

(3) For the purpose of this section, the amount of gross profit of a company from directory advertising for the year 1982 is the actual gross profit derived from such advertising for that year. If, however, the expense to a company to furnish directories in 1982 exceeded 40 percent of the gross revenue derived from its directory advertising, the 1982 level of gross profit shall be adjusted to reflect a cost of 40 percent of its 1982 gross revenue. This adjusted 1982 gross profit level shall be utilized in lieu of actual gross profit for 1982 when making the calculations in subsection (1).

(4) Any profit associated with providing directory advertising service outside the franchise area of a company may not be considered when determining gross profit derived from directory advertising for ratemaking purposes. Any investment or expenses associated with providing directory advertising service outside its franchise area may not be recovered through rates for telephone service.

(5) Notwithstanding any provision of this section to the contrary, no less than two-thirds of the total gross profit of a company from directory advertising within its local franchise area for any year shall be included in the regulated portion of its operation when establishing rates.

History.—ss. 1, 7, ch. 83-72.

[1]Note.—Expires October 1, 1989, pursuant to s. 7, ch. 83-72, and is scheduled for review pursuant to s. 11.61 in advance of that date.

[1]364.04 Schedules of rates, tolls, rentals, contracts, and charges; filing; public inspection. —

(1) Upon order of the commission, every telephone company shall file with the commission, and shall print and keep open to public inspection at such points as the commission may designate, schedules showing the rates, tolls, rentals, contracts, and charges of that company for messages, conversations, and services rendered and equipment and facilities supplied for messages and service to be performed within the state between each point upon its line and

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Adoption of Rule 25-4.405 - Telephone Directory Advertising Revenues.	Docket No. 840128-TL Filed: December 27, 1985

Comments of the Citizens of the State of Florida

Pursuant to Section 25-22.16, Florida Administrative Code, the Citizens, by and through the Public Counsel, Jack Shreve, submit these Comments regarding Proposed Rule 25-4.405.

The purpose of the proposed rule is to implement Section 364.037, Florida Satutes. (See appendix 2). Through the statute, the Legislature has directed that directory advertising revenues in the form of gross profits be shared between the ratepayers and shareholders. To this end the statute provides a mechanism for the allocation of this profit. In designating the amount of gross profit to be allocated to the ratepayers, the statute requires that a benchmark amount of gross profit is established using 1982 actual gross profit, adjusted for growth. If the benchmark amount of gross profit is greater than actual test year gross profit, then the ratepayer receives the benefit of the entire actual test year gross profit. If, however, the actual test year amount is greater than the benchmark amount, the ratepayers get the greater of the benchmark or two thirds of the actual. The rest goes to the shareholders. The determination of the level of this residual amount is at issue in this rulemaking.

12-31-85
cc-R. Stoney
WBB

The Commission staff has proposed a rule which simply and straightforwardly implements the intent of Legislature. Simply stated, the rule requires that the benchmark gross profit be calculated by subtracting total expenses for furnishing telephone directories from total revenues from yellow and white page advertising. The same calculation is performed to determine test year gross profit. Once the benchmark amount has been determined by adjusting the 1982 gross profit figure for inflation and growth, the allocation is properly made.

In light of the fact that a portion of the revenues are being diverted to the deregulated operations, the Citizens feel that the rule as proposed by the staff vigilantly and fairly protects the remaining revenues for the benefit of the ratepayer. Our comments are made primarily for the purpose of supporting Staff's draft, and proposing several amendments to the rule consistent with the statute and the Staff's stated intentions. To this end we propose five changes found in appendix 1. Four of the changes are offered merely as clarification, while the fifth is new, yet entirely consistent with the subject matter of the rule.

The thrust of the Companies' (United, Gentel, & Southern Bell) objections to the proposed rule is to seek to have the rule rewritten in such a way that would allow them to divert from the ratepayers an additional $25.8 million in a manner not comtemplated by the statute. (See appendix 3). Their argument is that all white page expenses should be excluded from the benchmark calculations found in Section 3 of the rule. They also contend that white page expenses should not be included in the gross profit calculation for the test year either. The rationale for this position is summed up by the testimony of Mr. Johnson on behalf of General Telephone where he asserts that "white page expense is a regulated Commission activity and has no relationship to Directory Advertising...[and] to include white page expense would appear to be contrary to this statute". (TR.27)

What the objectors like Mr. Johnson fail to realize, however, is that the statute plainly requires that white page expenses be included in the gross profit calculations. The Commission should be mindful that 364.037(3) flatly directs that the gross profit be calculated by subtracting the "expense to a company to furnish directories" from the gross revenue derived from directory advertising. While this section of the statute refers to gross profit calculation to be made for the year 1982, there is nothing in the statute, however, which suggests that the gross profit calculation for the test year should be made in any different manner. In fact, the only logical conclusion is that, for comparison purposes, the intent of the statute is for the test year calculations to be done exactly the same way.

Section 2(f) of the purposed rule is in complete accord with this interpretation of the statute. There, the gross profit is calculated by subtracting the amount recorded in expense account 649 from the amount recorded in revenue account 523. Mr. Johnson himself acknowledged the correctness of the Staff's interpretation of the statute. On the witness stand, he agreed that white page expenses are recorded in expense account 649 and are expenses incurred in furnishing directories. (TR. 34 & 35)

Although any dispute in this docket can be readily resolved by reference to the plain meaning of the language of the statute, it should be further noted that the statute and the rule as proposed comport with the realities of the situation. Since telephone directories are the vehicle for getting the white and yellow page advertising "in the door" so to speak, the expenses associated with furnishing directories are properly included in the gross profit calculations. The language of the statute is entirely consistent with the view that all costs incurred in furnishing telephone directories and associated white and yellow pages advertising are joint costs and as such are properly includable in the gross profit calculations.

The bottom line is that the Company's argument, that inclusion of white page expense is contrary to the statute is without foundation and, in fact, plain wrong.

The Citizens feel that the rule as drafted by the staff implements both the spirit and the letter of the statute. It is our view that as written the statute unequivocally requires that white page expenses be included in gross profit calculations. However, since the companies in their comments at hearing and in prefiled testimony have suggested that the rule requires that only expenses associated with directory advertising should be included in the gross profit calculations, the Citizens offer language designed to eliminate any doubt about what expenses are to be included. Therefore, we propose that any reference to the phrase "directory advertising expenses" be eliminated and instead the phrase "expenses incurred in furnishing directories" be subsituted. (See 2(f) & (g) in appendix 1). As written, this proposed language makes it abundantly clear that all white page expenses are to be included consistent with the statutory intent.

Citizens also purpose two other changes to the rule that are merely technical and designed to eliminate any future confusion as to what is intended by the rule. One change merely indicates that the gross profit base is that which the staff has calculated and included in Section 3 of the rule, while the other is intended to avoid any problems associated with a possible future resetting of the CPI base year and/or base number. (See 2(a) and (c) in appendix 1).

The Citizens also proposed a new Section 2(h) in order that the level of commissions paid by local exchange telephone companies will be subject to close scrutiny so that the profits from directory advertising are not improperly diverted to the shareholders in an indirect manner. Conceivably, companies which contract with affiliated companies for provision of directories could artifically escalate the level of commissions paid to those affiliates. If there is no mechanism for keeping these commission levels in check, revenues which would otherwise flow to the ratepayers in the form of gross profits allowed under 364.037 could be diverted to the shareholders of the parent company. The

Commission must be able to take a hard look at the level of commission payments in order to insure that they are reasonable in light of circumstances. Such circumstances should include the nature of the affiliate relationship, the level of payments made by companies to non-affiliated telephone directory providers, and the economies of scale which would be expected in provision of large number of telephone directories. The Citizens feel that the rule as proposed and the proposed new Section 2(h) are consistent in that each is a mechanism which will allow the ratepayers of the telephone companies to retain the maximum benefit of directory advertising revenues consistent with the statute. At a minimum, the companies would be on notice that commission payments would be subject to review.

In sum, the statute and the proposed rule provide the companies with an incentive to maximize profits from directory advertising so that their shareholders may now share in a source of revenue which previously innured solely to the benefit of the ratepayers. The staff of the Commission has acted responsibly in providing a fair method of allocation of directory advertising profits and we urge the Commission to adopt the rule along with the suggested amendments.

Respectfully submitted,

/s/
Jack Shreve
Public Counsel
State of Florida

Charles J. Beck
Associate Public Counsel

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202 Blount Street
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(904) 488-9330

Attorneys for the Citizens
of the State of Florida

Citizens Proposed Changes to Rule 25-4.405

(2)(a) The Test Year Regulated Gross Profit is determined as follows: Test Year Regulated Gross Profit = 1982 Gross Profit Base (as shown in Section (3) below) x Customer Growth Factor x CPI Factor.

(c) The CPI Factor reflects CPI adjustments made using the annual average Consumer Price Index - All Urban (CPI-U) as follows:

CPI Factor = Annual average CPI-U for test year / 289.1 (or equivalent)

(f) Each local exchange company shall record its directory advertising revenues in revenue account 523 (Directory Revenues) and shall record ~~its-directory-advertising-expenses~~ the expenses incurred in furnishing directories in expenses account 649 (Directory Expense). The actual test year gross profit from telephone directory advertising shall be determined by subtracting the amount recorded in expense account 649 from the amount recorded in revenue account 523, with such adjustments as the Commission deems appropriate.

(g) ~~Directory-advertising-revenues-and-expenses,-as-used in-this-rule,-shall-include-revenue-and-expenses-from-both~~

~~yellow--page-advertising,-including-national-advertising, and-any-boldface-or-other-highlighted--white--page--listings--for directories--within-the-franchised-area-of-the-exchange-telephone company.~~

(g) Directory advertising revenues as used in this rule, shall include revenues from yellow pages advertising, including national, as well as the revenues from any boldface or highlighted white page listing for directories within the franchised area of the exchange telephone company. Expenses as used in this rule shall include expenses incurred by the exchange telephone companies in furnishing directories, including white page expense.

New

(h) The Commission shall also determine the reasonableness of the amount of test year payments made by each local exchange telephone company to its telephone directory provider(s), especially if the provider(s) is an affiliate, when determining adjustments to be made under (f) above.

'364.037 **Telephone directory advertising revenues.**—The commission shall consider revenues derived from advertising in telephone directories when establishing rates for telecommunication services. When establishing such rates, the gross profit from all directory advertising in the local franchise area of a telephone company shall be allocated between the regulated portion and the nonregulated portion of its operation as provided in this section.

(1) The gross profit derived from directory advertising to be included in the calculation of earnings for ratemaking purposes shall be the amount of gross profit derived from directory advertising during the year 1982 adjusted, for each subsequent year, by the Consumer Price Index published by the United States Department of Commerce and by customer growth or, if lesser, the amount of gross profit actually derived from directory advertising in the local franchise area for the year.

(2) The gross profit derived from directory advertising to be allocated to the nonregulated operation of a company shall be the gross profit which is in excess of the adjusted 1982 amount determined in accordance with subsection (1).

(3) For the purpose of this section, the amount of gross profit of a company from directory advertising for the year 1982 is the actual gross profit derived from such advertising for that year. If, however, the expense to a company to furnish directories in 1982 exceeded 40 percent of the gross revenue derived from its directory advertising, the 1982 level of gross profit shall be adjusted to reflect a cost of 40 percent of its 1982 gross revenue. This adjusted 1982 gross profit level shall be utilized in lieu of actual gross profit for 1982 when making the calculations in subsection (1).

(4) Any profit associated with providing directory advertising service outside the franchise area of a company may not be considered when determining gross profit derived from directory advertising for ratemaking purposes. Any investment or expenses associated with providing directory advertising service outside its franchise area may not be recovered through rates for telephone service.

(5) Notwithstanding any provision of this section to the contrary, no less than two-thirds of the total gross profit of a company from directory advertising within its local franchise area for any year shall be included in the regulated portion of its operation when establishing rates.

History.—ss. 1, 7, ch. 83-73.
[illegible]

APPENDIX 3

SUMMARY OF WHITE PAGE EXPENSE
EFFECT ON DIRECTORY ADVERTISING
GROSS PROFIT FOR UNITED, GENTEL, & SOUTHERN BELL

REVENUES EXCLUDED
FROM REGULATION

	W/WHITE PAGES EXPENSE	W/O WHITE PAGES EXPENSE	DIFFERENCE
SOUTHERN BELL	$9,510,263	$27,936,551	$18,426,288
UNITED	3,753,575	4,960,479	1,206,904
GENTEL	7,472,143*	13,669,461	6,197,318
TOTAL	$20,735,981	$46,566,491	$25,830,510

*Adjusted to account for the capping of expense @40% omitted in Gentel's late filed Exhibit No. 6, p. 1 of 2.

Source: Late filed Exhibit No. 6 as filed by the companies.

CERTIFICATE OF SERVICE
Docket No. 840128-TL

I HEREBY CERTIFY that a copy of the foregoing has been furnished, by United States Mail, this 27th day of December, 1985 to the following:

Thomas R. Parker, Esq.
General Telephone Company
of Florida
Post Office Box 110
Tampa, Florida 33601

Sam E. Whalen
Central Telephone Company
Post Office Box 2214
Tallahassee, Florida 32316

DeWayne Lanier
Gulf Telephone Company
115 West Drew Street
Post Office Box 1120
Perry, Florida 32347

John H. Vaughan
Florala Telephone Company
Post Office Box 186
Florala, Alabama 36442

Charles L. Dennis
Indiantown Telephone System, Inc.
Post Office Box 277
Indiantown, Florida 33456

David B. Erwin, Esquire
Mason, Erwin &
Horton, P.A.
1020 E. Lafayette St.
Suite 202
Tallahassee, Florida 32301

William B. Barfield
(Attn: Mr. Frank Meiners)
Southern Bell
311 S. Calhoun St.
Suite 204
Tallahassee, Florida 32301

Wallace S. Townsend
ALLTEL Florida, Inc.
Post Office Box 550
Live Oak, Florida 32060

B. R. Gibson, Jr.
St. Joseph Telephone and
Telegraph Company
Post Office Box 220
Port St. Joe, Florida 32456

Paul Sexton, Esq.
Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32301

Jeff McGehee
Southland Telephone Company
Post Office Box N
Atmore, Alabama 36504

Scott Chesbro
Continental Telephone of the
South-Florida
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Leon Conner
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MacClenny, Florida 32063

Lila D. Corbin
Quincy Telephone Company
Post Office Box 189
Quincy, Florida 32351

/s/
Charles J. Beck

FPSC EXHIBIT NUMBER ____________
FPSC DOCKET 920260–TL
REID EXHIBIT WSR–8

Correction of Amortization Expense
($000)

		Depreciation & Amort.
As shown on Exhibit WSR–2, October 1, 1993		(12,951)
General purpose computer and corporate communications equipment (A)	(2,272)	
Expiring amortization of Operator Systems – Crossbar (B)	(1,557)	
Subtotal		(3,829)
Revised intrastate expiring amortizations – 1994		(16,780)

Notes:

(A) Correction to remove one extra months' amortization expense
(B) Correction to include impact of expiring amortization

CALCULATION OF INCOME TAXES

1993
INTRASTATE

1	Net Income	389,166,000	A-2e, Pg 1 of 1
2	Add - AFUDC	1,115,000	
3		390,281,000	Sum of L.(1+2) & C-23b, Pg 1 of 2
4	Add - Taxes	131,114,000	C-23b, Pg 1 of 2
5	Less - Fixed Charges	104,790,000	C-23b, Pg 1 of 2
6		416,605,000	
7	Add - Permanent Diffs	19,390,425	
8	Less - State Taxes (See Page 2)	(25,174,003)	Pg 2
9			
10	Federal Taxable Income	410,821,422	
11			
12	Federal Taxes - 34%	139,679,283	L.9 * .34
13	Add - SIT	25,174,003	L.7
14	ITC Amortized	(18,152,000)	C-2b,L1, Col. 14+15
15	Federal Flow-Through	(15,867,446)	Pg 2
16	Other Taxes Adj.	280,163	C-23b, p2
17			
18	Total Income Taxes Calculated	131,114,003	
19			
20	Total Income Taxes Per FL MFR Schedules	131,114,003	

1	Total Adjustments to Income (incl. State Tax)	26,335,697	C-23b, Pg 1 of 2
2	Reverse State Tax Amount	25,174,003	Pg 2
3	Deduct Permanent Differences	(19,390,425)	
4			
5	Florida's Federal Timing Differences	32,119,275	L.1 + L.2 + L.3
6			
7			
8	Current Tax Expense - 34%	10,920,554	L. 5 * 34%
9			
10	Deferred Federal Tax Expense	(26,788,000)	C-23e, Pg 2 of 4
11			
12	Florida's Flow-Through	(15,867,446)	L. 8 + L. 10
13			
14			
15			
16	State Tax Calculation:		
17	BST Net Income	2,262,547,000	C-23b, Pg 1 of 2
18	Add: Income Tax	928,056,000	C-23b, Pg 1 of 2
19	Less: Fixed Charges	576,166,000	C-23b, Pg 1 of 2
20		2,614,437,000	
21	Adjustments to Taxable Income	(171,094,000)	C-23b, Pg 1 of 2
22	Taxable Income	2,443,343,000	
23			
24	Florida State Apportionment Factor	24.2961%	OPC 53rd, Item 1332
25	Florida Statutory State Tax Factor	5.5%	
26	Combined Apportionment and State Tax Factor	1.336284%	L. 24 * L. 25
27			
28	Florida Combined Current State Income Tax	32,650,002	L. 26 * L. 22
29	Intrastate Separations Factor	65.58652000%	C-23b, Pg 1 of 2
30	Florida Intrastate Current State Income Tax	21,414,000	L. 28 * L. 29
31	Add Intrastate State Deferred Income Tax	3,760,003	C-23e, Pg 4 of 4
32		25,174,003	

Analysis of Voucher Charges Listed on
OPC Witness DeWard's Schedule 34

DeWard's Sch 34 Page No.	DeWard's Sch 34 Serial No.	Account HQ/FL	1992 Schedule Amount	1992 Florida Combined	1992 Florida Intrastate	Amount to be Removed 1992
1	1249	6722 HQ	$4,435.72	$1,159.50	$864.77	$290.99 #
1	4635	6623 HQ	$5,393.71	$1,548.53	$1,230.65	$1,230.65
1	4419	6728.9 HQ	$5,000.00	$1,307.00	$941.84	$574.90 &
1	18145	6728.9 HQ	$10,000.00	$2,614.00	$1,883.68	$1,149.80 &
1	44735	6612 HQ	$5,000.00	$1,306.50	$899.00	$899.00
1	40365	6612 HQ	$15,000.00	$3,921.00	$2,698.02	$2,698.02
1	13093	6728.9 HQ	$40,000.00	$10,456.00	$7,534.70	$7,534.70
1	8921	6728.9 HQ	$10,000.00	$2,614.00	$1,883.68	$1,883.68
1	39892	6728.9 HQ	$5,000.00	$1,307.00	$941.84	$941.84
2	6122	6728.9 FL	$25,000.00	$25,000.00	$18,015.26	$18,015.26
3	33564	6728.9 FL	$10,000.00	$10,000.00	$7,206.10	$7,206.10
3	3333	6728.9 FL	$5,000.00	$5,000.00	$3,603.05	$3,603.05
3	27488	6728.9 FL	$5,000.00	$5,000.00	$3,603.05	$3,603.05
3	27652	6728.9 FL	$2,500.00	$2,500.00	$1,801.53	$1,801.53
3	13986	6728.9 FL	$5,000.00	$5,000.00	$3,603.05	$3,603.05
3	18537	6728.9 FL	$2,500.00	$2,500.00	$1,801.53	$1,801.53
3	3935	6728.9 FL	$15,000.00	$15,000.00	$10,809.16	$10,809.16
3	44704	6728.9 FL	$5,000.00	$5,000.00	$3,603.05	$3,603.05
3	4936	6728.9 FL	$5,000.00	$5,000.00	$3,603.05	$3,603.05
3	4939	6728.9 FL	$7,865.20	$7,865.20	$5,667.75	$1,907.20 #
3	13904	6728.9 FL	$8,250.00	$8,250.00	$5,945.04	$5,945.04
Total To Be Removed of DeWard's Ina			$195,944.63	$122,348.73	$88,139.78	$82,704.64
5	45763	6722 FL	$19,170.00	$19,170.00	$14,297.19	$14,297.19
5	89068	6722 FL	$90,000.00	$15,000.00	$11,187.16	$11,187.16
5	16149	6722 HQ	$100,000.00	$16,667.00	$12,430.42	$12,430.42
5	49162	6722 HQ	$13,820.20	$3,612.60	$2,694.31	$2,694.31
5	49104	6722 HQ	$10,000.00	$2,614.00	$1,949.55	$1,949.55
Total To Be Removed of DeWard's Ext			$232,990.20	$57,063.60	$42,558.63	$42,558.63
6	2878	6613 HQ	$10,000.00	$2,377.00	$1,637.35	$1,637.35
Total To Be Removed of DeWard's Adv			$10,000.00	$2,377.00	$1,637.35	$1,637.35
Grand Total			$438,934.83	$181,789.33	$132,335.76	$126,900.62

& Partially removed based on Florida Public Affairs Office Expenses
# Partially removed based on Florida State Regulatory Office Expenses

Analysis of Voucher Charges Listed on
OPC Witness DeWard's Schedule 34

DeWard's Sch 34 Page No.	DeWard's Sch 34 Serial No.	Account HQ/FL	1993 Schedule Amount	1993 Florida Combined	1993 Florida Intrastate	Amount to be Removed 1993
1	42978	6613 HQ	$12,110.22	$3,050.56	$2,118.47	$521.93 @
2	49745	6728.9 FL	$25,000.00	$25,000.00	$18,544.85	$18,544.85
2	83903	6728.9 FL	$5,000.00	$5,000.00	$3,708.97	$3,708.97
2	41	6728.9 FL	$5,000.00	$5,000.00	$3,708.97	$3,708.97
2	133413	6728.9 FL	$5,000.00	$5,000.00	$3,708.97	$3,708.97
2	98597	6728.9 FL	$5,000.00	$5,000.00	$3,708.97	$3,708.97
2	25560	6728.9 FL	$10,000.00	$10,000.00	$7,417.94	$7,417.94
2	25560	6728.9 FL	$7,500.00	$7,500.00	$5,563.45	$5,563.45
2	18017	6728.9 FL	$5,000.00	$5,000.00	$3,708.97	$3,708.97
2	5076	6728.9 FL	$10,000.00	$10,000.00	$7,417.94	$7,417.94
2	65183	6728.9 FL	$13,500.00	$13,500.00	$10,014.22	$10,014.22
2	13586	6728.9 FL	$8,000.00	$8,000.00	$5,934.35	$5,934.35
2	43799	6728.9 FL	$5,000.00	$5,000.00	$3,708.97	$3,708.97
2	W2772	6728.9 FL	$9,275.00	$9,275.00	$6,880.14	$2,429.37 @
4	24335	6711 HQ	$14,184.39	$3,629.79	$2,689.29	$1,344.64 *
Total To Be Removed of DeWard's Inapp			$139,569.61	$119,955.35	$88,834.45	$81,442.50
5	90845	6722 HQ	$17,300.00	$4,427.07	$3,366.26	$3,366.26
5	14850	6722 FL	$13,000.00	$13,000.00	$9,884.96	$9,884.96
Total To Be Removed of DeWard's Exter			$30,300.00	$17,427.07	$13,251.22	$13,251.22
6	68627	6613 HQ	$26,893.00	$6,774.35	$4,704.46	$4,704.46
Total To Be Removed of DeWard's Adver			$26,893.00	$6,774.35	$4,704.46	$4,704.46
	Grand Total		$196,762.61	$144,156.77	$106,790.13	$99,398.18

* Partially removed - spouse portion of expense
@ Partially removed, balance previously removed

Analysis of Voucher Charges Listed on
OPC Witness DeWard's Schedule 34

Amounts Which Are NOT in Cost of Service

DeWard's Sch 34 Page No.	DeWard's Sch 34 Serial No.	Account	HQ/FL	1992 Schedule Amount	1992 Florida Combined	1992 Florida Intrastate	Expenses Previously Removed 1992
1	1249	7370.5	HQ	$917.96			$917.96 &
1	13142	7370.5	HQ	$250.00			$250.00 &
3	67875	6728.9	HQ	$173,507.64	$45,354.90	$32,683.21	$4,359.57 @
3	86237	6728.9	HQ	$137,173.61	$35,857.18	$25,839.06	$6,800.93 @
3	26876	6728.9	HQ	$220,952.00	$57,756.85	$41,620.19	$1,329.12 @
3	18275	6728.9	HQ	$179,221.00	$46,848.37	$33,759.43	$1,417.43 @
3	13910	6728.9	HQ	$467,022.72	$122,079.74	$87,971.94	$14,649.69 @
3	31523	6728.9	HQ	$192,795.75	$50,396.81	$36,316.47	$4,912.11 @
4	37864	6728.9	HQ	$117,294.02	$30,660.66	$22,094.39	$2,225.51 @
4	40176	6723	HQ	$7,629.67	$1,998.97	$1,425.94	$1,425.94 @
Subtotal DeWard's Inapp Items				$1,496,764.37	$390,953.48	$281,710.62	$38,288.24
Subtotal DeWard's Ext Rel Items				$0.00	$0.00	$0.00	$0.00
6	L9288	6613	HQ	$157,500.00	$37,437.75	$25,788.34	$25,788.34 *
6	L9288	6613	HQ	$219,174.01	$52,097.66	$35,886.56	$35,886.56 *
Subtotal DeWard's Adv Items				$376,674.01	$89,535.41	$61,674.90	$61,674.90
Grand Total				$1,873,438.38	$480,488.89	$343,385.53	$99,963.15

& Charged to 7XXX Account (Below the Line)
* Previous Proforma Adjustment
@ Amount Removed Represent a Portion of the Voucher Charged to Other Companies

Analysis of Voucher Charges Listed on
OPC Witness DeWard's Schedule 34

Amounts Which Are NOT in Cost of Service

DeWard's Sch 34 Page No.	DeWard's Sch 34 Serial No.	Account HQ/FL	1993 Schedule Amount	1993 Florida Combined	1993 Florida Intrastate	Expenses Previously Removed 1993
1	15891	7370.9 HQ	$2,000.00			$2,000.00 %
1	42978	6613 HQ	$12,110.22	$3,050.56	$2,118.47	$1,596.54 $
2	W2772	6728.9 FL	$9,275.00	$9,275.00	$6,880.14	$4,450.76 *
2	32018	6728.9 FL	$5,000.00	$5,000.00	$3,708.97	$3,708.97 *
4	33781	6613 HQ	$4,830.00	$1,216.68	$844.92	$84.49 *
Subtotal DeWard's Inapp Items			$33,215.22	$18,542.24	$13,552.50	$11,840.77
5	14850	7370.9 FL	$7,000.00			$7,000.00 %
Subtotal DeWard's Ext Rel Items			$7,000.00	$0.00	$0.00	$7,000.00
6	92017	6613 HQ	$13,125.00	$3,306.19	$2,295.99	$2,295.99 *
6	31967	6613 HQ	$223,150.33	$56,211.57	$39,036.23	$39,036.23 *
6	81705	6613 HQ	$129,055.33	$32,509.04	$22,575.96	$22,575.96 *
Subtotal DeWard's Adv Items			$365,330.66	$92,026.79	$63,908.18	$63,908.18
	Grand Total		$405,545.88	$110,569.03	$77,460.68	$82,748.95

% Charged to 7XXX Account (Below the Line)
* Previous Proforma Adjustment
$ Partially Previously Proforma Adjustment and Partially Charged to Other Companies with the Remainder Being Removed From Cost of Service

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY

REBUTTAL TESTIMONY OF GARY M. HOELTKE

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

DECEMBER 10, 1993

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. I AM GARY M. HOELTKE. MY CURRENT POSITION IS WITH THE GALLUP ORGANIZATION AS SENIOR VICE-PRESIDENT AND SENIOR ANALYST. I HAVE HELD THESE POSITIONS FOR THE LAST SEVERAL YEARS. MY BUSINESS ADDRESS IS 300 SOUTH 68TH STREET PLACE, LINCOLN, NEBRASKA.

Q. WHAT IS YOUR MARKET RESEARCH BACKGROUND?

A. I HAVE BEEN IN MARKET RESEARCH OVER 20 YEARS. DURING THAT TIME, I HAVE DESIGNED AND WRITTEN HUNDREDS OF MARKET RESEARCH STUDIES AND REPORTS. OVER THE YEARS, I HAVE WORKED WITH FORTUNE 500 COMPANIES AND MULTIPLE SMALLER COMPANIES. RECENT EXAMPLES OF MAJOR COMPANIES FOR WHICH I HAVE CONDUCTED MARKET RESEARCH STUDIES INCLUDE MCI IN

COMMUNICATIONS, JOHN HANCOCK, CIGNA AND BLUE CROSS AND BLUE SHIELD IN INSURANCE AND UNION CAMP IN MANUFACTURING.

IN ADDITION TO CONDUCTING MARKET RESEARCH STUDIES, I HAVE ALSO SERVED AS AN EXPERT WITNESS IN APPROXIMATELY 20 LEGAL CASES. THESE CASES INCLUDED TESTIMONY INVOLVING RESEARCH AND/OR SURVEY DATA FOR WHICH I WAS RESPONSIBLE.

Q. WHAT IS YOUR ACADEMIC TRAINING AND EXPERIENCE?

A. I RECEIVED MY DOCTORATE IN EDUCATION FROM THE UNIVERSITY OF NEBRASKA IN 1966 WITH A DEGREE IN EDUCATIONAL PSYCHOLOGY AND MEASUREMENT. EDUCATIONAL PSYCHOLOGY AND MEASUREMENT INCLUDED STATISTICS AND RESEARCH DESIGN AND MEASUREMENT. THESE WERE MY MAJOR FIELDS OF CONCENTRATION.

PRIOR TO GOING INTO MARKET RESEARCH, I WAS HEAD OF EDUCATIONAL RESEARCH AND MEASUREMENT AND DIRECTOR OF THE BUREAU OF EDUCATIONAL RESEARCH AT THE UNIVERSITY OF KANSAS. IN ADDITION TO ADMINISTRATION, I TAUGHT STATISTICS AND MEASUREMENTS AT THE UNIVERSITY OF KANSAS. I HAVE

ALSO TAUGHT BASIC AND ADVANCED STATISTICS, REGRESSION ANALYSIS AND NONPARAMETRIC STATISTICS AS WELL AS APPLIED AND THEORETICAL MEASUREMENT.

Q. WERE YOU CONTACTED BY SOUTHERN BELL TO DO A STUDY?

A. YES. I WAS CONTACTED BY SOUTHERN BELL TO PERFORM A STUDY OF CUSTOMER SATISFACTION IN FLORIDA. I WAS ALSO ASKED TO COMMENT ON SOUTHERN BELL'S CUSTOMER TRACKING SYSTEM FOR RESIDENCE CUSTOMER SERVICE AND SMALL BUSINESS CUSTOMER SERVICE, KNOWN AS THE TELSAM SURVEY.

Q. WHAT WAS YOUR INVOLVEMENT IN THE SOUTHERN BELL STUDY?

A. I WAS RESPONSIBLE FOR APPROVING THE STUDY DESIGN INCLUDING SAMPLING, MEASUREMENT AND DATA COLLECTION, AS WELL AS ANALYZING AND INTERPRETING THE RESULTS.

Q. WHAT WAS THE PURPOSE OF THE SOUTHERN BELL STUDY?

A. THE PURPOSE OF THE SOUTHERN BELL STUDY WAS TO COMPARE USER EVALUATION OF SOUTHERN BELL SERVICES

WITH THE CORRESPONDING RESULTS FOR OTHER LOCAL TELEPHONE CARRIERS OPERATING IN FLORIDA. THE PRIMARY PURPOSE WAS TO COMPARE CUSTOMER SATISFACTION RELATIVE TO SERVICE AND VALUE. OF SECONDARY IMPORTANCE, WERE COMPARISONS OF OTHER ISSUES FREQUENTLY PERCEIVED TO BE RESPONSIBILITIES OF TELEPHONE COMPANIES. SECONDARY COMPARISONS INCLUDED CARING ABOUT CUSTOMERS, BEING ACTIVE IN THE COMMUNITY AND ATTRACTING NEW BUSINESS TO THE COMMUNITY.

Q. HOW WAS THE STUDY DESIGNED?

A. CONSIDERING THE STUDY PURPOSE, IT WAS DECIDED THAT TELEPHONE SURVEY METHODOLOGY WAS APPROPRIATE. THIS METHOD PROVIDES RELIABLE AND VALID DATA THAT DIRECTLY ADDRESSES THE STUDY'S PURPOSE.

THE SAMPLE PLAN WAS BASED ON DISPROPORTIONAL SAMPLING BECAUSE SOUTHERN BELL HAS ABOUT 60% OF THE ACCESS LINES WHILE THE SECOND LARGEST CARRIER HAS ONLY ABOUT ONE-FIFTH OF THE ACCESS LINES. RESIDENCE NUMBERS WERE DRAWN SO A MINIMUM OF 1000 SOUTHERN BELL CUSTOMERS WOULD BE INTERVIEWED AND A MINIMUM OF 1000 OTHER LOCAL CARRIER CUSTOMERS WOULD

BE INTERVIEWED. BUSINESS NUMBERS WERE DRAWN SO A MINIMUM OF 400 SOUTHERN BELL CUSTOMERS WOULD BE INTERVIEWED AND A MINIMUM OF 400 OTHER LOCAL CARRIER CUSTOMERS WOULD BE INTERVIEWED. ALL SAMPLE MEMBERS (RESIDENCE AND BUSINESS) WERE RANDOMLY SELECTED.

CONSIDERING THE STUDY PURPOSE, IT WAS EVIDENT THAT TWO DIFFERENT SAMPLES NEEDED TO BE CONSIDERED. ONE SAMPLE WAS HOUSEHOLD RESIDENTS AND THE OTHER SAMPLE WAS BUSINESSES. WHILE THE UNDERLYING ISSUE OF COMMUNICATION WAS COMMON TO BOTH SAMPLES, THE SPECIFICS OF EACH WERE DIFFERENT. THEREFORE, A SAMPLE PLAN FOR HOUSEHOLDS WAS DEVELOPED, AS WAS A SAMPLE FOR BUSINESSES.

THE HOUSEHOLD SAMPLE PLAN WAS BASED ON A LIST-ASSOCIATED RANDOM-DIGIT DESIGN. USING A RANDOM-DIGIT DESIGN, BOTH LISTED AND UNLISTED (INCLUDING NOT-YET-LISTED) NUMBERS WERE INCLUDED IN THE HOUSEHOLD SAMPLE.

THE BUSINESS SAMPLE PLAN WAS BASED ON THE DUN AND BRADSTREET LIST OF BUSINESSES SUPPLEMENTED BY AN INTERNAL GALLUP LIST OF BUSINESSES. USING A

SYSTEMATIC RANDOM SAMPLING PROCEDURE (N SELECT), THE NUMBERS WERE IDENTIFIED FOR INCLUSION WITH THE RANDOM DRAW THEN PROPORTIONALIZED, OR STRATIFIED, BY SIZE (NUMBER OF EMPLOYEES) OF BUSINESS.

CONCURRENT WITH DEVELOPING THE SAMPLING PLAN, STUDY INSTRUMENTS WERE DEVELOPED. THE STUDY INSTRUMENTS WERE PREPARED SPECIFICALLY FOR THIS STUDY AND WERE BASED ON THE STUDY PURPOSE. SEPARATE INSTRUMENTS WERE PREPARED FOR HOUSEHOLDS AND FOR BUSINESSES. EACH INSTRUMENT WAS REVIEWED FOR LENGTH AND BIAS AND THEN PILOT-TESTED. FOLLOWING PILOT-TESTING, THE INSTRUMENTS WERE RE-EVALUATED. THESE INSTRUMENTS ARE INCLUDED AS EXHIBIT GMH-1.

NUMBERS IDENTIFIED IN THE PRECEDING FASHION WERE ENTERED INTO GALLUP'S COMPUTERIZED PHONE MANAGEMENT SYSTEM. THIS SYSTEM IS AN AUTOMATED SAMPLE SERVER THAT DISTRIBUTES TELEPHONE NUMBERS TO EACH INTERVIEWER ACCORDING TO CUSTOMIZED DESIGN. A COMPLETE CONNECT HISTORY IS RECORDED FOR EACH NUMBER. THE HISTORY INCLUDES TIME AND DATE OF ATTEMPT, INTERVIEWER ID AND CALL DISPOSITION. NUMBERS NOT RESOLVED DURING AN ATTEMPT ARE DISTRIBUTED ACCORDING TO SCHEDULED CALL DESIGN.

WITH HOUSEHOLD AND BUSINESS NUMBERS, MULTIPLE ATTEMPTS WERE MADE TO COMPLETE CALLS, EACH ATTEMPT ON A DIFFERENT DAY AT A DIFFERENT TIME.

Q. DESCRIBE THE ACTUAL DATA COLLECTION PROCEDURES.

A. WITH THE HOUSEHOLD SAMPLE, THE RESPONDENT SELECTION PROCEDURE WAS TO INTERVIEW THE YOUNGEST AVAILABLE MALE (AGED 18 OR OLDER) OR THE OLDEST AVAILABLE FEMALE. THIS PROCEDURE IS AN EMPIRICALLY-BASED PROCEDURE DEVELOPED AT GALLUP TO CONTROL FOR NON-RESPONSE BIAS. THE PROCEDURE PROVIDES A CLOSER APPROXIMATION TO CENSUS DATA FOR GENDER-BY-AGE DISTRIBUTION. IT IS NOT A RANDOMIZED PROCEDURE (HOUSEHOLDS WERE RANDOMIZED), BUT DOES PRODUCE A SAMPLE OF COMPLETED INTERVIEWS THAT MORE CLOSELY MIRRORS THE AGE-WITHIN-GENDER RESULTS THAN THE TRUE RANDOMIZED SYSTEMS.

WITH THE BUSINESS SAMPLE, THE RESPONDENT SELECTED WAS THE INDIVIDUAL WITHIN THE BUSINESS MOST FAMILIAR WITH THEIR LOCAL TELEPHONE COMPANY AND THE BUSINESS INTERACTION WITH THE LOCAL TELEPHONE COMPANY. THE INDIVIDUAL INTERVIEWED AT A GIVEN BUSINESS WHO MET THE CRITERIA WAS IDENTIFIED BY THE

BUSINESS AT THE TIME OF INITIAL CALL CONTACT.

THE STUDY WAS CONDUCTED DURING NOVEMBER AND DECEMBER, 1993. SURVEY ADMINISTRATION FOR BOTH SAMPLES WAS VIA COMPUTER ADMINISTRATION AND ENTRY. THE STUDY SURVEY INSTRUMENTS WERE PROGRAMMED FOR ADMINISTRATION AND INTERVIEWERS WORKED FROM THE PROGRAMMED INTERVIEWS. THIS PROCEDURE AUTOMATICALLY HANDLES ALL SKIP PATTERNS WITH THE SURVEY AND AUTOMATICALLY ENTERS THE NAME OF THE TELEPHONE COMPANY FROM WHICH RESPONDENTS REPORT THEY RECEIVE SERVICE. THE PROGRAM ALSO MONITORS FOR OUT-OF-BOUND RESPONSES. RESPONSES TO OPEN-ENDED QUESTIONS WERE ENTERED AT THE TIME OF THE INTERVIEW AND SUBSEQUENTLY CODED BY EXPERIENCED PROFESSIONAL GALLUP CODERS.

TELEPHONE INTERVIEWS WERE COMPLETED BY TRAINED, EXPERIENCED PROFESSIONAL TELEPHONE INTERVIEWERS EMPLOYED BY THE GALLUP ORGANIZATION. IN ADDITION TO TRAINING AND ONGOING EVALUATION, ALL INTERVIEWS WERE BRIEFED SPECIFICALLY FOR THIS PROJECT. THE STUDY WAS DESCRIBED TO HOUSEHOLD RESPONDENTS AS A STUDY OF SERVICE PROVIDED BY DIFFERENT COMPANIES. WITH THE BUSINESS SAMPLE, IT WAS DESCRIBED AS A

STUDY OF AREA BUSINESSES REGARDING THE SERVICE THEY RECEIVE FROM VARIOUS COMPANIES. HOWEVER, NO GALLUP INTERVIEWER WAS INFORMED ABOUT THE POTENTIAL USE OF THE RESULTS OF THIS STUDY.

INTERVIEWING QUALITY WAS EVALUATED BY CONSISTENT SILENT MONITORING OF SELECT INTERVIEWS BY GALLUP SUPERVISORY PERSONNEL. GALLUP INTERVIEWERS GIVE PERMISSION FOR SILENT MONITORING AS A REQUIREMENT FOR EMPLOYMENT. IN ADDITION, A MINIMUM OF 10% OF ALL COMPLETED INTERVIEWS WERE INDEPENDENTLY VERIFIED BY SUPERVISORY CALL-BACKS.

Q. HOW WERE THE DATA EVALUATED?

A. RESULTS FOR BOTH STUDY SAMPLES WERE COMPUTER SUMMARIZED BY GALLUP PERSONNEL USING GALLUP EQUIPMENT. FOR RATING PURPOSES, DATA SUMMARIZATION INCLUDED PERCENT RESULTS AND COMPUTATION OF AVERAGE VALUES AND ASSOCIATED STANDARD DEVIATION VALUES. WHEN AVERAGE VALUES WERE DERIVED FOR RATING QUESTIONS, THE HIGHER THE VALUE, THE GREATER THE SATISFACTION. SAMPLES WERE SUBDIVIDED BY LOCAL CARRIERS WITH LONG DISTANCE CARRIERS DELETED. RESIDENT RESULTS WERE WEIGHTED BY NUMBER OF ACCESS

LINES PER CARRIER AND BUSINESS RESULTS WERE WEIGHTED BY NUMBER OF EMPLOYEES AND NUMBER OF ACCESS LINES PER CARRIER.

RESULTS FOR SOUTHERN BELL AND OTHER CARRIERS WERE STATISTICALLY COMPARED USING EITHER THE INDEPENDENT SAMPLE _Z_-TEST FOR PERCENTS OR THE INDEPENDENT SAMPLE _T_-TEST FOR MEANS. IN ALL STATISTICAL COMPARISON, STATISTICAL SIGNIFICANCE WAS DEFINED AS THE .05 LEVEL OF PROBABILITY.

Q. HOW WERE THE PRIMARY RESULTS CATEGORIZED?

A. STUDY RESULTS WERE SUMMARIZED AS MAJOR OR MINOR RESULTS BY SAMPLE. MAJOR RESULTS WERE THOSE ASSOCIATED WITH THE OVERALL IMPRESSION OF LOCAL TELEPHONE SERVICE AND THE RATING OF SATISFACTION WITH OVERALL LOCAL TELEPHONE SERVICE. MINOR RESULTS WERE SPECIFIC RATING RESULTS FOR DIFFERENT ASPECTS OF LOCAL TELEPHONE SERVICE.

Q. WHAT WERE THE PRIMARY STUDY RESULTS FOR RESIDENTIAL CUSTOMERS?

A. THE MAJOR RESIDENTIAL RESULTS WERE:

(1) GENERAL IMPRESSION OF LOCAL TELEPHONE COMPANY. A TEN-POINT RATING SCALE WAS USED FOR THIS QUESTION WHERE 1= POOR OVERALL IMPRESSION THROUGH 10= EXCELLENT OVERALL IMPRESSION. THE WEIGHTED AVERAGE RATING FOR SOUTHERN BELL WAS 8.43 WITH 77% RATING SOUTHERN BELL AT SCALE POINTS 8, 9 OR 10. THE WEIGHTED AVERAGE RATING FOR OTHER LOCAL TELEPHONE COMPANIES WAS 8.02 WITH 67% RATING OTHER LOCAL TELEPHONE COMPANIES AT SCALE POINTS 8, 9 OR 10. THE AVERAGE RATING OF 8.43 FOR SOUTHERN BELL WAS STATISTICALLY SIGNIFICANTLY HIGHER THAN THE AVERAGE RATING OF 8.02 FOR OTHER LOCAL SERVICE TELEPHONE COMPANIES.

(2) OVERALL SERVICE PROVIDED BY LOCAL TELEPHONE COMPANY. A FOUR-POINT RATING SCALE WAS USED FOR THIS QUESTION, WITH THE RATING POINTS RANGING FROM 1= VERY DISSATISFIED THROUGH 4= VERY SATISFIED. THE WEIGHTED AVERAGE RATING FOR SOUTHERN BELL WAS 3.63 AND 67% WERE VERY SATISFIED. THE CORRESPONDING RESULT FOR OTHER LOCAL SERVICE TELEPHONE COMPANIES WAS 3.49 WITH 61% VERY SATISFIED. THE DIFFERENCE BETWEEN

3.63 AND 3.49 WAS STATISTICALLY SIGNIFICANT. CUSTOMERS OF SOUTHERN BELL WERE SIGNIFICANTLY MORE LIKELY TO BE VERY SATISFIED.

Q. PLEASE DESCRIBE WHAT YOU TERM "MINOR" RESULTS FOR RESIDENTIAL CUSTOMERS.

A. RESIDENTIAL CUSTOMERS WERE ASKED TO RATE THEIR LOCAL TELEPHONE COMPANY ACROSS EIGHT SPECIFIC VARIABLES. FOR EACH SPECIFIC VARIABLE, A TEN-POINT SCALE WAS USED WHERE 1= POOR THROUGH 10= EXCELLENT. ALL RESPONDENTS WERE ALSO ASKED IF THEY HAD EXPERIENCED ANY PROBLEMS WITH REGARD TO THEIR PHONE OR PHONE SERVICE DURING THE LAST THREE MONTHS. THIS QUESTION WAS ASKED AS A "YES" OR A "NO" RESPONSE QUESTION. SPECIFIC SERVICE VARIABLES CONSIDERED AND COMPARATIVE RESULTS PER VARIABLE AND PERCENT RESULTS FOR PHONE PROBLEMS ARE SUMMARIZED IN EXHIBIT GMH-2.

Q. PLEASE COMMENT ON THE SPECIFIC SOUTHERN BELL RESULTS REFLECTED IN EXHIBIT GMH-2.

A. FOR SIX OF THE EIGHT SPECIFIC VARIABLES, THE AVERAGE RATING ASSIGNED BY SOUTHERN BELL CUSTOMERS

WAS STATISTICALLY SIGNIFICANTLY HIGHER OR MORE POSITIVE THAN CORRESPONDING RESULTS FOR OTHER LOCAL SERVICE TELEPHONE COMPANIES. SOUTHERN BELL WAS RATED SIGNIFICANTLY HIGHER FOR:

- CARING ABOUT THEIR CUSTOMERS

- PROVIDING A GOOD VALUE FOR THE MONEY YOU SPEND ON TELEPHONE SERVICE

- BEING ACTIVE IN THE COMMUNITY

- KEEPING RATES FAIR AND REASONABLE

- ATTRACTING NEW BUSINESSES TO THE COMMUNITY

- PROVIDING GOOD CUSTOMER SERVICE

HOWEVER, FOR TWO SPECIFIC VARIABLES, THERE WAS NO STATISTICALLY SIGNIFICANT DIFFERENCE IN ASSIGNED AVERAGE RATINGS. THE TWO VARIABLES THAT DID NOT REFLECT A SIGNIFICANT DIFFERENCE WERE:

- PROVIDING ERROR-FREE BILLING

. PROVIDING PROMPT REPAIR AND INSTALLATION SERVICE

IN ADDITION, FIFTEEN PERCENT OF THE SOUTHERN BELL CUSTOMERS REPORTED THEY HAD PROBLEMS WITH THEIR PHONE OR PHONE SERVICE DURING THE LAST THREE MONTHS. FIFTEEN PERCENT OF THE CUSTOMERS OF OTHER LOCAL TELEPHONE COMPANIES ALSO REPORTED A PROBLEM WITH THEIR PHONE OR PHONE SERVICE OVER THE LAST THREE MONTHS. OBVIOUSLY, THERE WAS NO SIGNIFICANT DIFFERENCE IN PERCENT REPORTING PROBLEMS.

Q. ARE THERE ANY OTHER RESIDENTIAL RESULTS FROM YOUR STUDY?

A. YES. RESIDENTIAL RESPONDENTS WERE ASKED SEVERAL OTHER QUESTIONS CONCERNING THEIR LOCAL TELEPHONE COMPANY. THE RESULTS FOR THE OTHER QUESTIONS ARE SUMMARIZED IN EXHIBIT GMH-3.

Q. PLEASE PROVIDE AN OVERVIEW OF THESE RESULTS.

A. THE AVERAGE IMPRESSION OF SOUTHERN BELL WAS SIGNIFICANTLY MORE POSITIVE THAN THE AVERAGE IMPRESSION OF THE NATURAL GAS COMPANY, THE ELECTRIC COMPANY AND LOCAL CABLE TELEVISION COMPANY. THE

AVERAGE IMPRESSION OF OTHER LOCAL TELEPHONE COMPANIES WAS, ON AVERAGE, SIGNIFICANTLY MORE POSITIVE THAN THAT OF THE NATURAL GAS COMPANY AND LOCAL CABLE TELEVISION COMPANY.

WHEN THOSE THAT WERE NOT SATISFIED WITH TELEPHONE SERVICE WERE ASKED WHAT THEY WERE DISSATISFIED WITH, A SIGNIFICANTLY HIGHER PERCENT OF SOUTHERN BELL CUSTOMERS CITED OUTAGES/DISRUPTION. BUT, A SIGNIFICANTLY LOWER PERCENT OF SOUTHERN BELL CUSTOMERS CITED BILLING PROBLEMS. IT SHOULD BE NOTED THAT THESE RESULTS ARE BASED ON LOW FREQUENCIES AND LOW PERCENTS.

ON AVERAGE, SOUTHERN BELL WAS CONTACTED LESS OFTEN BY THEIR CUSTOMERS THAN OTHER LOCAL CARRIERS. OF THOSE WHO CONTACTED THEIR LOCAL TELEPHONE COMPANY, SOUTHERN BELL CUSTOMERS WERE MORE LIKELY TO REPORT A SERVICE PROBLEM OR SERVICE DISCONNECT.

ALSO ON AVERAGE, SOUTHERN BELL CONTACTED THEIR CUSTOMERS ABOUT THE SAME AS OTHER LOCAL TELEPHONE COMPANIES. SOUTHERN BELL CUSTOMERS WERE SIGNIFICANTLY MORE LIKELY TO REPORT THE CONTACT WAS DUE TO PHONE BILLS OR TO SEE IF THE CUSTOMER WAS

SATISFIED. SOUTHERN BELL WAS LESS LIKELY TO CONTACT THE CUSTOMER DUE TO A PROBLEM WITH THE PHONE. FURTHERMORE, WHEN CUSTOMERS WHO WERE CONTACTED BY THEIR LOCAL TELEPHONE COMPANY RATED THE SERVICE REPRESENTATIVE THEY TALKED WITH, REPRESENTATIVES OF SOUTHERN BELL WERE RATED SIGNIFICANTLY MORE POSITIVE FOR CARING ABOUT THE PROBLEM OR REQUEST.

OF THOSE WHO WROTE TO THEIR TELEPHONE COMPANY, A SIGNIFICANTLY LOWER PERCENT OF SOUTHERN BELL CUSTOMERS REPORTED THEY RECEIVED A RESPONSE TO THEIR CORRESPONDENCE.

ALSO, OF THOSE CUSTOMERS REPORTING A PROBLEM IN THE LAST THREE MONTHS, A SIGNIFICANTLY HIGHER PERCENT OF SOUTHERN BELL CUSTOMERS SAID THE PROBLEM WAS BILLING; HOWEVER, A SIGNIFICANTLY LOWER PERCENT OF SOUTHERN BELL CUSTOMERS SAID THE PROBLEM WAS STATIC OR A POOR CONNECTION.

Q. MR. HOELTKE, YOU MENTIONED EARLIER THAT YOU ALSO SURVEYED BUSINESS CUSTOMERS. WHAT WERE THE MAJOR RESULTS FOR BUSINESS CUSTOMERS?

A. THE MAJOR RESULTS FOR BUSINESS CUSTOMERS WERE:

(1) <u>GENERAL IMPRESSION OF LOCAL TELEPHONE COMPANY</u>. A TEN-POINT RATING SCALE WAS USED FOR THIS QUESTION WHERE 1= POOR OVERALL IMPRESSION THROUGH 10= EXCELLENT OVERALL IMPRESSION. THE WEIGHTED AVERAGE RATING FOR SOUTHERN BELL WAS 8.31 WITH 75% RATING SOUTHERN BELL AT SCALE POINTS 8, 9 OR 10. THE WEIGHTED AVERAGE RATING FOR OTHER LOCAL TELEPHONE COMPANIES WAS 8.03 WITH 76% RATING OTHER LOCAL TELEPHONE COMPANIES AT SCALE POINTS OF 8, 9 OR 10. THE AVERAGE RATING OF 8.31 FOR SOUTHERN BELL WAS STATISTICALLY SIGNIFICANTLY HIGHER THAN THE AVERAGE RATING OF 8.03 FOR OTHER LOCAL TELEPHONE COMPANIES.

(2) <u>OVERALL SERVICE PROVIDED BY LOCAL TELEPHONE COMPANY</u>. A FOUR-POINT RATING SCALE WAS USED FOR THIS QUESTION, RATING POINTS RANGING FROM 1= VERY DISSATISFIED THROUGH 4= VERY SATISFIED. THE WEIGHTED AVERAGE RATING FOR SOUTHERN BELL WAS 3.63 AND 69% WERE VERY SATISFIED. THE CORRESPONDING RESULT FOR OTHER LOCAL TELEPHONE COMPANIES WAS 3.58 WITH 65% VERY SATISFIED.

THE DIFFERENCE BETWEEN 3.63 AND 3.58 WAS NOT STATISTICALLY SIGNIFICANT. ESSENTIALLY, BOTH SOUTHERN BELL AND OTHER LOCAL TELEPHONE COMPANIES EARNED THE SAME AVERAGE SATISFACTION SCORES.

Q. NOW, PLEASE DESCRIBE ANY MINOR RESULTS FOR THESE BUSINESS CUSTOMERS SURVEYED.

A. BUSINESS CUSTOMERS WERE ASKED TO RATE THEIR LOCAL TELEPHONE COMPANY ACROSS EIGHT SPECIFIC VARIABLES. FOR EACH SPECIFIC VARIABLE, A TEN-POINT SCALE WAS USED WHERE 1= POOR THROUGH 10= EXCELLENT. ALL RESPONDENTS WERE ALSO ASKED IF THEY HAD EXPERIENCED ANY PROBLEMS WITH REGARD TO THEIR PHONE OR PHONE SERVICE DURING THE LAST THREE MONTHS. THIS QUESTION WAS ASKED AS A "YES" OR "NO" RESPONSE QUESTION. SPECIFIC SERVICE VARIABLES CONSIDERED AND COMPARATIVE RESULTS PER VARIABLE AND PERCENT RESULTS FOR PHONE PROBLEMS ARE SUMMARIZED IN EXHIBIT GMH-4.

Q. WHAT WERE YOUR BASIC FINDINGS ABOUT THESE RATINGS?

A. ACROSS THE EIGHT SPECIFIC VARIABLES, THERE WAS NO

STATISTICALLY SIGNIFICANT DIFFERENCE BETWEEN SAMPLES EXCEPT FOR ONE VARIABLE. THE EXCEPTION WAS ACTIVE IN THE COMMUNITY, WHERE SOUTHERN BELL WAS RATED SIGNIFICANTLY LOWER. FOR ALL INTENTS AND PURPOSES, SOUTHERN BELL AND OTHER LOCAL TELEPHONE COMPANIES EARNED THE SAME AVERAGE SCORE.

HOWEVER, 30% OF THE SOUTHERN BELL BUSINESS CUSTOMERS REPORTED THEY HAD PROBLEMS WITH THEIR PHONE OR PHONE SERVICE DURING THE LAST THREE MONTHS. TWENTY-TWO PERCENT OF THE BUSINESS CUSTOMERS OF OTHER LOCAL TELEPHONE COMPANIES REPORTED A PROBLEM WITH THEIR PHONE OR PHONE SERVICE OVER THE LAST THREE MONTHS. THE 8% DIFFERENCE WAS STATISTICALLY SIGNIFICANT. SOUTHERN BELL BUSINESS CUSTOMERS WERE SIGNIFICANTLY MORE LIKELY TO REPORT THEY HAD PHONE PROBLEMS DURING THE LAST THREE MONTHS.

Q. ARE THERE ANY OTHER RESULTS FOR BUSINESS CUSTOMERS BASED ON YOUR STUDY?

A. BUSINESS CUSTOMERS WERE ASKED SEVERAL OTHER QUESTIONS CONCERNING THEIR LOCAL TELEPHONE COMPANY. THE RESULTS FOR THE OTHER QUESTIONS ARE SUMMARIZED

IN EXHIBIT GMH-5.

Q. PLEASE BRIEFLY DISCUSS THESE RESULTS.

A. WHEN BUSINESS CUSTOMERS WHO WERE DISSATISFIED WITH THEIR TELEPHONE SERVICE WERE ASKED WHY THEY WERE DISSATISFIED, THE RESULTS WERE AS FOLLOWS:

(1) A STATISTICALLY SIGNIFICANTLY LOWER PERCENT OF SOUTHERN BELL CUSTOMERS WERE DISSATISFIED BECAUSE OF:

(A) COST TOO HIGH
(B) OUTAGES/DISRUPTING OF SERVICES
(C) DIFFICULTY GETTING THROUGH FOR SERVICE

(2) A STATISTICALLY SIGNIFICANTLY HIGHER PERCENT OF SOUTHERN BELL CUSTOMERS WERE DISSATISFIED BECAUSE OF UNRESPONSIVENESS TO A PROBLEM AND OTHER PROBLEMS.

ALSO, ON AVERAGE, SOUTHERN BELL RECEIVED A STATISTICALLY SIGNIFICANTLY HIGHER NUMBER OF TELEPHONE CALLS FROM CUSTOMERS THAN OTHER LOCAL TELEPHONE COMPANIES. OF THOSE WHO CALLED, A SIGNIFICANTLY HIGHER PERCENT OF SOUTHERN BELL

CUSTOMERS CALLED TO REPORT A PROBLEM, BUT A SIGNIFICANTLY LOWER PERCENT CALLED BECAUSE OF A BILLING PROBLEM OR BECAUSE OF SERVICE DISCONNECT.

USING WEIGHTED VALUES, SOUTHERN BELL CONTACTED THEIR CUSTOMERS SIGNIFICANTLY MORE OFTEN THAN OTHER LOCAL TELEPHONE COMPANIES. OF THOSE CONTACTED BY THE TELEPHONE COMPANY, A SIGNIFICANTLY LOWER PERCENT WERE CONTACTED BY SOUTHERN BELL BECAUSE OF DOWN PHONE LINES/PHONE OUT OF ORDER, WHILE A SIGNIFICANTLY HIGHER PERCENT OF SOUTHERN BELL CUSTOMERS CITED OTHER LOW FREQUENCY REASONS.

WHEN THOSE CUSTOMERS THAT TALKED WITH A SERVICE REPRESENTATIVE OF THE TELEPHONE COMPANY RATED THE REPRESENTATIVE, A SIGNIFICANTLY MORE POSITIVE AVERAGE RATING WAS ASSIGNED TO SOUTHERN BELL REPRESENTATIVES FOR CARING ABOUT THE PROBLEM/REQUEST AND FOR BEING KNOWLEDGEABLE.

IN ADDITION, THOSE CUSTOMERS THAT REPORTED A PROBLEM WITH THEIR PHONE DURING THE LAST THREE MONTHS WERE ASKED WHAT THE PROBLEM WAS. A SIGNIFICANTLY HIGHER PERCENT OF SOUTHERN BELL RESPONDENTS CITED SOME EQUIPMENT WENT DOWN. IN

CONTRAST, A SIGNIFICANTLY LOWER PERCENT OF SOUTHERN BELL RESPONDENTS SAID THE PROBLEM WAS UNDERGROUND LINE SEVERED OR UNRESPONSIVE/SLOW SOLVING PROBLEMS.

Q. GIVEN THE RESULTS OF THIS STUDY, WHAT WERE YOUR CONCLUSIONS?

A. THE BASIC CONCLUSIONS I DREW FROM THE STUDY RESULTS WERE:

(1) WITH RESIDENTIAL CUSTOMERS, COMPARATIVE RESULTS INDICATED THAT SOUTHERN BELL WAS PERCEIVED TO BE EQUAL OR BETTER THAN OTHER LOCAL TELEPHONE COMPANIES IN FLORIDA. RARELY WAS SOUTHERN BELL SIGNIFICANTLY LOWER THAN OTHER LOCAL COMPANIES AND THEY WERE FREQUENTLY SIGNIFICANTLY HIGHER.

(2) WITH BUSINESS CUSTOMERS, COMPARATIVE RESULTS INDICATED THAT SOUTHERN BELL WAS PERCEIVED TO BE ESSENTIALLY THE SAME AS OTHER LOCAL TELEPHONE COMPANIES. SOUTHERN BELL WAS SIGNIFICANTLY HIGHER ON SELECT VARIABLES INCLUDING THE MAJOR OUTCOME OF OVERALL IMPRESSION. ON SELECT VARIABLES, INCLUDING A MINOR OUTCOME, THEY WERE SIGNIFICANTLY LOWER.

HOWEVER, LOWER (LESS POSITIVE) RESULTS WERE NOT AS COMMON AS HIGHER (MORE POSITIVE) RESULTS.

Q. IN ADDITION TO THE STUDY, WERE YOU ASKED TO PERFORM ANY OTHER SERVICE FOR SOUTHERN BELL?

A. YES, I WAS ASKED TO REVIEW AND COMMENT ON THE SOUTHERN BELL CUSTOMER TRACKING SYSTEM FOR RESIDENCE CUSTOMER SERVICE AND SMALL BUSINESS CUSTOMER SERVICE (TELSAM).

Q. WHAT ARE YOUR COMMENTS OR OBSERVATIONS CONCERNING THE RESIDENTIAL CUSTOMER SERVICE TRACKING SYSTEM?

A. MY REACTIONS AND COMMENTS ARE:

(1) FOR THE PURPOSE OF TRACKING, THE SAMPLING SYSTEM, AS DESCRIBED IN MATERIAL PROVIDED, APPEARS TO BE SATISFACTORY.

(2) TRAINING OF INTERVIEWERS THAT ADMINISTER THE RESIDENT CUSTOMER SERVICE WAS DESCRIBED IN THE PROVIDED MATERIAL. THE TRAINING, AS DESCRIBED, CERTAINLY MEETS, AND LIKELY EXCEEDS, INDUSTRY STANDARDS.

(3) THE INTERVIEW INTRODUCTION USED BY INTERVIEWERS WAS PROVIDED. THE INTRODUCTION IS, IN MY OPINION, APPROPRIATE AND ACCEPTABLE.

(4) AS DESCRIBED IN MATERIALS PROVIDED, RESULTS ARE REPORTED AS PERCENT VALUES. THIS IS A COMMONLY USED UNIT OF MEASUREMENT.

(5) TAKEN IN TOTAL, FOR INTERNAL TRACKING PURPOSES, THE RESIDENT CUSTOMER SERVICE SURVEY IS APPROPRIATE FOR THE PURPOSES INTENDED. IT IS ALSO VERY LIKELY THAT THE TRACKING RESULTS PROVIDE A HELPFUL INFORMATION SOURCE BEYOND THE ORIGINAL PURPOSE. THIS IS PARTICULARLY TRUE WHEN THE RESULTS ARE CONSIDERED OVER TIME. IN MY OPINION, THE DATA OF THE RESIDENT CUSTOMER SERVICE STUDY IS RELIABLE AND VALID.

Q. WHAT WERE YOUR COMMENTS AND OBSERVATIONS ABOUT THE SMALL BUSINESS CUSTOMER SERVICE?

A. MY COMMENTS AND REACTIONS FOR THE SMALL BUSINESS CUSTOMER SERVICE WERE ESSENTIALLY THE SAME AS FOR THE RESIDENT CUSTOMER SERVICE.

Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?

A. YES. BASED ON THE STUDY RESULTS FROM SURVEYING CUSTOMERS IN FLORIDA, SOUTHERN BELL SERVICE WAS PERCEIVED TO BE EQUAL TO IF NOT BETTER THAN THE SERVICE PROVIDED BY OTHER LOCAL TELEPHONE COMPANIES IN THE STATE. IN ADDITION, BASED ON MY REVIEW OF SOUTHERN BELL'S TELSAM SURVEY ON RESIDENCE AND SMALL BUSINESS CUSTOMER SERVICE, THE SURVEY ADEQUATELY MEETS THE TRACKING MEASUREMENT PURPOSES INTENDED.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. YES, IT DOES.

ASSOC,BEL16644
A644

FIELD FINAL - NOVEMBER 8, 1993

AC917
Project Registration #40309701
BELLSOUTH

Quality Benchmark Study - Business
The Gallup Organization
Cal Martin/
Ami Heusinkvelt, Specwriter
November, 1993

_X_ APPROVED BY CLIENT

DATE______________________

INTERVIEWED BY______________________

I.D.#: ____0____ (1-6)

**AREA CODE AND TELEPHONE NUMBER: (   )____________________ ______ ______ (32 - 41)

**INTERVIEW TIME: -- ______ (42) ______ (43)

Hello, this is ____________________ with The Gallup Organization of Lincoln, Nebraska. Today, we are conducting a brief study with businesses in your area about the service they receive from various companies. First of all, we need to speak to the individual in your company who is most familiar with your local telephone company and your company's interactions with your local telephone company.

1 Respondent available - (Continue)

2 Respondent not available - (Set time for call back)

3 (Refused) - (Thank and Terminate) ______(375)

S1. NUMBER OF EMPLOYEES: (Code from call record card)

1 Less than 25
2 25 - 49
3 50 - 499
4 500+ ______(655)

____(18-19)

S2. Which company currently provides your local telephone service? (Open ended and code)

01 Other (list)

02 (DK)
03 (Refused)
04 HOLD
05 HOLD
(Thank and Terminate)

06 Bell South

2.30

________________________________ ___ ___
(516) (517)

S3. How many employees are there in your company (read A-B)? (Open ended and code actual number)

9997 9,997+

9998 (DK)
9999 (Refused)
(Thank and Terminate)

A. At this location:

________________________ ___ ___ ___ ___
(656) (657) (658) (659)

B. In total:

________________________ ___ ___ ___ ___
(660) (661) (662) (663)

S4. QUOTA: (Number of employees)

(If code "06" in S3)

1	(AND code "0001-0024 in S4-A:)	Less than 25 (n=150)
2	(AND code "0025-0049 in S4-A:)	25 - 49 (n=100)
3	(AND code "0050-0499 in S4-A:)	50 - 499 (n=100)
4	(AND code "0500-9997 in S4-A:)	500+ (n=50)

(If code "01" in S3)

5	(AND code "0001-0024 in S4-A:)	Less than 25 (n=150)	
6	(AND code "0025-0049 in S4-A:)	25 - 49 (n=100)	
7	(AND code "0050-0499 in S4-A:)	50 - 499 (n=100)	
8	(AND code "0500-9997 in S4-A:)	500+ (n=50)	____(520)

1. First, I would like to get your general impressions regarding your local telephone company. Please rate your impression of (response in S1) on a scale of one to ten, where "1" means you have a poor overall impression (POI) of that company, and "10" means you have an excellent overall impression (EOI) of that company. What is your overall impression of (response in S1)?

POI									EOI	(DK)	(RF)	3.30	
01	02	03	04	05	06	07	08	09	10	11	12	(525)	(526)

2. In thinking about the overall services provided by (response in #1); that is your local telephone service, customer assistance, and other services, how satisfied are you with the services? Are you (read 1-4)?

1	Very satisfied - (Skip to #4)		
2	Somewhat satisfied	(Continue)	
3	Somewhat dissatisfied, OR		
4	Very dissatisfied		
5	(DK)	(Skip to #4)	
6	(Refused)		4.30(531)

3. (If code "2-4" in #2, ask:) Why aren't you very satisfied with (response in #1)? (Open ended)

01 Other (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

5.30

____________________________________ (538) (539)

4. Now, I'd like to ask you about some specific aspects of (response in #1). I'm going to read you some statements about (response in #1). Using a scale from one to ten, where "1" means poor (P), and "10" means excellent (E), please tell me how you would rate their performance on each of the following. How about (read and rotate A-H)?

A. Caring about their customers:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(542)	(543)

B. Providing a good value for the money you spend on telephone service:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(544)	(545)

C. Being active in the community:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(546)	(547)

D. Keeping rates fair and reasonable:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(548)	(549)

E. Attracting new business to the community:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(550)	(551)

F. Providing good customer service:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(552)	(553)

4. (Continued:)

G. Providing error-free billing:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(554)	(555)

H. Providing prompt repair and installation service:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(556)	(557)

5. In the last month, how many times have you, for any reason, called or written your local telephone company? (Open ended **and code actual number**)

00 None - (Skip to #7)

97 97+

98 (DK)
99 (Refused) (Skip to #6)

(558) (559)

5a. **(If code "01-97" in #5, ask:)** Was this most recent contact by telephone, written communication, or both?

1 Telephone
2 Written
3 Both
4 (DK)
5 (Refused) ____(560)

6. And, what was the primary reason for your most recent contact with your local telephone company? (Open ended and code)

01 Other (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

06 Billing
07 Request for service (new/transfer)
08 Service disconnect
09 Report service problem
10 Update account information
11 Request information about programs or special services
12 Complaints

8.10

(561) (562)

7. During the last month, other than sending you a monthly bill, how many times has your local telephone company called, written, or visited you? (Open ended **and code actual number**)

00 None - (Skip to "Note" before #9)

97 97+

98 (DK)
99 (Refused) (Skip to #8)

9.10

(563) (564)

7a. (If code "01-97" in #7, ask:) Was this most recent contact by telephone, written communication, or both?

1 Telephone
2 Written
3 Both
4 (DK)
5 (Refused)

______(565)

8. And, what was the primary reason they contacted you? (Open ended)

01 Other (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

10.10

(566) (567)

(If code "4" or "5" to BOTH #5a AND #7a,
Skip to #10;
If code "1" or "3" in #5a or #7a, Continue;
Otherwise, Skip to "Note" at #9a)

9. Using a ten-point scale, where "1" means poor (P), and "10" means excellent (E), how would you rate the rep you spoke with most recently on each of the following? How about (read and rotate A-D)? (NA=Not applicable)

A. Caring about your problem or request:

P									E	(DK)	(RF)	(NA)		
01	02	03	04	05	06	07	08	09	10	11	12	13	(568)	(569)

B. Being courteous:

P									E	(DK)	(RF)	(NA)		
01	02	03	04	05	06	07	08	09	10	11	12	13	(570)	(571)

C. Being knowledgeable:

P									E	(DK)	(RF)	(NA)		
01	02	03	04	05	06	07	08	09	10	11	12	13	(572)	(573)

D. Clearly explaining the facts about your request, problem or question:

P									E	(DK)	(RF)	(NA)		
01	02	03	04	05	06	07	08	09	10	11	12	13	(574)	(575)

9a. (If code "2" or "3" in #5a or #7a, ask:) Did the company respond to your written question or comment?

1	2	3	4	
Yes (Continue)	No	(DK) (Skip to #10)	(RF)	11.50(576)

9b. (If code "1 - Yes" in #9a, ask:) Did the response address your concern?

1	2	3	4	
Yes	No	(DK)	(RF)	____(577)

10. In the last three months, have you experienced any problems with regard to your phone or phone service?

1	2	3	4	
Yes (Continue)	No	(DK) (Go to Demos)	(RF)	12____(578)

11. <u>(If code "1 - Yes" in #10, ask:)</u> What was your problem? (Open ended)

01 Other (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

13.10

____ ___ ___
(579) (580)

(GO TO DEMOGRAPHICS)

DEMOGRAPHICS BEGIN HERE:

D1. GENDER: <u>(Do not ask: code only)</u>

1 Male 2 Female ___(44)

D2. ZIP CODE: Please tell me what your zip code is? (Open ended <u>and code all five digits of zip code)</u>

99998 (DK) 99999 (Refused)

___ ___ ___ ___ ___
(21) (22) (23) (24) (25)

(VALIDATE PHONE NUMBER AND THANK RESPONDENT)

INTERVIEWER I.D.#: ___ ___ ___ ___
(241) (242) (243) (244)

vkt\assoc\bell-bus.311

ASSOC.BEL16643
A643

FIELD FINAL - NOVEMBER 4, 1993

AC911
Project Registration #40309702
BELLSOUTH

Quality Benchmark Study - Residential
The Gallup Organization
Cal Martin/
Ami Heusinkvelt, Specwriter
November, 1993

__X__ APPROVED BY CLIENT

DATE______________________

INTERVIEWED BY______________________

I.D.#: ___0___(1-6)

**AREA CODE AND TELEPHONE NUMBER: (   )______________ _____ _____ (32 - 41)

**INTERVIEW TIME: -- _____ _____ (42) (43)

Hello, this is ____________________ with The Gallup Organization of Lincoln, Nebraska. May I please speak with the YOUNGEST MALE, 18 years of age or older, who is now at home? (INTERVIEWER NOTE: Need youngest AVAILABLE male, not necessarily the youngest adult male member of the household) (If "No male", ask:) May I please speak with the OLDEST FEMALE, 18 years of age or older, who is now at home? (When qualified respondent is reached, continue:) Today, we are conducting a brief study with people in your area about the service they receive from various companies.

1 Yes, male
2 Yes, female (Continue)

3 No adult 18 or older in household - (Thank, Terminate & Tally)

4 No adult 18 or older available - (Set time to call back) _____(44)

_____(18-19)

S1. Which company, if any, currently provides your (read and rotate A-D)? (Open ended and code)

01 Other (list)
02 (DK)
03 (Refused)
04 None/Don't have
05 HOLD

06 Bell/Bell South

A. Natural gas:

2.10

______________________________ (512) (513)

B. Electricity:

2.20

______________________________ (514) (515)

C. Local telephone service:

2.30

______________________________ (516) (517)

D. Cable television service:

2.40

______________________________ (518) (519)

<u>(If code "06" in S2-C, Code S3 as "1";
If code "01" in S2-C, Code S3 as "2";
If code "02", "03" or "04 to S2-C,
Go to Demos)</u>

S2. QUOTA GROUPS:

1 Bell Customer (n=1,000)
2 Non-Bell (n=1,000) ______(520)

<u>(If "Quota Group" is filled,
Go to Demos)</u>

1. First, I would like to get your general impressions regarding some local companies in your area. I'm going to read you some company names, and I'd like you to rate each one on a scale of one to ten, where "1" means you have a poor overall impression (POI) of that company, and "10" means you have an excellent overall impression (EOI) of that company. What is your overall impression of (read and rotate A-D, as appropriate)? (NA=Not applicable)

A. [(Response in S2-A)/Your local natural gas company]:

POI									EOI	(DK)	(RF)	(NA)		
01	02	03	04	05	06	07	08	09	10	11	12	13	(521)	(522)

B. [(Response in S2-B)/Your local electric company]:

POI									EOI	(DK)	(RF)	(NA)		
01	02	03	04	05	06	07	08	09	10	11	12	13	(523)	(524)

C. [(Response in S2-C)/Your local telephone company]:

POI									EOI	(DK)	(RF)	(NA)		
01	02	03	04	05	06	07	08	09	10	11	12	13	(525)	(526)

D. [(Response in S2-D)/Your local cable television company]:

POI									EOI	(DK)	(RF)	(NA)		
01	02	03	04	05	06	07	08	09	10	11	12	13	(527)	(528)

2. In thinking about the overall services provided by (read and rotate A-D, as appropriate); that is, (gas/electricity/local telephone/cable television) service, customer assistance, and other services, how satisfied are you with the services? Are you very satisfied (VS), somewhat satisfied (SS), somewhat dissatisfied (SD), or very dissatisfied (VD)? (NA=Not applicable)

	VS	SS	SD	VD	(DK)	(RF)	(NA)	
A. {(Response in S2-A)/ Your local natural gas company}	1	2	3	4	5	6	7	____(529)
B. {(Response in S2-B)/ Your local electric company}	1	2	3	4	5	6	7	____(530)
C. {(Response in S2-C)/ Your local telephone company}	1	2	3	4	5	6	7	____(531)
D. {(Response in S2-D)/ Your local cable television company}	1	2	3	4	5	6	7	____(532)

HOLD __0__(533)

(If code "1", "5", "6" or "7" to ALL in #2 A-D, Skip to #4; Otherwise, Continue)

3. (For each code "2-4" in #2 A-D, ask:) Why aren't you very satisfied with (read and rotate A-D, as appropriate)? (Open ended)

01 Other (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

A. [(Response in S2-A)/Your local natural gas company]:

5.10

______________________ (534) (535)

B. [(Response in S2-B)/Your local electric company]:

5.20

______________________ (536) (537)

C. [(Response in S2-C)/Your local telephone company]:

5.30

______________________ (538) (539)

D. [(Response in S2-D)/Your local cable television company]:

5.40

______________________ (540) (541)

4. Now, I'd like to ask you specifically about [(response in S2-C)/your local telephone company], I'm going to read you some GENERAL statements about [(response in S2-C)/your local telephone company]. Using a scale from one to ten, where "1" means poor (P), and "10" means excellent (E), please tell me how you would rate their performance on each of the following. How about (read and rotate A-H)?

A. Caring about their customers:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(542)	(543)

B. Providing a good value for the money you spend on telephone service:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(544)	(545)

C. Being active in the community:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(546)	(547)

D. Keeping rates fair and reasonable:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(548)	(549)

E. Attracting new business to the community:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(550)	(551)

F. Providing good customer service:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(552)	(553)

4. (Continued:)

G. Providing error-free billing:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(554)	(555)

H. Providing prompt repair and installation service:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(556)	(557)

5. In the last month, how many total times have you, for any reason, called or written your local telephone company? (Open ended and code actual number)

00 None - (Skip to #7)

97 97+

98 (DK)
99 (Refused) > (Skip to #6)

______ (558) (559)

5a. (If code "01-97" in #5, ask:) Was this most recent contact by telephone, written communication, or both?

1 Telephone
2 Written
3 Both
4 (DK)
5 (Refused) ______(560)

6. And, what was the primary reason for your most recent contact with your local telephone company? (Open ended and code)

01 Other (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

06 Billing
07 Request for service (new/transfer)
08 Service disconnect
09 Report service problem
10 Update account information
11 Request information about programs or special services
12 Complaints

8.10

______ (561) (562)

7. During the last month, other than sending you a monthly bill, how many times has your local telephone company called, written, or visited you? (Open ended <u>and code actual number)</u>

00 None - (Skip to "Note" before #9)

97 97+

98 (DK)
99 (Refused) (Skip to #8)

9.10

______________________ (563) (564)

7a. <u>(If code "01-97" in #7, ask:)</u> Was this most recent contact by telephone, written communication, or both?

1 Telephone
2 Written
3 Both
4 (DK)
5 (Refused)

______(565)

8. And, what was the primary reason they contacted you? (Open ended)

01 Other (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

10.10

______________________ (566) (567)

(If code "4" or "5" to BOTH #5a AND #7a, Skip to #10;
If code "1" or "3" in #5a or #7a, Continue;
Otherwise, Skip to "Note" at #9a)

9. Using a ten-point scale, where "1" means poor (P), and "10" means excellent (E), how would you rate the rep you spoke with on each of the following? How about (read and rotate A-D)?

A. Caring about your problem or request:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(568)	(569)

B. Being courteous:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(570)	(571)

C. Being knowledgeable:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(572)	(573)

D. Clearly explaining the facts about your request, problem or question:

P									E	(DK)	(RF)		
01	02	03	04	05	06	07	08	09	10	11	12	(574)	(575)

9a. (If code "2" or "3" in #5a or #7a, ask:) Did the company respond to your written question or comment?

1 Yes (Continue)	2 No	3 (DK) (Skip to #10)	4 (RF)	11,50(576)

9b. (If code "1 - Yes" in #9a, ask:) Did the response address your concern?

1 Yes	2 No	3 (DK)	4 (RF)	____(577)

10. In the last three months, have you experienced any problems with regard to your phone or phone service?

1 Yes (Continue)	2 No	3 (DK) (Skip to #12)	4 (RF)	12 ___(578)

11. (If code "1 - Yes" in #10, ask:) What was your problem? (Open ended)

01 Other (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

13.10

___ ___ (579) (580)

12. NUMBER IN HOUSEHOLD: Including yourself, how many individuals currently live in your household? (Open ended and code actual number)

98 (DK)
99 (Refused)

___ ___ (612) (613)

13. INDIVIDUALS EMPLOYED: Including yourself, how many individuals currently living in your household are employed full-time? (Open ended and code actual number)

00 None
98 (DK)
99 (Refused)

___ ___ (614) (615)

14. TYPE OF HOME: What type of dwelling do you currently live in? (Open ended)

01 Other (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

16.10

___ ___ (617) (618)

15. Do you own or rent your current residence?

1 Own
2 Rent
3 (Other)
4 (DK)
5 (Refused)

_____(619)

(GO TO DEMOGRAPHICS)

DEMOGRAPHICS BEGIN HERE:

D1. AGE: Please tell me how old you are? (Open ended <u>and code actual age)</u>

00 (Refused) 99 99+

18.10

______ ______
(45) (46)

D2. EDUCATION: What is the highest level of education you have completed? (Open ended and code)

1 Less than high school graduate (0-11)
2 High school graduate (12)
3 Some college
4 Trade/Technical/Vocational training
5 College graduate
6 Post-graduate work/Degree
7 (DK)
8 (Refused) ______(47)

D3. ETHNICITY: Are you, yourself, of Hispanic origin or descent, such as Mexican, Puerto Rican, Cuban, or other Spanish background?

1	2	3	4
Yes	No	(DK)	(RF)

______(49)

D4. RACE: What is your race? Are you white, African-American, or some other race? <u>(NOTE: If respondent says "Hispanic", ask:)</u> Is that white Hispanic or black Hispanic? <u>(If respondent says "just Hispanic", code as "06-White")</u>

01 Some other race (list)
02 (DK)
03 (Refused)
04 HOLD
05 HOLD

06 White
07 African-American

21.10

______ ______
(650) (651)

(DEMOGRAPHICS CONTINUED)

D5. INCOME: Is your total annual household income, before taxes, over or under $25,000?

(If "Under", ask:) Is it over or under $15,000?

(If "Over", ask:) Is it over or under $35,000?
(If "Over", ask:) Is it over or under $45,000?
(If "Over", ask:) Is it over or under $55,000?
(If "Over", ask:) Is it over or under $75,000?
(If "Over", ask:) Is it over or under $100,000?

1 Under $15,000
2 $15,000 to $24,999
3 $25,000 to $34,999
4 $35,000 to $44,999
05 $45,000 to $54,999
06 $55,000 to $74,999
07 $75,000 to $99,999
08 $100,000 or more
09 (DK)
10 (Refused) ____ ____
(53) (54)

D6. ZIP CODE: Please tell me what your zip code is? (Open ended and code all five digits of zip code)

99998 (DK) 99999 (Refused)

________________ ____ ____ ____ ____ ____
(21) (22) (23) (24) (25)

(VALIDATE PHONE NUMBER AND THANK RESPONDENT)

INTERVIEWER I.D.#: ____ ____ ____ ____
(241) (242) (243) (244)

vkt\assoc\bell-res.311

FPSC Exhibit Number ______
FPSC Docket 920260-TL
Hoeltke Exhibit GMH-2

MAJOR AND MINOR RESULTS[1]
(Residential Customers - Weighted Data)

Question/Issue	Southern Bell Avg.	Southern Bell % Top[2]	Other Local Avg.	Other Local % Top[2]	Avg. Diff.
Major Results					
Overall impression of telephone company	8.43	77%	8.02	67%	.41*
Overall satisfaction with telephone company	3.63	67	3.49	61	.14*
Minor Results					
Caring about customer	8.14	70%	7.86	63%	.28*
Good value	7.87	64	7.36	59	.51*
Active in community	7.28	38	7.01	39	.27*
Rates fair and reasonable	7.46	56	7.11	50	.35*
Attract new business to community	7.12	31	6.43	31	.69*
Good customer service	8.44	75	7.96	69	.48*
Error-free billing	8.42	75	8.33	73	.09
Prompt repair and installation	8.29	67	8.18	68	.11
Problems with telephone last three months (yes response)		15		15	0

1 N, n, and s given in tabulated results
2 % Top for 10-point scale was 8-10, for 4-point scale was 4
* $p<.05$

OTHER RESULTS[1]
(Residential Customers - Weighted Data)

Question/Issue	Avg.	% Top
Overall impression natural gas company	7.63	14%
Overall impression electric company	8.07	69
Overall impression local cable TV company	5.88	27
Overall impression Southern Bell	8.43	77
Overall impression other local telephone company	8.02	67
Overall satisfaction with natural gas company	3.43	13%
Overall satisfaction with electric company	3.54	62
Overall satisfaction with local cable TV company	2.82	22
Overall satisfaction with Southern Bell	3.63	67
Overall satisfaction with other local telephone company	3.49	61

	Southern Bell Avg/%[2]	Other Local Avg/%[2]	Avg/% Diff.
(If dissatisfied with telephone service) Why?			
Cost to high	22%	21%	1%*
Billing problems	6	12	6*
Outages/Disruption	6	2	4*
Long wait for installation	5	5	0
Room for improvement	1	7	6*
Other	43	39	4
Number of contacts with telephone company (respondent initiated)	.52	.80	.28*
(If contacted) Method of contact			
Telephone	94%	91%	3%
Written	3	6	3
Both	3	2	1

	Southern Bell Avg/%[2]	Other Local Avg/%[2]	Avg/% Diff.
(If contacted) Reason			
Billing	35%	39%	4%
Request for service (new/transfer)	21	25	4
Report service problem	17	11	6*
Service disconnect	8	2	6*
Request for information	5	7	2
Other	14	17	3
Number of times contacted by telephone company	.18	.13	.05*
(If contacted) Method of contact			
Telephone	42%	60%	18%*
Written	43	17	26*
Both	11	22	11*
(If contacted) Reason			
Offer more services	35%	42%	7%
Discussing phone bills	14	4	10*
Calling to see if I was satisfied with service	13	4	9*
Problem with phone	8	29	21*
Other	21	6	15*
(If contacted) Rating of telephone representative			
Caring about your problem/request	8.47	8.10	.37*
Being courteous	9.02	8.77	.25
Being knowledgeable	8.42	8.24	.18
Clearly explaining the facts about your request/question	8.40	8.09	.31
(If respondent wrote to company) Did company respond to written question? (yes)	50%	79%	29%*

	Southern Bell Avg/%[2]	Other Local Avg/%[2]	Avg/% Diff.
(If yes) Did response address concern? (yes)	96%	100%	4%
If problem in last 3 months, What was the problem?			
Static on line/poor connection	39%	56%	17%*
Phone dead/was not working	28	31	3
Billing problem	15	6	9*
Other	17	6	11*

1 N, n, and s given in tabulated results
2 % Top for 10-point scale was 8-10, for 4-point scale was 4
* $p<.05$

MAJOR AND MINOR RESULTS[1]
(Business Customers - Weighted Data)

Question/Issue	Southern Bell Avg.	Southern Bell % Top[2]	Other Local Avg.	Other Local % Top[2]	Avg. Diff.
Major Results					
Overall impression of telephone company	8.31	75%	8.03	76%	.28*
Overall satisfaction with telephone company	3.63	69	3.58	65	.05
Minor Results					
Caring about customer	7.99	68%	7.95	64%	.04
Good value	7.66	59	7.68	58	.02
Active in community	7.56	39	7.98	46	.42*
Rates fair and reasonable	7.27	50	7.25	47	.02
Attract new business to community	6.98	29	7.35	28	.37
Good customer service	8.31	77	8.28	73	.03
Error-free billing	8.44	74	8.37	70	.07
Prompt repair and installation	8.12	73	8.03	67	.09
Problems with telephone last three months (Yes response)		30%		22%	8%*

1 N, n, and s given in tabulated results
2 % Top for 10-point scale was 8-10, for 4-point scale was 4
* $p<.05$

OTHER RESULTS[1]
(Business Customers - Weighted Data)

	Southern Bell Avg/%[2]	Other Local Avg/%[2]	Avg/% Diff.
(If dissatisfied with telephone service) Why?			
Cost too high	7%	29%	22%*
Unresponsive to problem	16	4	12*
Lack of service/don't offer enough	3	6	3*
Poor service/poor customer service	10	5	5
Room for improvement	4	5	1
Billing problems	3	4	1
Outages/disruption of service	6	16	10*
Difficulty getting through for service	1	15	14*
Other	28	8	20*
Number of contacts with telephone company (respondent initiated)	3.82	1.25	2.57*
(If contacted) Method of contact			
Telephone	90%	98%	8*
Written	1	0	1
Both	9	2	7*
(If contacted) Reason			
Request for service (new/transfer)	30%	23%	7%
Report a problem	33	22	11*
Billing	11	23	12*
Service disconnect	4	17	13*
Other	20	15	5
Number of times contacted by telephone company	1.89	.52	1.37*
(If contacted) Method of contact			
Telephone	50%	51%	1%
Written	18	16	2
Both	26	19	7

	Southern Bell Avg/%[2]	Other Local Avg/%[2]	Avg/% Diff.
(If contacted) Reason			
Offer more services	31%	26%	5%
Calling to see if satisfied with repairs	16	10	5
Confirming new service	10	12	2
Requested Contact	7	15	8
Phone line down/phone out	3	12	9*
General repair/service	8	5	3
Other	15	5	10*
(If contacted) Rating of telephone representative			
Caring about your problem/request	8.52	7.87	.65*
Being courteous	9.06	8.86	.20
Being knowledgeable	8.49	7.88	.61*
Clearly explaining the facts about your request/question	8.32	7.95	.37
(If respondent wrote to company) Did company respond to written question? (yes)	75%	76%	1%
(If yes) Did response address concern? (yes)	91%	100%	9%
What was the problem?			
Phone dead/wasn't working	26%	29%	3
Some equipment went down	17	3	14*
Static on line/poor connection	22	19	3
Underground line severed	4	16	12*
Unresponsive/slow solving problems	1	17	16*
Other	23	14	9

1 N, n, and s given in tabulated results
2 % Top for 10-point scale was 8-10, for 4-point scale was 4
* $p<.05$

REBUTTAL TESTIMONY OF

J. BRADFORD BRANCH

Before the

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

December 10, 1993

Q. Please state your name, address and occupation.

A. My name is J. Bradford Branch. My business address is 100 Peachtree Street, N.E., Atlanta, Georgia 30303. I am a general partner in the accounting, auditing and management consulting firm of Deloitte & Touche ("D&T").

Q. Would you briefly summarize your academic and professional background?

A. I received a Bachelor of Arts degree in Business Administration from the University of North Carolina (Charlotte) and a Master of Business Administration from the University of North Carolina (Chapel Hill). Over the past 15 years, I have practiced in the accounting and auditing division of D&T, serving regulated clients in telecommunications, gas and electric industries and public and private commercial entities in a variety of industries including real estate, manufacturing and distribution.

Q. What is your role within D&T?

A. I am D&T's National Audit Partner for the Telecommunications Industry practice. In this capacity, I provide technical support on accounting, auditing and regulatory accounting matters to D&T practice offices serving telecommunications industry clients. My major activities in this role include (i) providing representation to and/or monitoring pertinent activities of groups formulating telecommunications industry accounting policies (e.g. AICPA, Federal Communications Commission), (ii) serving as D&T's representative at industry accounting forums, and (iii) providing technical accounting advice and opinions. I have provided technical consultation on the accounting and reporting requirements for affiliated interest transactions and the reporting requirements pertaining to the Joint Cost Order of the Federal Communications Commission on numerous occasions.

I also serve as an accounting and auditing services partner responsible for the overall supervision of audit and attest services provided to regulated industry clients. In this capacity, I have supervised numerous engagements requiring the application of affiliate transaction rules of the Joint Cost Order of the FCC.

Q. **Are you licensed as a Certified Public Accountant?**

A. Yes. I am licensed as a Certified Public Accountant in the state of Florida and numerous other states.

Q. **Have you previously testified as an expert witness on accounting and regulatory issues?**

A. Yes. I previously testified before the Louisiana Public Service Commission (Docket No. U-17949 - Subdocket A) on accounting and management auditing matters pertaining to affiliated interest transactions, joint cost allocations and other regulatory issues.

Q. **What is the purpose of your testimony?**

A. Southern Bell Telephone and Telegraph Company has requested that I respond to positions taken by Office of Public Counsel witness Kimberly H. Dismukes ("Ms. Dismukes") in testimony filed November 8, 1993 (Docket 920260-TL), pages 62 through 85, and related exhibits.

The positions that I address relate to real estate transactions involving BellSouth Corporation ("BSC") and certain BSC affiliates. Specifically, my testimony: (1) responds to Ms. Dismukes' recommended disallowances pertaining to the Campanile Building, the Miami warehouse, and the Jacksonville warehouse, (2) discusses Ms. Dismukes' application of the affiliate transaction pricing provisions of the Federal Communications Commission, USOA Part 32 and Part 64 and the Joint Cost Order, and (3) corrects substantial factual errors and omissions in Ms. Dismukes' testimony. My testimony is organized in three sections: (1) Campanile building issues, (2) Miami warehouse issues and (3) Jacksonville warehouse issues.

SPECIFIC ISSUES RELATED TO THE CAMPANILE BUILDING

Q. Please summarize the relevant facts surrounding BellSouth Corporation's lease of office space in the Campanile Building in Atlanta?

A. BellSouth Corporation leases office space in the Campanile building at 1155 Peachtree, a location approximately two miles north of what is generally considered downtown Atlanta. The Campanile Building is owned by 1155 Peachtree Associates, a joint venture between BellSouth Corporation and CA Fourteenth Investors, Ltd. The building serves as headquarters office space for BSC and provides space to BSC affiliates and other non-affiliated companies. Attached hereto as **Exhibit JBB-1** is a summary of the primary tenancy of the Campanile as of September 1, 1993 according to Schedule 16 of Ms. Dismukes' testimony. According to this schedule, BSC leases approximately 67.2% of the building and the largest non-affiliated tenant, Coopers & Lybrand, leases 16.3% of the building. Space leased to BSC and affiliated entities totals approximately 72.6% of the building.

BSC treats its lease of the Campanile building space as an affiliate transaction. The affiliate transaction pricing rules applied by BSC to the lease payments to 1155 Peachtree Associates (and subject to allocation to BST, as a component of corporate expense charges) are those dictated by the FCC in CFR 47, Section 32.27(d) of the Uniform System of Accounts, CFR 47, Section 64.901 and the FCC's Joint Cost Order (FCC Docket 86-111). These rules require that transactions between regulated and non-regulated affiliates be governed by the following pricing hierarchy:

> "Services provided to an affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. ["tariff pricing"] Services provided by an affiliate to the regulated activity, when the same services are also provided by the affiliate to unaffiliated persons or entities, shall be recorded at the market rate. ["prevailing market rate pricing"] When a carrier provides substantially all of a service to or receives substantially all of a service from an affiliate which are not also provided to unaffiliated persons or entities, the services shall be recorded at cost which shall be determined in a manner that complies with the standards and procedures for the apportionment of joint and common costs between the regulated and non-regulated operations of the carrier entity." ["fully distributed cost pricing" or "FDC"] (CFR 47, 32.27(d))

BSC's lease of office space in the Campanile Building is not governed by any tariff. BSC believes that 1155 Peachtree Associates participates in a substantial outside market in its leases of space in the Campanile building to non-affiliate tenants, and therefore, has applied the "prevailing market rate" affiliate pricing rule to this transaction. This pricing methodology is specified in BSC's Cost Allocation Manual, filed with the FCC, and has been subject to annual independent audits, without exception.

Of critical importance, if neither the "tariff pricing" provisions nor the "prevailing market rate pricing" provision of Section 32.27(d) and Section 64.901 were applicable to this transaction, then BST would be required to compensate the non-regulated affiliate for its allocation of the charge for leased space using fully distributed cost pricing.

Q. Please describe how BSC applied prevailing market rate pricing in the Campanile lease.

A. In applying the prevailing market rate pricing, BSC was required to charge BST, through allocation, not more than the price charged to the most comparable non-affiliate tenant in the building which was, in this case, Coopers & Lybrand (C&L). C&L leases 16.3% of the available building space.

As Ms. Dismukes acknowledges [line 7-9, page 67], BSC performed an appropriate comparison of lease rates between BSC and C&L using a net present value methodology. The comparison considered tenant improvement allowances, rent abatements, moving allowances, differences between the rent per square foot, the timing of the cash flows of each lease and the time value of money. This comparison demonstrated that the lease rate payable by BSC to 1155 Peachtree Associates exceeded the prevailing market rate payable by C&L. The comparison further showed that an amount of $ per square foot of BSC lease space should be retained by BSC beginning in 1993 and should not be subject to allocation to BST. The application of this retention amount was necessary to account for both future and historical differences and equalize net present value, all in compliance with prevailing market rate pricing.

Q. Does Ms. Dismukes recommend an adjustment regarding the Campanile Building and this retention amount?

A. Yes. On page 73, lines 7-10, Ms. Dismukes recommends an adjustment of $93,380. The purpose of this adjustment is to "put the BSC lease in terms comparable to the Coopers & Lybrand lease." This adjustment is based upon the $ per square foot figure determined by BSC through the analysis, undertaken of their own volition, as described above.

Ms. Dismukes, however, makes this recommendation based on speculation that BSC is not currently retaining this amount. On page 67, line 19 Ms. Dismukes refers to a memorandum that she reviewed that recommends that BSC increase the amount of the BSC Campanile lease payment that is retained by BSC to $ per square foot on a going forward basis. Instead of verifying that BSC followed through on its stated intention, Ms. Dismukes merely states, "It is unclear however, what option, if any, BSC chose." Had she investigated this matter further, Ms. Dismukes would have learned that BellSouth Corporation, had, in fact, increased the retainage amount to $ per square foot.

According to page 1 of POD item # 736, attached hereto as **Exhibit JBB-2**, produced by BellSouth in response to Office of Public Counsel's 48th POD, an internal BellSouth memo dated November 24, 1992, from Frances Dennis, Operations Manager - BST Comptrollers to John Robinson, Operations Manager - BSC Comptrollers and Mike Denson, Operations Manager - BSC Corporate Support, indicates that the Company intended to increase the retained charge to $ per square foot effective January 1, 1993. Furthermore, I have verified that $ per square foot is actually being retained by BSC.

Given the above facts, no adjustment is warranted or required, as the appropriate amount is already being retained. Any adjustment would overstate the retained amount. Therefore, Ms. Dismukes' recommendation regarding this issue is not substantiated by the facts. In reality, the facts available in this proceeding, readily available from BST, and actually provided in POD item # 736 are in direct contradiction to Ms. Dismukes' recommendation. No action should be taken by the Commission as a result of Ms. Dismukes' recommendation on this issue.

Q. Do you have any views about Ms. Dismukes' statements regarding the existence of a substantial outside market for purposes of applying prevailing market rate pricing based upon a 16% to 18% share of the total rentable square footage?

A. Yes. The FCC has not clearly defined what constitutes a "substantial outside market". BSC believes that a substantial outside market exists for the Campanile building. Ms. Dismukes is apparently ambivalent on this point stating that, "basing the BSC lease on the lease rate paid by C&L does not conform to the FCC's JCO rules, unless one believes that 16% to 18% represents a "substantial" outside market." [line 14, page 69] In this case, BSC believes that a lease of 16% to 18% of a building does represent a substantial outside market. Indeed, according to information provided in response to Florida Public Service Commission Staff data requests 2-054, Attachment G and 2-131, over 27% of building space is <u>not</u> leased by affiliates and approximately 27% of 1992 building revenue is <u>not</u> from affiliates. This is a further indication that a significant portion of the building is attributable to non-affiliate activities and a substantial outside market exists.

Q. What would be the result if a substantial outside market did not exist for the Campanile building?

A. If prevailing market rate were not the appropriate pricing rule to govern the charges to BST for BSC's Campanile building lease, the fully distributed cost pricing methodology would be required by the affiliate transaction pricing rules specified by CFR 47, Part 32.27(d) and the FCC's Joint Cost Order. In other words, the pricing hierarchy established by the FCC does not allow for the arbitrary selection of a pricing methodology for affiliate transactions. Fully distributed cost is required in cases where tariffs or prevailing market rates are not appropriate for use.

Q. **Have you performed an analysis of the cost to BST of the Campanile lease space if fully distributed costing were used?**

A. Yes. My analysis shows that if prevailing market rate pricing were not allowed to be used by BSC, and, consequently, BSC was then required to use fully distributed cost as the pricing rule governing the Campanile lease, the cost to the ratepayer would increase significantly. Simply put, the fully distributed cost of BellSouth Corporation's lease of Campanile Building space is much greater than the prevailing market rate. The following table compares the charge per square foot for BSC's leased space under prevailing market rate pricing and the same charge using fully distributed cost pricing for 1992: As shown below for 1992, the total fully distributed cost per square foot for BSC's leased space of [redacted] would increase BSC's charge to BST's regulated operations by 53%. If the fully distributed cost for 1992 of [redacted] remained the same during 1993, and was used to determine charges to BST for the Campanile lease instead of the market rate for 1993 of [redacted] (after applying the [redacted] retention) the charge to BST's regulated operations would increase by 75%.

	Under Fully Distributed Cost	Under Prevailing Market Rate	Increase Required
Effective 1992 BST Rate	$ [redacted]	$ [redacted]	53%

Q. **Have you prepared an Exhibit which supports your FDC computation?**

A. Exhibit JBB-3 contains the computations supporting the FDC lease rate specified above. Exhibit JBB-3 was created by extracting estimated cost and investment information from OPC POD #794, by using the current pretax allowable rate of return, and by applying the current BSC and affiliate company occupancy percentage specified by Ms. Dismukes' Schedule 16 (reproduced herein on Exhibit JBB-1). Headquarters operating expenses, included in the FDC analysis, were estimated based on historical information provided by BSC, updated at an estimated five percent annual rate of increase.

Q. Can you briefly summarize what this analysis demonstrates?

A. It demonstrates that the discontinuance of prevailing market rate pricing would significantly increase the 1993 cost of the Campanile lease to BST's regulated operations, and therefore, to ratepayers. This is particularly important considering Ms. Dismukes' view about the prospective application of the FCC's proposed revision to affiliate transaction rules expressed in the Notice of Proposed Rulemaking ("NOPR"), FCC Docket No. 93-251, dated October 20, 1993. Ms. Dismukes expresses the view, beginning in line 18, page 70 of her testimony, that "without a doubt the use of the C&L lease does not fall near the FCC's proposed standard" [for use of prevailing market rate]. Fully distributed cost would therefore be required to be used as a consequence. Fortunately, Ms. Dismukes' speculation of the effects of the NOPR is irrelevant for the 1993 test year, as the FCC has made no final ruling.

Q. Does Ms. Dismukes have another recommended adjustment pertaining to the Campanile building?

A. Yes. On page 73, Ms. Dismukes recommends, "that the Commission reduce the lease charged to BSC by 10% to reflect the fact that the marketing costs and business risk associated with the lease should be minimal. This would reduce BSC lease expense for the Campanile building by $ and the amount charged to the Company's intrastate operations in 1993 by $104,777." This recommendation, and the underlying logic offered in its support, is flawed because:

1. Ms. Dismukes' recommendation is arbitrary and ignores the value of the substantial benefits of purchasing from affiliates,

2. The pricing rule recommended by Ms. Dismukes, namely "market rate less 10%" is not recognized by any of the affiliate transaction pricing rules available to the Company; proscribing the use of prevailing market rate pricing would cause the pricing methodology to revert to fully distributed cost, to the ratepayers detriment,
3. Ms. Dismukes' proposal to reduce the amount charged to BSC, a non-regulated entity, and to 1155 Peachtree Associates, another non-regulated entity, is not actionable by BST, and
4. The calculation supporting her recommendation is methodologically incorrect.

First, Ms. Dismukes' recommendation is completely arbitrary. She recommends a 10% adjustment to BSC's market-based lease rate based upon the perception that marketing costs and business risk associated with BSC's lease of office space in the Campanile building are lower than marketing costs and business risk of leases to non-affiliated tenants. But, at the same time, Ms. Dismukes ignores the significant benefits and cost savings to BSC, as lessee, of doing business with an affiliate that has knowledge of BSC's special needs. She offers no quantification or method for measuring the difference in "business risk" between leasing to Coopers & Lybrand versus leasing to BST supporting her determination that a 10% adjustment is appropriate.

Not only does this suggestion of a ten percent reduction have no basis in fact, a pricing rule of "market rate less 10%" is not available to BSC under the FCC affiliate transaction pricing rules. If prevailing market rate was not the appropriate pricing rule to govern the Campanile building lease, BSC would be required under CFR 47, Part 32.27(d) to revert to the fully distributed cost of leasing its space in the building. This reversion would cause a substantial increase in the allocated cost to BST's regulated operations.

Furthermore, Ms. Dismukes proposes reducing the amount charged to BSC [line 3, page 73] a non-regulated entity, which is not actionable by BST, the entity which is subject to the rules of the Florida Public Service Commission.

And finally, based upon the information in Ms. Dismukes' testimony on page 63, line 20, the Company's 1993 intrastate operations were budgeted to be charged $773,000 for BSC's leases of the Campanile building. Applying Ms. Dismukes' recommended 10% reduction yields a result of $77,300, not the $104,777 specified in Ms. Dismukes' testimony [line 6, page 73]. The computation appears to be mathematically incorrect.

Due to the inherent flaws, lack of any meaningful substantiation, and the arbitrary nature of Ms. Dismukes' recommended adjustment that "market less 10%" is the appropriate pricing rule for BSC's Campanile lease, and the potential for reversion to the more costly FDC based lease rate should prevailing market rate pricing not be used, I can find no reason for the Commission to act on her recommendation.

Q. **Do you have any further views about Ms. Dismukes' mention of potential discrepancies between BSC's lease rate as compared with BellSouth Enterprise's ("BSE") lease rate or BellSouth Information System's ("BIS") lease rate?**

A. Yes. There are many factors which influence individual lease rates including the condition in which the space is provided to the tenant, the condition of the market at the time the lease was negotiated, the size of the space, and any amenities. The differences in leasing rates that Ms. Dismukes indicates [line 18, page 68] are primarily due to the differences in the terms of the leases and the condition of the space as provided to BSE and BIS.

For example, the space BIS currently leases is the building's uppermost floor, which is considered substandard for office space; accordingly, the rate is much less. Landlords typically rent such space as storage to enhance revenue. BIS' space on the 21st. floor of the Campanile building is best described as equipment/mechanical space, and has limited access. Therefore, it should be no surprise that the lease rates are different.

Q. Can you summarize your opinion regarding the portion of Ms. Dismukes' testimony concerning the Campanile building?

A. Yes. Ms. Dismukes' conclusions regarding the Campanile building are not supported by the evidence. Her analyses are faulty and incomplete. No action should be taken based upon her testimony and no adjustments are necessary.

SUNLINK'S LEASE OF THE MIAMI WAREHOUSE SPACE TO BST

Q. Ms. Dismukes recommends an adjustment of $54,030 to exclude the expenses associated with the unused portion of the Miami warehouse. Is this adjustment justified?

A. No. Ms. Dismukes bases her recommendation upon the space in the Miami warehouse not being "used and useful" [lines 7-9, page 85]. A brief description outlining the history of the Miami warehouse is needed to correctly describe the facts.

Title to the Miami warehouse, referred to intermittently by Ms. Dismukes as the Miami warehouse or the Ojus warehouse, was transferred to Sunlink as part of the divestiture agreement. From divestiture until 1989, BellSouth Services Incorporated (BSSI) leased the warehouse space from Sunlink. In 1989, BSSI vacated the warehouse due to a consolidation of two warehouses, one in Jacksonville and one in Miami. Ms. Dismukes' testimony is correct on these facts. However, contrary to the testimony of Ms. Dismukes, between 1989 and August, 1992, BSSI or BST did not lease space or pay rental charges for the Miami warehouse.

On August 24th, 1992, Hurricane Andrew hit Florida leaving massive destruction behind. Within the week, BST responded to a request from the Salvation Army for warehouse space and entered into a commitment with Sunlink to lease the unused Miami warehouse. BST committed that it would reimburse Sunlink only for all direct operating costs associated with the space. BST then gave use of the space to the Salvation Army's, "We Will Rebuild" effort as an "in kind" contribution for a period of 13 months ending September 30, 1993. On October 1, 1992, BST entered into a written lease agreement for the Miami warehouse with Sunlink in exchange for $1 per year plus additional charges in the amount of all utility, tax, security and any other direct expenses related to the operation of the warehouse. This information was provided to the OPC in POD items #461 and #826(b). Furthermore, the rent and expense associated with the Miami warehouse were charged to account 7370 - Special Charges (Contributions). According to FCC CFR 47, Part 32.7370, charges booked to the 7370 account series "are presumed to be excluded from the costs of service in setting rates."

Beginning September 1, 1993, BST amended its lease with Sunlink for the Miami warehouse to extend the term to June 30, 1994 in exchange for per month rent net of expenses. BST and the Salvation Army's, "We Will Rebuild" entered into a lease for $ per month payable to BST. The includes an additional amount for janitorial services not included in the Sunlink agreement. This contract is to effectively reimburse BST for costs incurred in connection with the Miami warehouse to the Salvation Army's, "We Will Rebuild" campaign.

It is unclear why Ms. Dismukes did not follow through and determine the final resolution of this situation. Ms. Dismukes' analysis is incomplete and the recommended adjustment of $54,030 should not be made.

SUNLINK'S LEASE OF THE JACKSONVILLE WAREHOUSE SPACE TO BST

Q. **Ms. Dismukes recommends an adjustment of $295,030, referenced as "Sunlink Lease" on Schedule 19 of Exhibit_(KHD-1). What issues do you have with this recommended adjustment?**

A. Ms. Dismukes briefly discusses the comparison she did to "correct for flaws" [line 3, page 82] and based upon this comparison proposes an adjustment of $295,030. Ms. Dismukes fails to provide sufficiently detailed calculations used to determine the value of each factor or the source for the factor if she did not derive it. The $295,030 is an aggregate amount and cannot be broken down into amounts associated with each adjustment. The accuracy and legitimacy of these figures, therefore, cannot be determined.

However, even assuming the values associated with each factor are correct mathematically, there are several problems with her reasoning. First, her assumption that BST will renew its lease [line 17, page 82] is purely speculative. In fact, I understand from the BST Property Management group that BST may purchase three of the Sunlink warehouses. Thus, Ms. Dismukes' argument about BST's exposure to future cost increases is not only speculative, but will perhaps be moot. These charges would simply cease to be affiliate transactions. The potential purchase of the warehouses clearly demonstrates speculation should not be taken into consideration.

Furthermore, Ms. Dismukes calculates ten different figures [Schedule 17 of Exhibit _(KHD)-1] and recommends one without supporting why that particular recommendation is the appropriate adjustment instead of any of the other calculations she derives.

The most important flaw in Ms. Dismukes' argument, however, is that her comparison is based upon a flawed presumption that a fully distributed cost computation should be considered on a net present value basis, but applied only to current and future projected costs. In other words, her comparison ignores prior underrecoveries of allowable costs computed under FDC.

Q. With regard to the last point, what is wrong with the idea of applying the time value of money concept to FDC comparisons in this manner?

A. Applying the standard financial concept of time value of money (net present value) is a valid method when comparing known and measurable cash flows for a given period of time. An example of this would be comparing the net present value of two lease payment streams, given the life of the lease and the amount of rent paid in each year. This allows a comparison of the two, taking into consideration the timing and amounts of all future cash flows. Ms. Dismukes, however, seems to equate FDC cost for the warehouse, which is not being paid by BST, to a hypothetical stream of cash flows. She then seeks to compare this to the real stream of lease payments but only for the present and future - ignoring all prior periods. The concept of time value of money cannot be validly applied in this manner to compare a lease payment stream to fully distributed cost. FDC is simply a cost allocation mechanism prescribed by the FCC's Joint Cost Order to allocate historical and current period costs that have been incurred and are known. Costs cannot be precisely forecast into the future, unlike a written lease which explicitly sets the cash flows.

BST's policy for these leases is to limit the cumulative lease payments established under the terms of a lease agreement to not more than cumulative FDC cost for the warehouse space.

The mechanism used by BST to assure that the cumulative lease payments for the Jacksonville warehouse are less than FDC is straightforward. Each year, BST compares the actual lease payments for the current annual period with the affiliated lessor's fully distributed cost of providing the warehouse space. Any excess of lease payments over FDC or, conversely, any excess of allowable recovery by the lessor at FDC over the actual lease payments in the current period is added to the cumulative excess of FDC over BST's actual lease payments for prior periods. This computation determines that, on a cumulative basis for all periods to-date, the prices actually paid by BST are <u>no more than</u> allowable costs which could be recovered by the affiliated lessor under FDC pricing.

If the cumulative charges actually paid by BST were to exceed the cumulative FDC calculations, BST would make an adjustment equal to the difference.

It is equally interesting to note that (although applying net present value to FDC is not appropriate in this instance) a net present value computation, applied in a situation where the actual lease payments are always less than or equal to the fully distributed cost (on a cumulative basis at the end of each year) will produce a result whereby the net present value of those lease payments will always <u>be less than</u> the net present value of the FDC costs. Ms. Dismukes' reasoning is flawed in that her net present value computations conveniently ignore all historical periods where BST's actual lease payments for the Jacksonville warehouse have always been less than the fully distributed cost of providing the warehouse space. Her net present value assessment is applied only to current and future periods, and the cumulative underrecovery of allowable FDC costs are ignored.

Q. Do you have any comments on the way Ms. Dismukes calculated the fully distributed cost she used?

A. Yes. In addition to the above mentioned shortcomings in her analysis, she made several other errors in calculating fully distributed cost, including:

- Removal of certain Sunlink costs from FDC calculations
- Reduction of land value

Q. Can you discuss Ms. Dismukes removal of certain Sunlink allocated costs in her FDC calculations?

A. Ms. Dismukes also recommends removing certain Sunlink costs from the fully distributed cost analyses [line 20, page 83]. It is not clear as to which Sunlink costs Ms. Dismukes is referring, so I am assuming she is concerned with Sunlink working capital costs. Her reasons to exclude these allocated working capital costs include:

- "Dramatic" increase in these costs from 1984 to 1992 [line 16, page 80]
- These costs may have nothing to do with the warehouses [line 23, page 80] and no adequate explanation is given as to why these costs are excluded from the Colonnade office building comparison [line 12, page 80]

Q. What about these "dramatic" cost increases?

A. On page 80, line 6, Ms. Dismukes states, "from 1984 to 1992 this category of expense increased by 326% -- or over 40% annually." This does not take into consideration the compounding effect of the 8 year period. Ms. Dismukes does not take into consideration the time value of money which she espoused just two pages prior, nor does she attempt to determine the underlying reasons for the cost increases. The correct figure of which may be attributable to valid changes in underlying cost allocations, is very different from "over 40% annually".

Q. Why are these Sunlink working capital costs included in the warehouse comparisons, but excluded from the Colonnade comparison?

A. According to C&L workpaper 110.4, BSS pays all operating and maintenance expenses directly for the Colonnade property. Therefore, minimal Sunlink working capital is associated with maintaining and operating the property attributable to the Colonnade leases. Accordingly, these costs are allocated only to the warehouses in conformity with cost causative allocation principles, appropriate under the FCC's Joint Cost Order.

If these working capital costs are removed from the FDC calculations for the warehouses, it would not change the outcome of the comparison as demonstrated by Exhibit JBB-4.

Of additional note, the same analysis as JBB-4, prepared to exclude the "allocated costs" appearing on line 4 under the caption "Expenses," instead of excluding working capital, would also not change the outcome of this comparison.

Q. Finally, Ms. Dismukes factored in a reduced land value as a proposed adjustment to the lease rate on the Jacksonville warehouse. What specifically is incorrect with this adjustment?

A. Ms. Dismukes states on page 84, line 7 that her calculations reduced the land value from $426,842 to $275,494 "because in 1990 Sunlink sold a portion of the land that was attributed to the warehouse. Clearly, the land was not needed [during the first six years of the lease] to house the warehouse or it would not have been sold." Ms. Dismukes does not specifically mention the property to which she is referring. However, assuming she is referring to the Jacksonville warehouse, it appears that her analysis is in error.

It is unclear as to how Ms. Dismukes applied her recommended adjustment to the land value for the first six years of the Jacksonville warehouse lease, because, once again, she provides no information to support her recommended adjustment. If her adjustment were appropriate, then it should be applied to reduce the investment associated with the Jacksonville warehouse in the FDC computation. I have performed this calculation.

Using $275,494 as the value of the land in the FDC analysis from 1984 to 1989, as Ms. Dismukes proposes [line 7-9, page 84] does not, in fact, change the net result. This is because the appropriate application of such an adjustment would reduce the fully distributed cost of providing the warehouse space, but not by enough to make the lease payment greater than FDC. As demonstrated in Exhibit JBB-5, the cumulative lease payments associated with the Jacksonville warehouse remain less than the fully distributed cost of providing the warehouse space, even if the land value is reduced to $275,494. Therefore, no adjustment associated with this recommendation is warranted.

Q. Can you summarize your findings regarding Ms. Dismukes suggested adjustment of $295,030?

A. Yes, due to lack of support and incorrect assumptions, I cannot concur with Ms. Dismukes on this adjustment. No action should be taken by the Commission regarding the proposed $295,030 adjustment.

Q. Ms. Dismukes' testimony mentions several issues related to the Jacksonville warehouse expansions. What is your view of these issues?

A. Ms. Dismukes takes issue with the expansion of the Jacksonville warehouse because the Company failed to solicit bids for these projects from companies other than Sunlink [line 17, page 77]. This issue is not quantified nor is it related to any proposed adjustment.

However, I will address this issue so that the Commission may have an accurate understanding of this situation.

The Jacksonville warehouse was part of the property transfer settlement at divestiture. As of January 1, 1984, ownership of this property was transferred from Western Electric to Sunlink. At the time that the expansion was requested by the tenant (BellSouth Services) Sunlink owned and controlled the Jacksonville warehouse. This was not a purchase/lease-back transaction. As owner of the property, Sunlink was within its rights to contract the expansion to whomever it desired, including performing the work itself. As a non-regulated affiliate, Sunlink was not required to seek competitive bids. Sunlink could have also refused BellSouth Services' request for the expansion. Conversely, BellSouth Services was not required to lease this additional space from Sunlink and was free to seek additional space from other lessors if it considered Sunlink's proposal to be unacceptable.

As this issue is not related to any proposed adjustment, this portion of Ms. Dismukes' testimony should be ignored.

Q. Does this conclude your testimony?
A. Yes.

EXHIBITS

JBB-1: CAMPANILE STACKING PLAN (MS. DISMUKES SCHEDULE-16)

JBB-2: CAMPANILE RETENTION MEMO, POD #736

JBB-3: CAMPANILE FDC ANALYSIS

JBB-4: WAREHOUSE FDC ANALYSES WITH WORKING CAPITAL REMOVED

JBB-5: JACKSONVILLE WAREHOUSE FDC WITH REDUCED LAND VALUE

Southern Bell Telephone and Telegraph Company
Square Feet Leased at the Campanile Building

Floor	Tenant	Rentable Square Feet	Percent of Total
21	BellSouth Information Systems	5,351	1.2%
	BellSouth Corporation	3,107	0.7%
20	BellSouth Corporation	23,296	5.3%
19	BellSouth Corporation	23,296	5.3%
18	BellSouth Corporation	23,296	5.3%
17	BellSouth Corporation	23,296	5.3%
16	BellSouth Corporation	23,296	5.3%
15	BellSouth Corporation	23,296	5.3%
14	BellSouth Corporation	23,296	5.3%
13	BellSouth Corporation	23,271	5.2%
12	BellSouth Corporation	22,886	5.2%
11	Coopers & Lybrand	22,609	5.1%
10	Coopers & Lybrand	22,627	5.1%
9	Coopers & Lybrand	22,627	5.1%
8	BellSouth Corporation	22,392	5.0%
7	BellSouth Corporation	22,392	5.0%
	Carter	18,523	4.2%
6	BellSouth Corporation	3,869	0.9%
	BellSouth Telecommunications	8,080	1.8%
	Available for Lease	3,079	0.7%
5	BellSouth Telecommunications	11,233	2.5%
	Georgia Telco Credit Union	15,360	3.5%
	Coopers & Lybrand	2,205	0.5%
4	Georgia Telco Credit Union	4,827	1.1%
3	BellSouth Corporation	22,392	5.0%
2	BellSouth Corporation	16,494	3.7%
1	Prudential Bache Securities	14,526	3.3%
	Peachtree News	8,405	1.9%
P1	BellSouth Corporation	1,101	0.2%
P2	BellSouth Corporation	260	0.1%
		6,108	1.4%
	Total Square Feet	443,500	100.0%

Total BellSouth	298,032	67.2%
Total BellSouth Affiliates	23,790	5.4%
Total BellSouth and Affiliates	321,822	72.6%
Coopers & Lybrand	72,473	16.3%
Other Nonaffiliates	37,972	8.6%
Total Nonaffiliates	110,445	24.9%
Available for Lease	11,233	2.5%

Source: Southern Bell Telephone and Telegraph Company, Response to Staff's Audit Request 2-054 Amended, Attachment G.

November 24, 1992

TO: John Robinson
Mike Denson

FROM: Frances Dennis

Subject: Review of BSC's Lease at Campanile

We have performed an analysis of BSC's lease at Campanile. The purpose of the analysis was to quantify the effect, if any, of implementing the "Comparative Lease Analysis Reference Guide" (Guide) issued by BellSouth in March, 1991. This analysis also includes the effect of changing the date of $ per square foot (psf) increase scheduled for August 15,1992 to January 1, 1993.

BSC leases office space at Campanile from an affiliate, Peachtree Associates. BSC charges $ psf of the rent paid to this affiliate to a BSC retained cost project. The amount psf retained is the difference between the average rate of $ psf paid by BSC to the average rate of $ psf paid by Coopers and Lybrand (C&L), an unaffiliated third party. Amounts charged to retained cost projects are not billed to regulated or nonregulated affiliates.

The Guide's standard for comparing leases is the net present value (NPV) of the tenant's cash outflows under the leases being compared. The effect of applying this Guide to the BSC and C&L leases is that the rate charged to the retained cost project increases from $ psf to $ psf (see Attachment A). The $ psf includes the effect of changing the date of the $ psf scheduled increase from August 15,1992 to January 1, 1993. Therefore, the billing rate to BellSouth Telecommunications and other BellSouth subsidiaries remains the same.

Also, we performed a separate analysis of the Fourth Amendment to this lease. Office space added by the Fourth Amendment to BSC's lease is at the market rate charged to an unaffiliated third party and requires no further action to comply with the FCC's affiliated transaction rules.

Please increase the rate charged BSC's retained cost project from $ psf to $ psf effective January 1, 1993. If you have questions, Please call Dell Coleman at (404) 249-3032 or me at 249-3026.

cc: Zelina Hines
Mike Deans

Attachment

PROPRIETARY INFORMATION
NOT FOR USE OR DISCLOSURE OUTSIDE
BELLSOUTH EXCEPT UNDER WRITTEN
AGREEMENT.

Fully Distributed Cost Analysis
Campanile Building
1992

		1992
	DIRECT COSTS	
6	BLDG. OPERATING EXP.	
7	DEPRECIATION	
8	HQ EXPENSES OVER COMMON	
9	TOTAL	
11	AVG. SQ. FT. OCCUPIED BY BSC	67.20%
12	SUBTOTAL	[redacted]
13	/BSC OCCUPIED SQ. FT.	298,032
14	BSC DIRECT COSTS PER SQ. FT.	[redacted]
	RETURN ON INVESTMENT: 1992 Average	[redacted]
17	Land	
18	Building	
19	Depreciation & Amort.	
20	Deferred Charges	
21	SUBTOTAL	
22	WORKING CAPITAL	
23	TOTAL INVESTMENT	
24	AVG. % OCCUPIED - BSC	67.20%
25	PORTION ALLOCABLE - BSC	
26	ALLOWABLE R.O.R	
27	ALLOWABLE RETURN	
28	AVG. SQ. FT. OCC.	298,032
29	ALLOWABLE RETURN PER SQUARE FOOT	
31	TOTAL FDC PER SQ. FT.	

[FDC.XLW]Jacksonville working cap.

JACKSONVILLE WAREHOUSE FDC ANALYSIS
EFFECT OF REMOVING WORKING CAPITAL FROM COOPERS & LYBRAND FDC ANALYSIS

ORIGINAL LEASE TERM: 8/1/87 - 7/31/92

		1984	1985	1986	1987*** 1/1 - 7/31	1987*** 8/1 - 12/31	1988	1989	1990	1991	1992
	Square Feet	186,252	186,252	186,252	186,252	286,252	286,252	286,252	286,252	286,252	286,252
	REVENUES										
9	RENT REVENUE (1)										
	EXPENSES										
11	DEPR - LAND IMP										
12	DEPR - BLDG										
13	PROPERTY TAXES										
14	ALLOCATED COSTS										
	NET INVESTMENT										
16	LAND										
17	LAND IMP.										
18	ACC. DEPR.-LI										
19	BUILDING										
20	ACC. DEPR-BLDG.										
21	DEFERRED TAXES										
22	WORKING CAPITAL										
	OTHER										
24	TOTAL NET INVESTMENT										
25	AVERAGE INVESTMENT										
26	RATE OF RETURN										
27	RETURN										
28	R.S.F. -- EFFECTIVE ACTUAL										
29	R.S.F. -- FDC										
30	CURRENT YEAR DIFF										
31	PRIOR YEAR CUM. DIFF										
32	CURRENT YEAR CUM. DIFF										

***total difference for the entire year is as follows:

		RENT	FDC	DIFF
35				
36	Jan.-July			
37	Aug.-Dec.			

LEASE CHARGES LESS THAN FDC DURING ENTIRE YEAR.

(1) RENT REVENUE = BOOK DEPRECIATION+PROPERTY TAXES+ALLOCATED COSTS+RETURN
(2) SOURCE OF INFORMATION IS C&L WORKPAPERS
(3) DIFFERENCES OF $1 BETWEEN COOPERS & LYBRAND FDC ANALYSIS DUE TO ROUNDING

SOUTHERN BELL
DOCKET NO. 920260-TL
EXHIBIT JBB-4
WITNESS: BRANCH
PAGE 1 OF 3

BIRMINGHAM WAREHOUSE FDC ANALYSIS
EFFECT OF REMOVING WORKING CAPITAL FROM COOPERS & LYBRAND FDC ANALYSIS

ORIGINAL LEASE TERM: 6/1/88-7/31/98

Square Feet	162,509	162,509	162,509	162,509	162,509	282,509	282,509	282,509	282,509	282,509
	1984	1985	1986	1987	1988*** 1/1 - 5/31	1988*** 6/1 - 12/31	1989	1990	1991	1992
REVENUES										
9 RENT REVENUE (1)										
EXPENSES										
11 DEPR - LAND IMP										
12 DEPR - BLDG										
13 PROPERTY TAXES										
14 ALLOCATED COSTS										
NET INVESTMENT										
16 LAND										
17 LAND IMP.										
18 ACC. DEPR.-LI										
19 BUILDING										
20 ACC. DEPR-BLDG										
21 DEFERRED TAXES										
22 WORKING CAPITAL										
OTHER										
24 TOTAL NET INVESTMENT										
25 AVERAGE INVESTMENT										
26 RATE OF RETURN										
27 RETURN										
28 R.S.F. -- EFFECTIVE ACTUAL										
29 R.S.F. -- FDC										
30 CURRENT YEAR DIFF.										
31 PRIOR YEAR CUM. DIFF.										
32 CURRENT YEAR CUM. DIFF.										

***Total difference for the entire year is as follows:

		RENT	FDC	DIFF
35				
36	Jan.-July			
37	Aug.-Dec.			

LEASE CHARGES LESS THAN FDC DURING ENTIRE YEAR.

(1) RENT REVENUE = BOOK DEPRECIATION+PROPERTY TAXES+ALLOCATED COSTS+RETURN
(2) SOURCE OF INFORMATION IS C&L WORKPAPERS
(3) DIFFERENCES OF $1 BETWEEN COOPERS & LYBRAND FDC ANALYSIS DUE TO ROUNDING

DOCKET NO. 920260-TL
EXHIBIT JBB-4
WITNESS: BRANCH
PAGE 2 OF 3

ST. AUGUSTINE WAREHOUSE FDC ANALYSIS
EFFECT OF REMOVING WORKING CAPITAL FROM COOPERS & LYBRAND FDC ANALYSIS

ORIGINAL LEASE TERM: 10/27/89 - 10/26/99

		1989 11/1 - 12/31	1990	1991	1992
	Square Feet	57,200	57,200	57,200	57,200
	REVENUES				
9	RENT REVENUE (1)				
	EXPENSES				
11	DEPR - LAND IMP				
12	DEPR - BLDG				
13	PROPERTY TAXES				
14	ALLOCATED COSTS				
	NET INVESTMENT				
16	LAND				
17	LAND IMP.				
18	ACC. DEPR.-LI				
19	BUILDING				
20	ACC. DEPR-BLDG.				
21	DEFERRED TAXES				
22	WORKING CAPITAL				
	OTHER				
24	TOTAL NET INVESTMENT				
25	AVERAGE INVESTMENT				
26	RATE OF RETURN				
27	RETURN				
28	R.S.F. -- EFFECTIVE ACTUAL				
29	R.S.F. -- FDC				
30	CURRENT YEAR DIFF.				
31	PRIOR YEAR CUM. DIFF.				
32	CURRENT YEAR CUM. DIFF.				

(1) RENT REVENUE = BOOK DEPRECIATION+PROPERTY TAXES+ALLOCATED COSTS+RETURN
(2) SOURCE OF INFORMATION IS C&L WORKPAPERS
(3) DIFFERENCES OF $1 BETWEEN COOPERS & LYBRAND FDC ANALYSIS DUE TO ROUNDING

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EXHIBIT JBB-4
WITNESS: BRANCH
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JACKSONVILLE WAREHOUSE FDC ANALYSIS
EFFECT OF USING REDUCED LAND VALUE ON COOPERS & LYBRAND FDC ANALYSIS

ORIGINAL LEASE TERM: 8/1/87 - 7/31/92

		1984	1985	1986	1987*** 1/1 - 7/31	1987*** 8/1 - 12/31	1988	1989	1990	1991	1992
	Square Feet	186,252	186,252	186,252	186,252	286,252	286,252	286,252	286,252	286,252	286,252
	REVENUES										
9	RENT REVENUE (1)										
	EXPENSES										
11	DEPR - LAND IMP										
12	DEPR - BLDG										
13	PROPERTY TAXES										
14	ALLOCATED COSTS										
	NET INVESTMENT										
16	LAND										
17	LAND IMP.										
18	ACC. DEPR.-LI										
19	BUILDING										
20	ACC. DEPR-BLDG.										
21	DEFERRED TAXES										
22	WORKING CAPITAL										
	OTHER										
24	TOTAL NET INVESTMENT										
25	AVERAGE INVESTMENT										
26	RATE OF RETURN										
27	RETURN										
28	R.S.F. -- EFFECTIVE ACTUAL										
29	R.S.F. -- FDC										
30	CURRENT YEAR DIFF.										
31	PRIOR YEAR CUM. DIFF.										
32	CURRENT YEAR CUM. DIFF.										

***total difference for the entire year is as follows:

		RENT	FDC	DIFF
35	Jan.-July			
36	Aug.-Dec.			
37				

LEASE CHARGES LESS THAN FDC DURING ENTIRE YEAR.

(1) RENT REVENUE = BOOK DEPRECIATION+PROPERTY TAXES+ALLOCATED COSTS+RETURN
(2) SOURCE OF INFORMATION IS C&L WORKPAPERS
(3) DIFFERENCES OF $1 BETWEEN COOPERS & LYBRAND FDC ANALYSIS DUE TO ROUNDING

DOCKET NO. 920260-TL
EXHIBIT JBB-5
WITNESS: BRANCH
PAGE 1 OF 1

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY

TESTIMONY OF STEPHEN P. BUDD

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

DECEMBER 10, 1993

Q: Please state your name, title, employer, and address.

A: My name is Stephen P. Budd. I am employed by Theodore Barry and Associates (TB&A) as a Managing Director. My business address is 50 Rockefeller Plaza, Suite 1035, New York, New York, 10020.

Q: Please give a brief description of your background and experience.

A: I have been employed by Theodore Barry & Associates since 1986. I became a Director of the firm in 1989 and a Managing Director in 1991. I currently head our Telecommunications practice and our New York office. At TB&A, I have managed and actively participated in many varied assignments related to regulatory policy, operational improvement, incentive regulation, and management decision making and control processes. Related to affiliate relations, I have managed or served as a lead technical consultant on assignments sponsored by commissions (e.g., Alabama, Tennessee, Kentucky, New York, Connecticut) and by companies (e.g., Southwestern Bell, BellSouth). In addition I have led TB&A studies of productivity and network modernization at New York Telephone on behalf of the New York Commission. I have made formal presentations to various industry groups, including NARUC, on topics such as ratemaking, cost-structure audits, and total quality management.

Prior to joining TB&A, I was employed by Price Waterhouse for seven years as a Managing Consultant where I specialized in management reporting systems and cost accounting. I hold a Bachelor of Science degree with a concentration in Information Systems from Florida State University and a Master's in Business Administration from the University of Georgia.

Q: **What is the purpose of your testimony?**

A: The purpose of my testimony is to respond to the direct testimony of Ms. Kimberly H. Dismukes as it relates to the affiliate transactions and cost allocations between BellSouth Corporation (BSC) and its subsidiary company BellSouth Telecommunications (BST).

Q: **Please summarize your testimony.**

A: The need to continually monitor affiliate transactions, not only to prevent cross-subsidization but to allow ratepayers to participate fairly in the benefits of diversification, is well understood by commissions and companies alike. In fact, the type of affiliate review that Ms. Dismukes conducted of certain BSC charges, as TB&A frequently has conducted on behalf of commissions, often results in constructive and corrective recommendations which typically are readily accepted and implemented by companies. In this case, however, while Ms. Dismukes has raised and purportedly examined some intriguing and controversial affiliate issues, her conclusions are unconvincing. Her analysis appears to be shallow and her recommendations arbitrary. I will show in my testimony that a more complete understanding of BSC products, services, and activities invalidates the conclusions reached by Ms. Dismukes.

Q: Would you like to offer some general comments concerning Ms. Dismukes' testimony related to BSC?

A. Yes. In the first section of her testimony (pages 3-8), Ms. Dismukes highlights the importance of closely monitoring affiliate transactions due to the potential abuses that may occur in any organizational relationship that consists of regulated and non-regulated entities. I agree with her characterizations of what could occur absent regulatory oversight.

However, I do not agree with her strong implication, in this section and other sections, that BSC is purposefully manipulating its affiliate transactions and cost allocations to the detriment of ratepayers. Theodore Barry & Associates has reviewed the management controls surrounding BSC's affiliate transactions on four occasions within the last six years (twice on behalf of state commissions and twice on behalf of the Company). We have met with numerous BSC managers and studied BSC's directives, policies, and guidelines related to affiliate transactions. Our overriding impression continues to be that (1) BSC is well aware of state and federal regulations regarding affiliate transactions; (2) BSC makes every attempt to adhere to those regulations; and (3) BSC is conservative and cautious in its interpretation of those regulations to avoid even the perception of impropriety. In my opinion, Ms. Dismukes is doing the Company and this Commission a disservice by putting forth sweeping, unsubstantiated statements and innuendoes.

Q: **Would you please comment on the statement from page 10 of Ms. Dismukes' testimony that reads "consequently, even if the Company follows the FCC's rules, this Commission could not be certain that Southern Bell's regulated operations were not unfairly burdened by the affiliate relationships."?**

A: This is one of several statements made by Ms. Dismukes where the whole point of the question and her response are unclear. One inference that can be drawn is that the Company currently is following the FCC rules. Another is that the FCC rules are not adequate for the Florida jurisdiction. Yet another is that the whole structure of FCC oversight and independent auditor attestation is of little or no value.

In places, the FCC rules are somewhat vague and allow some degree of discretion on behalf of the utility as to their implementation. However, the critical measure of Company behavior is not the perceived adequacy and level of specificity of the FCC rules, but rather the interpretation and application of those rules by the Company. We have found a concerted effort by BSC not only to comply with FCC rules (i.e., Joint Cost Order (JCO), Part 32, Part 64) but to specify in detail the appropriate corporate activities required. This is evidenced by:

- A comprehensive policy framework delineated through a hierarchy of BSC and BST documents;
- A clear assignment of responsibilities for interpreting regulations and monitoring compliance; and
- Pervasive awareness by BSC personnel of JCO requirements and intentions.

Furthermore, the periodic internal and external audits, including those by the FCC, and various BST reports on affiliate activities, should provide regulators with a high level of comfort that affiliate relationships do not "unfairly burden" regulated operations.

Q: **Would you please comment on the statement from page 21 of Ms. Dismukes' testimony related to the use of the general allocator that reads "the use of a size-based allocator is analogous to charging a 210-pound man twice as much to see a movie as a 105-pound woman is charged, merely because he is double her weight."?**

A: I find the analogy to be a humorous sound bite but not helpful for the topic at hand. Size in the case of a movie admission price clearly is not related to cost causation (unless someone needs two seats) and, following the FCC rules, would not be appropriate for consideration. (Size, however, could make sense as a representative basis in the case of movie refreshments.)

The process for developing cost-causative allocation bases is well defined and well understood within BSC. Ms. Dismukes' own testimony, at pages 18 and 19, discusses the numerous types of allocation factors developed by the Company to allocate common costs in the most cost-causative way reasonably possible. The general allocator is to be used only in situations where costs cannot be directly assigned, directly attributed, or indirectly attributed. BellSouth's procedures state, "the general allocator should only be used in the absence of a relationship between the functions performed and the entities billed."

To the specific point about unduly influencing the general allocator by using a measure of entity size, the critical issue is finding the most representative basis to distribute unattributable costs. Part 64 of the FCC rules state that when neither direct nor indirect measures of cost allocation can be found, "the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and non-regulated activities." This rule applies to the separation of a carrier's regulated and non-regulated costs. While there is no such rule prescribed for the development of a general allocator at BSC's level, BSC has attempted to establish a surrogate measure that parallels the FCC rule for BST. I find Ms. Dismukes' recommendation as to a general allocator to be illogical and far more arbitrary than BSC's current general allocator.

Ms. Dismukes also gives the impression that most of BSC's costs are distributed through the general allocator. In fact, the general allocator has been used to distribute $26.6 million out of $125.6 million, or 21.2 percent, of the total costs incurred by BSC from January through September of 1993.

Q: Would you please comment on the statement from page 19 of Ms. Dismukes' testimony that reads "I question the fairness of an allocation method that results in such a large allocation of common costs to BellSouth's predominantly regulated operations. I believe that it fails to reflect the benefit that BellSouth's numerous subsidiaries are obviously receiving from shared services."?

A: This is one of many places in her testimony where Ms. Dismukes relies on her assessment of perceived benefit in criticizing BSC's cost allocation bases. The cost apportionment principles set forth in Part 64 of the FCC rules very clearly adopt the attributable cost method of fully distributing costs. This methodology is based on the principle of cost causation, meaning that the cost of a function or service must be borne by the activity or entity that directly or indirectly causes the costs to be incurred. This principle of cost-causation is ingrained in BSC policies and approaches to developing allocation methods.

Q: Would you please comment on the statement from page 19 of Ms. Dismukes' testimony that reads "Southern Bell's cost

allocation manual is sorely deficient in explaining how BellSouth's costs are allocated to its affiliates and subsidiaries. There is no discussion of the allocation factors used, their development, or their application -- all of which are necessary in order for the Commission to properly evaluate the reasonableness of the allocation method used by BellSouth."?

A: The cost allocation manual ("CAM") filed annually with the FCC has consistently been found by the FCC to comply with disclosure requirements. These requirements include descriptions of the following:

- Affiliate activities
- Affiliate transactions
- Transfer pricing
- Cost pool formulation
- Cost pool allocation.

Various BSC and BST accounting documents further delineate the approach used by BSC and BST in adhering to FCC requirements for affiliate transactions and cost allocations. Recommending that the CAM should include "BellSouth's cost allocation policies and procedures, the allocation factors, and the cost assignment methodologies by responsibility code" shows that Ms. Dismukes (1) does not understand the purpose and disclosure requirements of the CAM (including the fact that the FCC CAM requirements apply to BST and the specific details of BSC's cost allocation methods are not required to be part of the CAM); (2) is not aware of the accepted industry practices as evidenced by the CAMs of other Tier 1 telecommunications providers; and (3) is not familiar with the form and substance of the related BellSouth documentation that is already available to regulators.

Q: Would you please comment on the statement from page 29 of Ms. Dismukes' testimony that reads "many of these ownership costs are duplicative of the costs incurred by BST."?

A: Ms. Dismukes' general characterization of ownership costs as "duplicative" is unsubstantiated and incorrect. While the specific BSC functions cited by Ms. Dismukes are discussed in subsequent sections of my rebuttal testimony, I believe it would be helpful here to present some overall observations.

From my reading of her testimony and familiarity with the documents she reviewed, it appears that Ms. Dismukes may have drawn her conclusions more from a comparison of BSC and BST functional names than from an analysis of the underlying products, services, and activities. For example, the fact that both BSC and BST have a function called Cash Management does not mean that those functions are duplicative.

Next, it appears that Ms. Dismukes either is not aware of or has dismissed the many significant organizational improvement programs undertaken by BSC over the past several years. These programs have had and continue to have a dramatic impact on reducing BSC cost structures and ultimately the costs charged to the Florida jurisdiction for BSC activities. Further reorganizations undoubtedly will be undertaken as technology enablers, regulatory requirements, and competitive pressures continue to evolve.

Finally, Ms. Dismukes either is not aware of or has dismissed the real and pervasive management controls and incentives imbedded within BSC and BST to avoid duplication and reduce BSC costs. These include, among other things, a comprehensive policy framework specified through a hierarchy of BSC documents, well prescribed BST procedures for reviewing BSC affiliate bills , and ongoing monitoring of BSC services by BST at the department level.

Q: **Please comment on Ms. Dismukes' opinion that many of BSC's senior executives "are only involved in a very indirect manner in providing specific technical and management guidance to Southern Bell."**

A: Ms. Dismukes appears to be concerned that in addition to providing overall management and guidance, many of BSC's senior executives are involved in work that, Ms. Dismukes alleges, is "more beneficial to the non-regulated subsidiaries of BSC than to Southern Bell." Ms. Dismukes then focuses on the costs associated with four BSC executives, who she feels are the most egregious examples of executives whose time benefits the non-regulated subsidiaries more than BST. These executives are: Mr. Clendenin, BSC's Chairman and Chief Executive Officer; Mr. Holding, BSC's former Vice Chairman; Mr. Alford, BSC's Executive Vice President and General

Counsel; and Mr. McGuire, BSC's Executive Vice President of Governmental Affairs.

Ms. Dismukes recommends that the Florida Commission disallow 50 percent of the costs associated with these four executives based on two points. First, Ms. Dismukes contends that these senior executives "are only involved in a very indirect manner in providing technical and management guidance to Southern Bell," and supposedly primarily concerned with strategic policies and promoting the image of BSC. Ms. Dismukes also believes that the time these individuals spend conducting public relations work provides greater benefit to the non-regulated subsidiaries than to BST.

Ms. Dismukes' arguments rely on several faulty underpinnings. I disagree with Ms. Dismukes' implication that the primary role of an executive at BSC should be to provide technical guidance. Although technical expertise is a requirement for heading a large telecommunications company or leading specific functions, technical proficiency is not the only requirement for these positions. The role of executives at a multi-billion dollar enterprise like BellSouth generally is not to offer technical assistance, but to develop the company vision, direct the strategies of the company, and provide leadership. Large companies, especially in industries like telecommunications which are dealing with fundamental changes in competition and technology, must direct resources toward the development of a vision and supporting strategies or accept the possibility of extinction. In general, BSC senior executives provide vision and strategy while BST has an operational and tactical orientation. By focusing on activities associated with short-term tactical deployment -- that is, technical guidance -- Ms. Dismukes is implying that Southern Bell should not fund efforts to plan for the future or develop long-term strategies that may prepare the Company for competitive threats or changes in technology. In my opinion, the activities associated with vision and strategy would certainly need to be conducted, even if BST were a stand-alone entity.

Ms. Dismukes' reliance on a speech made by Mr. Clendenin to the financial community as evidence that Mr. Clendenin is not concerned about BST's local exchange business is hardly compelling. In her testimony, Ms. Dismukes states "while the regulated telephone operations are still important to BSC, many of the non-regulated diversified operations are receiving considerable attention from BSC's executives." In my opinion, within the current telecommunications environment, BSC executives should be concerned with all aspects of telecommunications. However, BSC has given no indication that pursuing all aspects of telecommunications is to be accomplished by placing a lesser importance on Southern Bell. In fact, in the same speech that Ms. Dismukes cited in her testimony, Mr. Clendenin stated, "while we see our value mix changing over time, I don't want anybody to conclude that we are anything but absolutely committed to our regulated wireline business as we seek to optimize the total business -- BellSouth Telecommunications business continues to be critical to all our future plans."

Ms. Dismukes' analytical approach is also confusing. By reviewing selected expenditures, she draws conclusions regarding the executive function in its entirety. The proposed disallowance of specific expenses is hardly grounds for disallowing the entire function. To the extent that the Florida Commission finds specific expenditures inappropriate, and finds that the expenditures have been charged to Florida, then the Commission should disallow those costs, similar to the way the Commission disallows other costs. After presenting shallow arguments for a general disallowance of the executive function, Ms. Dismukes offers no rational basis or quantification for her recommendation.

Q: Please comment on Ms. Dismukes' opinion that although BSC Corporate Planning "provides a great deal of strategic planning service, only a small portion deals with the regulated telecommunications industry" and therefore 50 percent of the department's expenses should be disallowed.

A: Ms. Dismukes makes four points regarding BSC corporate planning in her testimony. First, Ms. Dismukes has summarily categorized all BSC corporate planning activities into one group called strategic planning. Second, Ms. Dismukes suggests that BSC expenses incurred in association with international travel are indicative of the type of work conducted by BSC in serving BST. Third, Ms. Dismukes alleges that BST does not need or benefit from BSC's strategic planning efforts as much as BSC's non-regulated affiliates. Fourth, Ms. Dismukes arbitrarily recommends that 50 percent of the costs associated with BSC Corporate Planning should be disallowed by the Florida Commission without providing any basis or quantification for her recommendation. Ms. Dismukes has mixed several somewhat distinct issues in her conclusions regarding the expenses associated with BSC Corporate Planning. I will address each of these points.

TB&A has reviewed BST's Corporate Planning function and found that the department provides three general services:

- First, the department conducts long-range strategic planning regarding the future of the telecommunications industry.
- Second, the department conducts planning and analyses with respect to specific projects, including those that may be international in nature.
- Third, the department is involved in development activities, which may include the analyses associated with mergers and acquisitions.

I agree with Ms. Dismukes that the latter two services performed by BSC Corporate Planning should not be charged to BST. BSC also agrees with Ms. Dismukes in that the costs of these activities are either retained by BSC or charged to BSC's non-regulated subsidiaries and not to BST.

Any international travel expenses incurred by BSC associated with its corporate planning efforts relate to corporate development activities and should not be charged to BST. Ms. Dismukes' assertion that such expenses are evidence that BSC's corporate planning activities do not pertain to BST indicates a lack of understanding of the departmental organization, work activities, and cost allocation bases. To the extent that any miscodings of expenses occur, it is BellSouth's practice to correct the items in error as soon as they are detected.

Ms. Dismukes' conclusion that BST receives a minimal benefit from BSC's corporate planning efforts is based on her misunderstanding of the types of activities associated with BSC's allocation to BST and her misunderstanding of the need for strategic planning. As I discussed above, the only BSC corporate planning activities charged to BST relate to long-range strategic planning regarding the future of the telecommunications industry. However, Ms. Dismukes goes so far as to suggest that much of BSC's strategic planning -- such as determining the long-term trends in telecommunications and the information industry, BSC's position on intelligent networks, and opportunities that may exist in serving customer segments, such as health care and education -- does not deal with the regulated telecommunications industry.

In my opinion, however, analyzing these issues and determining a corporate response is both required and prudent for any company in, and hoping to remain in, the regulated telecommunications industry in the 1990s. Ms. Dismukes takes a very short-term perspective in drawing her conclusion. Major corporations have engaged in long-term strategic planning throughout much of their existence. In fact, management audits conducted by regulatory commissions examine and look for opportunities for regulated companies to improve their strategic planning functions. Long-term planning has become an even greater imperative for companies like BST, at a time when the regulated local exchange business is in a period of unprecedented transition.

Ms. Dismukes appears concerned that the benefits of BSC's strategic planning efforts accrue unequally to BSC's unregulated affiliates. As I discussed earlier, Ms. Dismukes vacillates between cost causation, as directed by the FCC, and benefit in assessing the reasonableness of allocation bases. Nevertheless, it is clear that BSC planning efforts focus primarily on interrelated telecommunications systems and the convergence of telecommunications technology. As a multi-billion dollar telecommunications company, BST -- even as a stand-alone entity decoupled from BSC -- would need to conduct similar long-term strategic planning. By allocating only part of this cost, BST "benefits" from sharing the cost.

Finally, Ms. Dismukes offers no rational basis for recommending that the Florida Commission disallow 50 percent of BSC's corporate planning charges. I disagree with her recommendation since BSC's strategic planning efforts do indeed deal with issues of critical importance to the regulated local exchange business.

Q: Would you please comment on Ms. Dismukes' opinion that costs incurred for BSC's cash management activities are redundant and consequently 25 percent should be disallowed?

A: Ms. Dismukes' position shows a lack of understanding of the treasury function in general and the services provided by BellSouth in particular. Ms. Dismukes' proposed disallowance of expenses is completely arbitrary and without merit. While both BST and BSC do indeed perform cash management and banking relations functions, the nature of the functions performed is fundamentally different, and therefore not redundant. Furthermore, if BST were not part of a holding company, BST itself would need to provide the services now provided by BSC.

Determining the redundancy of BSC services provided to BST requires a thorough understanding of the activities undertaken by both parties. As regards cash management, BST's activities focus on handling large volumes of receipts from customers and disbursement of high volumes of payments to personnel and suppliers. BST's banking relationships reflect this activity: relationships are maintained with many local banks, and a strong emphasis is placed on effective utilization of lock boxes. BST's cash forecasting activities focus on the flows associated with such high volume activities as well as any financing-related requirements.

In contrast, BSC's cash functions focus largely on the following eight areas, which are clearly distinct from BST's activities:

(1) Investment of BellSouth's cash balances, including BST's. This function is centralized at BSC and not performed at BST.

(2) Management of the short-term pension cash investment.

(3) Oversight of BSC banking relationships and coordination of BSC financial activities, most notably those of the stock transfer bank and the dividend paying bank. This function principally involves different types of banking activities and therefore different issues and interfaces than those of BST. BSC also periodically aggregates information regarding bank services performed for all subsidiaries to support the evaluation of various subsidiary banking relationships.

(4) Processing of corporate cash disbursements, principally tax payments. Tax payments are centralized at BSC, while other disbursements are made for BSC personnel and operating expenses.

(5) Development of cash forecasts for corporate receipts and disbursements. BSC cash forecasts focus on different cash flow streams than BST's.

(6) Provision of short-term loans to subsidiaries, including selected unregulated BST subsidiaries. Provision of advances to unregulated BST subsidiaries is not offered by BST.

(7) Receipt and deposit of BSC receipts. This function relates to activities that support the full range of services provided by BSC.

(8) Maintenance of the cash books for BSC. This function also relates to activities that support the full range of services provided by BSC.

Given that the services provided by BSC, when reviewed in appropriate detail, clearly are not redundant and generally would be required by BST if it were a stand-alone company, the costs of such services should not be disallowed by the Commission.

Q: **Would you please comment on Ms. Dismukes' statement that "many of the costs incurred by the [BSC Assistant Secretary/Corporate Counsel] department are duplicative of costs incurred at the BST level. .....I recommend that the commission disallow 50 percent of the costs charged to this department."?**

A: Again, Ms. Dismukes' statements indicate a lack of understanding of the Assistant Secretary/Corporate Counsel function in general and the specific services provided to BST by BellSouth in particular. Similarly, her proposed disallowance of the related expenses is completely arbitrary and without merit. The principal issues addressed by the BSC Assistant Secretary/Corporate Counsel are fundamentally different from those addressed at BST. If BST were not part of the holding company, BST would have to increase considerably the scope of responsibilities currently residing at BST and add a comparable personnel complement to handle that increase.

The Assistant Secretary/Corporate Counsel function at BSC provides the following services:

- Provides advice and review as to shareholder matters, proxy development, corporate governance practices, and other miscellaneous corporate matters
- Assures compliance with all federal, state, and foreign securities laws, SEC rules and regulations, state and foreign corporate laws, and stock exchange requirements (foreign and domestic)
- Provides counsel to BellSouth headquarters and Board of Directors on corporate law and practice
- Coordinates actions and materials that require Board approval.

A detailed review of the specific services provided by BSC relative to the responsibilities of BST indicates that there are significant differences between the two, which stem largely from the difference in legal and fiduciary responsibilities of a board of a publicly owned company and that of a subsidiary:

- The BSC Board has responsibility for a different and much broader range of SEC and similar filings due to BSC's listing on stock exchanges in the U.S. and overseas. Most notable among these is the annual proxy statement.

- Insider trading-related counsel and filings are provided exclusively by the BSC Assistant Secretary.

- Shareholder demands and derivative suits are handled centrally by the BSC Assistant Secretary. All current demands relate to BST activities.

- Selected corporate policy issues, such as officer and director liability insurance, employee benefit plans, and officer compensation, are decided by the BSC Board with support from the BSC Assistant Secretary.

- General Board-related issues, such as benefits for the outside Board members, are decided by the BSC Board with the advice of the Assistant Secretary and then implemented at the BST level.

In contrast, the equivalent BST general attorney spends about 15 percent of his time, with some support from his staff, on Board-related matters, which principally relate to BST's operating issues.

Since the specific services provided by BSC's Assistant Secretary/Corporate Counsel clearly do not duplicate those of BST, and since BST would need to perform similar functions were it an independent entity, a portion of the cost of this function is appropriately allocated to BST.

Q: Would you please comment on the statement from pages 44-45 of Ms. Dismukes' testimony that reads "within the Public Relations department there are four sections which incur costs that should not be charged to ratepayers. They are: corporate affairs, educational affairs, executive support, and external affairs. .....In my opinion the costs incurred for this department do not provide a direct tangible benefit to Florida ratepayers."?

A: Ms. Dismukes' evidently limited review and selection of activities from cost assignment forms does not entitle her to misrepresent the purpose of these functions nor to make a sweeping and unsubstantiated conclusion that Florida ratepayers receive no direct tangible benefit from these activities. Moreover, her argument that the Company must prove a direct tangible benefit before it may recover an expense is a completely inappropriate test and inconsistent with long-standing regulatory and business principles. There are many examples of activities that even regulated companies, such as BST, perform as part of their normal business operations for which no "direct tangible benefit" to ratepayers must be proven. Obvious examples include activities related to general financial and operational planning. The issue is simply whether the expenses are consistent with prudent business practice and to what extent they form part of the overall value chain to customers.

It should be obvious that a company the size of BSC, which employs approximately 100,000 employees, the vast majority of whom work in the southeast region of the United States, has a legitimate interest in the affairs of the region, its educational infrastructure, and its economic development. The commitment that BSC has made to advance the educational agenda in the region, and the responsibility it has assumed as a corporate citizen, are intended to ensure that the ratepayers of Florida and other BST jurisdictions participate in the fruits of the information age.

BSC activities related to corporate and educational affairs reflect the Company's commitment to promote public-private partnerships that benefit all regional stakeholders. BSC's concern for regional economic growth, future revenue opportunities, and a supply of highly skilled employees is embodied in the work of the Corporate and Educational Affairs unit. The unit participates in a variety of forums and conferences that are directed at improving and expanding the role of technology in education. It is actively engaged in leveraging BellSouth resources to promote education development, primarily in elementary and secondary education. Additionally, by developing and nurturing the relationships between the educational community and the Company, an opportunity is created to enhance BST's share of the education market for telecommunications services.

The Corporate and Educational Affairs unit also administers activities related to the BellSouth Foundation. The work of the Foundation fosters mutually beneficial relationships between BSC companies and the community. Through the Foundation's work, BST state managers and employees engage in a dialogue and develop alliances with local and state officials. These officials help decide the future economic development of Florida and the southeast region by developing educational standards and policies, and by directing investments in infrastructure and information technologies that may be provided by BellSouth Telecommunications. In fact, BellSouth has contributed almost $2.5 million in recent years to Florida's public and private educational institutions.

The corporate giving program is also administered by the Corporate and Educational Affairs group and is another example of BSC's participation in improving the economic vitality and overall quality of life in the communities that are served by BellSouth Telecommunications. The interaction between BST managers and local social and civic leaders provides BST with an opportunity to strengthen existing business relationships, develop new contacts, and work to promote a common community agenda and vision. These activities and responsibilities go hand-in-hand with being a major service provider in the community and go well beyond corporate image making. By participating on these various community boards and in nonprofit organizations, the Company is involved in shaping the future social and business context in which Southern Bell operates. The goodwill that is created from these programs, and any business opportunities that develop, serve the best interests of ratepayers.

I have also reviewed the activities performed at BSC that relate to Executive Services and Employee Communications and, once again, I find Ms. Dismukes' position to be arbitrary and unenlightening. She simply lists activities performed by BSC individuals and offers no explanation or analysis to support her conclusion. As is the case with the previously discussed activities, Ms. Dismukes apparently presumes that the list speaks for itself. It does not.

The executive support functions that Ms. Dismukes wishes to disallow are basic and essential components of any large, publicly traded enterprise. Shareholder meetings are required by law, and the planning and execution of those meetings is a logical support component. Executive conferences, and the associated planning and preparation, are also essential components of a business. Those Company executives who attend these conferences expect to become more knowledgeable in particular areas and more effective managers. The ratepayers of the regulated enterprise are direct beneficiaries.

Also, employee communications are part of an ongoing corporate effort to maintain open communications. As the industry continues to undergo often painful restructuring, it is essential that employees are well-informed about the current business environment and the changes that directly impact their lives. In my opinion, the employee communication materials that are developed and distributed by both BST and BSC provide meaningful and distinct information services.

My review of BSC functions related to corporate, external, and educational affairs, executive services, and employee communications leads me to conclude that the activities performed are appropriate for a corporation of the size and scope of BSC and that the associated expenses are properly recoverable.

Q: **Would you please comment on the statement from page 43 of Ms. Dismukes' testimony that reads "I have reviewed the advertisements which the Company believes should be included in test year expenses. In my opinion, these BSC advertisements are just as much designed to boost BSC's image as those that the Company itself disallowed."?**

A; Ms. Dismukes' statements reveal a limited understanding of the current marketing environment in general, and the nature and purpose of BSC's advertising efforts in particular.

She offers no analysis or factual basis to support her assertion that BSC advertisements are just as much designed to boost BSC's image as those that the Company itself currently retains. While it is certainly true that an image-oriented campaign can be completely devoid of any sales or marketing emphasis, such is not the case here. In fact, the evidence Ms. Dismukes relies upon can be used just as effectively to demonstrate an efficient, well-designed, and effective corporate sales strategy.

In today's market for advanced telecommunications products and services, numerous companies compete for the business of diverse sets of customers, who are generally well-informed and highly demanding when it comes to telecommunications services. These products and services are becoming an ever more critical component, not only in the daily lives of individuals, but in the day-to-day operations, and indeed long-term viability, of companies. BellSouth's corporate advertising is mainly intended to influence the purchasing decisions of such increasingly sophisticated consumers.

The advertisements that Ms. Dismukes suggests are primarily corporate image boosters are actually part of an on-going campaign to communicate a message of technological leadership, integrated solutions, and service excellence. These messages are just as likely to produce sales for BST products and services as would any other product-focused advertisement. In fact, the messages conveyed in the BSC corporate advertisements alluded to in Ms. Dismukes' testimony have a significant sales orientation and are designed to establish, in the consumer's mind, a link between the BellSouth family of companies and the ability to deliver integrated technology and business solutions. In this context, image is a very legitimate component of a sophisticated sales and marketing program, the costs of which are properly included for recovery.

Q: Would you please comment on the statement from page 47 of Ms. Dismukes' testimony that reads "the expenses charged to both the Media Relations and the Vice President of Public Relations departments should not be charged to ratepayers as they receive little direct benefit from the functions performed in these departments."?

A: First I would like to comment on a BSC organizational change that occurred in 1993, which relates to Ms. Dismukes' comments regarding the Vice President of Public Relations. I will then comment on the remaining activities within the Public Relations organization that were not previously addressed in my testimony. Finally, I will respond to Ms. Dismukes' opinion regarding media relations activities.

In an effort to achieve both greater efficiency and cost reduction, BellSouth Corporation consolidated several organizations. This consolidation resulted in a reduced number of officer positions at corporate headquarters. Mr. Yarbrough, to whom Ms. Dismukes refers in her testimony, left BellSouth on March 31, 1993 in his capacity as Vice President of BellSouth Public Relations. A new position, Vice President of Corporate Relations, was created that combined Mr. Yarbrough's public relations job and the duties of Mr. Roy Howard, who retired from the position of Senior Vice President of Human Relations. Ms. Dismukes made no reference to this organizational consolidation in her testimony.

Once again, Ms. Dismukes bases her opinion on a general description of activities that are selectively taken from cost assignment forms prepared within BSC. I have previously discussed some major activities that fall within BSC's Public Relations function under the current organization. In addition to Employee Communications and Executive Services, the head of Public Relations is responsible for all financial communications and public relations planning and issues management. Financial Communications activities, such as the production and distribution of the annual report, must be performed by any properly managed publicly-traded enterprise.

Activities related to public relations planning and issues management are discretionary only to the extent that the focus of the activities and the level of investment reflect management interests and values. BSC's Public Relations department provides a strategic and operational response to issues that affect the various BellSouth subsidiaries, their employees, their customers, and the communities in which they do business. The cost-allocation process is designed to reflect the cost-causative nature of the services provided. Furthermore, all activities that support MFJ grassroots lobbying are tracked and retained by BSC. Accordingly, I believe the Commission should reject Ms. Dismukes' recommendation regarding an adjustment.

The Media Relations function is another area in which Ms. Dismukes seeks an adjustment without offering any logical basis. And, once again, she presumes that a selected list of functions performed is prima facie evidence for disallowance. A more discerning and less biased analysis produces a different conclusion.

The Media Relations unit provides a single point of contact between the BellSouth companies and all forms of public media. The centralized placement of the function reflects a management decision to provide cohesive, consistent, and timely messages to the public via the various media organs. While it is certainly true that the unit attempts to promote a positive image of BellSouth companies, its principal mission is to inform the public about issues and events that directly affect their service. Given the critical, life-serving nature of the public-switched network, an efficient, media relations organization is an essential element of good service. This capability was brought to light both during and after Hurricane Andrew when a well-organized media effort by the BSC Media Relations department supported Southern Bell's response.

However, I do not wish to imply that the only value to Florida ratepayers comes from a crisis management capability. The telecommunications industry is experiencing considerable change that will continue to affect the price and availability of public switched network services. In my opinion, BellSouth has an obligation to inform and educate the public, through the media, on how these changes are expected to affect their lives. It is through the media that many consumers are apprised of new products and services, network operations, and public policy initiatives that will directly affect their current and future local service. By utilizing media avenues to get the message out to consumers, ratepayers avoid a significant expense that would be incurred if BellSouth relied solely on media advertising.

The media also provide an effective mechanism for gauging consumer needs and attitudes. The BellSouth Media Relations unit receives a large number of inquiries from various media within the operating jurisdictions. Given the dynamic nature of legislative and regulatory events at the state and federal level, as well as new market realities, many reporters rely on companies like BellSouth to evaluate and decipher the meaning of these events for consumers generally. Consumers and ratepayers, in turn, benefit from the subsequent reporting and analysis. Moreover, they are all the more likely to receive this information via the additional distribution channels that the media controls.

BellSouth's decision to staff and maintain a centralized media relations function within BSC to coordinate and disseminate consumer and other business-related information is appropriate, as is the requirement for ratepayers to share in paying for these services.

Q: **Would you please comment on the statement from pages 47-48 of Ms. Dismukes' testimony that reads "BSC's Legal department has a group of lawyers that represent BSC in MFJ and antitrust legal matters....In my opinion, these costs should not be passed on to ratepayers unless the Company can demonstrate that the antitrust matters relate to the Company's regulated operations and that no antitrust laws have been**

violated. ....With respect to MFJ matters, I also do not believe that such legal costs should be charged to ratepayers."?

A: Ms. Dismukes' argues that recovery for general antitrust expenses associated with legitimate legal activity be contingent upon the outcome of litigation. Given the breadth and scope of services provided by BellSouth to its customers, it is to be expected that some antitrust claims will be lodged against the Company. I believe that it is unfair to assert that the right to recover expenses associated with mounting a legal defense be based on the outcome of the litigation. If we follow Ms. Dismukes' reasoning, any legal expense associated with an unfavorable outcome could be disallowed. For example, if the IRS ruled retroactively against the Company in a case involving the interpretation of a tax law, under Ms. Dismukes' concept the Commission could disallow the legal expense BSC incurred in its defense. Likewise, if a plaintiff sues BSC on breach of contract, the Company could be denied recovery of expenses pending a successful outcome.

Legal departments deal with many matters of law and policy and they obviously will not always prevail on all issues. To the extent that a court finds BSC to have violated antitrust law, there are numerous legal remedies that can be applied. For the Commission to withhold recovery of an expense pending resolution of a legal action would establish an unreasonable burden on the Company and it would set an unworthy policy precedent.

Furthermore, a review of antitrust claims reveals that the vast majority of the litigation involves BST operations. Of the eight antitrust claims currently before the Company, six involve inside wire and one involves a coin operated telephone claim against BST. As BST products and services become increasingly subject to competition, more antitrust claims by new entrants can be expected. And while BST is engaged in antitrust litigation, the BSC Legal Department provides a high level of substantive support on antitrust compliance and defense work.

On the matter of MFJ-related legal expenses, Ms. Dismukes' argument implies that ratepayers are somehow disadvantaged by participating in legal expenses associated with MFJ pleadings. While Southern Bell is certainly not the only BSC company with an interest in MFJ issues, those familiar with recent MFJ history should recognize that BST is the BellSouth company most directly impacted by the ongoing legal and policy debate. In my opinion, issues related to the MFJ prohibition on manufacturing and long-distance directly affect the availability and pricing of BST services. In fact, at the request of the Florida Commission, BellSouth recently filed a long-distance related waiver request with the MFJ court seeking permission to offer Extended Area Service. The court denied the request. It is interesting to note that under Ms. Dismukes' previously discussed outcome determinative argument for recovery, the costs associated with this waiver request could be disallowed.

To the extent that current MFJ pleadings reflect activities performed for non-regulated BellSouth entities, the cost assignment process adequately captures that effort and assigns costs accordingly. The attorneys who perform work on MFJ and other legal matters follow a prescribed set of rules that assign expenses based on a diligent analysis of cost-causation. Ms. Dismukes has not shown any instance where charges related to these attorneys have been misapplied.

Q: **Please summarize your testimony.**

A: The Commission should reject the recommendations made by Ms. Dismukes related to BSC activities. I believe I have presented in my testimony an analysis that shows Ms. Dismukes' level of understanding of BSC functions, products, and services to be relatively superficial. Unfortunately, this generally has led her to make incorrect conclusions. In my experience, the Company has been willing to accept or examine all constructive and corrective recommendations related to affiliated transactions. As regards BSC's services charged to BST, no significant supportable recommendations were offered by Ms. Dismukes.

Q: **Does this conclude your testimony?**

A: Yes.

SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY

REBUTTAL TESTIMONY OF A. WAYNE TUBAUGH

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

DECEMBER 10, 1993

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. MY NAME IS A. WAYNE TUBAUGH. I AM EMPLOYED BY BELLSOUTH TELECOMMUNICATIONS, INC. D/B/A SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY ("SBT" OR "THE COMPANY"). MY BUSINESS ADDRESS IS SUITE 400, 150 SOUTH MONROE STREET, TALLAHASSEE, FLORIDA 32301.

Q. PLEASE GIVE A BRIEF DESCRIPTION OF YOUR BACKGROUND AND EXPERIENCE.

A. I WAS GRADUATED FROM FLORIDA STATE UNIVERSITY IN 1973 WITH A BACHELOR OF SCIENCE DEGREE IN FINANCE AND MANAGEMENT.

I STARTED WITH SOUTHERN BELL IN JULY OF 1973, IN FLORIDA, WHERE I HELD ASSIGNMENTS IN THE NETWORK AND

PERSONNEL DEPARTMENTS. IN 1983, I ASSUMED RESPONSIBILITIES IN SOUTHERN BELL'S HEADQUARTERS RATES AND TARIFFS DEPARTMENT INVOLVING ACCESS TARIFF AND REGULATORY MATTERS. IN THAT CAPACITY, I TESTIFIED BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION ON SEVERAL OCCASIONS CONCERNING ACCESS SERVICE AND COMPENSATION RELATED ISSUES.

IN 1987, I RETURNED TO THE FLORIDA NETWORK DEPARTMENT WITH RESPONSIBILITIES FOR INSTALLATION AND MAINTENANCE IN THE GAINESVILLE, FLORIDA DISTRICT. IN APRIL OF 1989, I ASSUMED MY CURRENT POSITION.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. THE PURPOSE OF MY TESTIMONY IS TO RESPOND TO THE DIRECT TESTIMONY OF NANCY PRUITT AND DONALD MCDONALD CONCERNING CUSTOMER COMPLAINTS AND SOUTHERN BELL'S SERVICE PERFORMANCE. ALSO, I RESPOND TO PORTIONS OF THE DIRECT TESTIMONY OF R. EARL POUCHER.

Q. WITH REGARD TO MS. PRUITT'S TESTIMONY, DO YOU BELIEVE THAT SOUTHERN BELL'S PERFORMANCE WITH REGARD TO COMPLAINT ACTIVITY WAS SIGNIFICANTLY WORSE THAN

THAT OF THE OTHER LOCAL EXCHANGE COMPANIES (LEC) IN FLORIDA?

A. NO. ON BALANCE, AFTER REVIEWING MS. PRUITT'S TESTIMONY AND EXHIBITS, TOGETHER WITH THE OTHER TESTIMONY FILED CONCERNING SOUTHERN BELL'S SERVICE PERFORMANCE, AND OUR CUSTOMERS' COMMENTS CONCERNING THEIR SATISFACTION WITH OUR PERFORMANCE, I BELIEVE THAT OUR PERFORMANCE IS AS GOOD OR BETTER THAN THE OTHER LECs IN FLORIDA IN ALMOST EVERY AREA.

INDEED, WHILE SOUTHERN BELL IS NOT SATISFIED WITH ITS POSITION, ITS COMPLAINT ACTIVITY PERFORMANCE IS NOT SIGNIFICANTLY DIFFERENT FROM THE LEC'S AVERAGE.

MOREOVER, CONSIDERING THAT THE MAJORITY OF COMPLAINTS INVOLVING SOUTHERN BELL CAME FROM COUNTIES THAT CONTINUE TO DEMONSTRATE SIGNIFICANT GROWTH AND ACCESS LINES INCREASES, ONE WOULD EXPECT THE COMPLAINT ACTIVITY TO BE HIGHER.

Q. IN MS. PRUITT'S TESTIMONY, AT LINES 4-6 ON PAGE 10, SHE MENTIONS DELAYED CONNECTIONS AS THE MAJOR COMPLAINT RECEIVED ABOUT SOUTHERN BELL IN 1991. DID YOU REVIEW THIS TESTIMONY?

A. YES. SOUTHERN BELL IS RESPONSIBLE FOR 60% OF THE RESIDENCE AND BUSINESS ACCESS LINES IN THE STATE OF FLORIDA (FLORIDA TELEPHONE ASSOCIATION (FTA) MEMBER COMPANIES SUMMARY OF STATISTICS 1988-1991). FURTHERMORE, SOUTHERN BELL IS RESPONSIBLE FOR 63% OF THE INCREASE IN RESIDENCE AND BUSINESS ACCESS LINES IN THE STATE SINCE 1988. SINCE THIS INWARD MOVEMENT ACTIVITY IS WHAT RESULTS IN THE POSSIBILITY OF DELAYED CONNECTS, ONE WOULD EXPECT THAT SOUTHERN BELL WOULD HAVE THE MOST DELAYED CONNECTS.

IT MUST ALSO BE RECOGNIZED THAT SOUTHERN BELL HAS MANY OF THE MAJOR METROPOLITAN AREAS OF THE STATE. IN THESE AREAS, ROADS AND BUILDINGS MAKE IT DIFFICULT TO PLACE NEW FACILITIES. THIS CAN CAUSE DELAYS IN GETTING PERMITS TO PLACE FACILITIES, A PROBLEM THAT WAS DESCRIBED IN SOUTHERN BELL'S ANSWER TO MANY OF THE COMPLAINTS LODGED AGAINST THE COMPANY.

BUSINESS CUSTOMERS, AND NOT THE COMPANY, ARE RESPONSIBLE FOR A NUMBER OF THE ITEMS NEEDED TO PROVIDE SERVICE, SUCH AS CONDUIT, SPACE, ELECTRICITY, BACKBOARDS, ETC. IF THE CUSTOMER DOES NOT PROVIDE THESE IN A TIMELY MANNER, IT CAN LEAD TO

CONFUSION ABOUT SERVICE CONNECTIONS AND CONSEQUENT COMPLAINTS. THIS WAS ALSO DESCRIBED IN OUR RESPONSES TO THE DIVISION OF CONSUMER AFFAIRS.

FINALLY, WE HAVE EXPERIENCED DELAYED CONNECTION COMPLAINTS AS A RESULT OF MULTIPLE FAMILIES RESIDING IN SINGLE DWELLINGS. THIS HAS OCCURRED PRINCIPALLY IN DADE COUNTY. BASED ON HISTORIC TRENDS, SOUTHERN BELL HAS FORECAST ONE AND ONE-HALF PAIRS TO EACH LIVING UNIT WHEN DESIGNING AND CONSTRUCTING ITS DISTRIBUTION PLANT. ALTHOUGH THIS PRACTICE HAS SERVED US WELL IN THE PAST, THIS HISTORICALLY BASED ENGINEERING DID NOT ANTICIPATE THE LIVING PATTERNS OF THE MOST RECENT INFLUX OF PEOPLE. OFTEN TWO OR MORE FAMILIES RESIDE IN WHAT HAVE TRADITIONALLY BEEN SINGLE FAMILY UNITS. EACH OF THESE FAMILIES OFTEN REQUESTS PRIMARY TELEPHONE SERVICE. NOT ONLY DOES THIS REQUIRE ADDITIONAL DISTRIBUTION FACILITIES BUT ALSO DROP WIRE, NETWORK INTERFACES AND, IN A GREAT MANY CASES, INSIDE WIRE AND JACKS. THE PLACEMENT OF THESE FACILITIES TAKES ADDITIONAL TIME, LEADING TO AN INCREASED NUMBER OF DELAYED CONNECT COMPLAINTS.

Q. DOES ANY PSC RULE AFFECT THE CALCULATION OF THIS GENERAL TYPE OF SERVICE COMPLAINT (DELAYED

CONNECTION) AGAINST SOUTHERN BELL?

A. YES. COMMISSION RULE 24-4.090(2) STATES THAT THE COMPANY HAS NO RESPONSIBILITY TO PROVIDE SERVICE UNDER PART VI, "...UNLESS RIGHTS OF WAY AND EASEMENTS SUITABLE TO THE UTILITY ARE FURNISHED BY THE APPLICANT IN REASONABLE TIME TO MEET SERVICE REQUIREMENTS AND AT NO COST, CLEARED OF TREES, TREE STUMPS, PAVING AND OTHER OBSTRUCTIONS, STAKED TO SHOW PROPERTY LINES AND FINAL GRADE, AND MUST BE GRADED TO WITHIN SIX (6) INCHES OF FINAL GRADE BY THE APPLICANT ALL AT NO CHARGE TO THE UTILITY." WHERE THE TERMS OF THE ABOVE RULE ARE NOT MET, DELAYED CONNECT COMPLAINTS SHOULD NOT BE CONSIDERED JUSTIFIED. HOWEVER, IN PRACTICE THIS IS NOT THE CASE. IT IS COMPANY POLICY TO PROVIDE SERVICE TO OUR CUSTOMERS WHENEVER POSSIBLE. THERE ARE MANY INSTANCES WHERE WE HAVE RECEIVED COMPLAINTS FROM CUSTOMERS WHEN WE HAVE BEEN DELAYED IN PROVIDING SERVICE AS A RESULT OF CONTRACTORS PLACING HINDRANCES SUCH AS CURBS, DRIVEWAYS, AND SIDEWALKS THAT HAVE INHIBITED OUR ABILITY TO INSTALL CABLE AND DROPS. FOR EXAMPLE, WE RECEIVED 17 CUSTOMER COMPLAINTS/INQUIRIES IN LOXAHATCHEE, LOCATED IN PALM BEACH COUNTY, A 28 SQUARE MILE DEVELOPMENT WHERE

THERE IS NOTHING BUT DIRT ROADS, CANALS AND POORLY DEFINED EASEMENTS. IN ACCORDANCE WITH THE COMMISSION'S RULE, WE DID NOT HAVE TO PROVIDE SERVICE. HOWEVER, IN EVERY CASE WHERE SERVICE WAS REQUESTED WE DID SO, ALTHOUGH PERHAPS NOT AS QUICKLY AS DESIRED BY THE CUSTOMER. IT IS DELAYS SUCH AS THESE, WHICH ARE BEYOND SOUTHERN BELL'S CONTROL, THAT OFTEN LEAD TO COMPLAINTS.

IT SHOULD BE NOTED THAT MR. MCDONALD RECOGNIZES, AS STATED IN HIS TESTIMONY AT LINES 16-18 ON PAGE 6 THAT SOUTHERN BELL'S DELAYED CONNECTION COMPLAINTS DECREASED 52% IN 1992 FROM 1991. THIS IS A SIGNIFICANT DECREASE AND SHOWS THE EXCELLENT PROGRESS THAT SOUTHERN BELL HAS MADE IN THIS AREA.

Q. ON PAGE 10, AT LINES 9-11, MS. PRUITT STATES, "CUSTOMERS WERE OFTEN NOT KEPT INFORMED OF THE DELAYS". DO YOU AGREE WITH THIS STATEMENT?

A. YES. THE <u>MAJOR</u> PROBLEM CAUSING CUSTOMER COMPLAINTS IS A BREAKDOWN IN COMMUNICATIONS WITH THE CUSTOMER. THIS RELATES NOT JUST TO ADVISING CUSTOMERS OF A DELAY IN INSTALLATION AND THE REASONS FOR SUCH, BUT ALSO EXPLAINING HOW SERVICES WORK, AS WELL AS

EXPLAINING VARIOUS OTHER ASPECTS OF SOUTHERN BELL'S POLICIES, PLANS AND PROCEDURES, E.G., OEAS, DEPOSITS AND MAINTENANCE OF WIRE. SOUTHERN BELL IS AGGRESSIVELY PROMOTING OUR CORPORATE VALUE OF "CUSTOMER FIRST", THROUGH A TOTAL QUALITY ADVANTAGE PROGRAM. IN PARTICULAR, THIS EFFORT IS DESIGNED TO KEEP THE CUSTOMER INFORMED AND KNOWLEDGEABLE OF OUR PRODUCTS AND HOW THEY WORK, THEREBY REDUCING CUSTOMER DISSATISFACTION AND RESULTANT COMPLAINT ACTIVITY.

Q. YOU HAVE DISCUSSED TOTAL COMPLAINTS. SHOULD THE LEVEL OF JUSTIFIED COMPLAINTS ALSO BE CONSIDERED?

A. YES. THE NUMBER OF JUSTIFIED COMPLAINTS IS THE MEASUREMENT THAT SHOULD BE REVIEWED. WHILE SOUTHERN BELL WOULD PREFER TO HAVE NO JUSTIFIED COMPLAINTS, I MUST NOTE THAT DURING THE 1987-1991 PERIOD, SOUTHERN BELL WAS NOT THE COMPANY WITH THE HIGHEST LEVEL OF JUSTIFIED COMPLAINTS PER 1000 ACCESS LINES. RATHER, SOUTHERN BELL WAS IN THE MIDDLE OF THE COMPANIES COMPARED BY MS. PRUITT ON NP-4. IN ADDITION, SOUTHERN BELL'S JUSTIFIED COMPLAINTS DECREASED IN 1988, 1989, AND 1990 OVER YEAR 1987. AS MENTIONED EARLIER, WHILE JUSTIFIED COMPLAINTS INCREASED IN

1991, 1992 RESULTS WERE .128 PER 1000 ACCESS LINES, WHICH WAS A REDUCTION OF 38% IN 1992 OVER 1991 RESULTS.

Q. WHILE YOUR EXPLANATION REGARDING DELAYED NEW CONNECTIONS ADDRESSES THE LARGEST PROBLEM IN 1991, MS. PRUITT REPORTS THAT THE LARGEST PROBLEMS IN 1992 AND 1993 WERE SERVICE OUTAGES AND, TO A LESSER EXTENT, CONTINUING SERVICE PROBLEMS. CAN YOU COMMENT?

A. YES. NO DOUBT MS. PRUITT HAS REPORTED THE RESULTS CORRECTLY, BUT THE EXPLANATION IS OBVIOUS. IN 1992, WE EXPERIENCED HURRICANE ANDREW, AND, IN MARCH, 1993, WE HAD WHAT HAS BEEN REFERRED TO AS THE "STORM OF THE CENTURY." WE HAVE HAD MASSIVE SERVICE PROBLEMS WHICH WERE WEATHER-RELATED. WE HAVE RESPONDED APPROPRIATELY. WE HAVE BROUGHT IN WORKERS TO THE AFFECTED AREAS FROM ALL OVER THE STATE AND, INDEED, FROM OTHER PORTIONS OF THE REGION. IN ADDITION, WE HAVE ADDED PERMANENT EMPLOYEES TO AID US WITH OUR OUTSIDE PLANT. NEVERTHELESS, IT IS DIFFICULT, IF NOT IMPOSSIBLE TO SATISFY EVERYONE WHO EXPERIENCES SERVICE PROBLEMS IN THESE CIRCUMSTANCES. CONSEQUENTLY, IT IS NOT SURPRISING THAT THESE TYPES

OF COMPLAINTS CONSTITUTED THE MAJOR COMPLAINT.

Q. YOU MENTIONED EARLIER THAT THE COMPANY MEASURES CUSTOMER SATISFACTION AS WELL AS THE COMPANY'S PERFORMANCE. TO WHAT WERE YOU REFERRING?

A. THROUGH AN INDEPENDENT CONTRACTOR, SOUTHERN BELL CONDUCTS A MONTHLY CUSTOMER SURVEY OF INSTALLATION AND MAINTENANCE ACTIVITY. THIS CUSTOMER SURVEY IS REFERRED TO AS TELSAM. THE QUESTIONS IN THE SURVEY WERE DEVELOPED TO DETERMINE IF OUR CUSTOMERS ARE SATISFIED WITH WORK PERFORMED FOR THEM BY SOUTHERN BELL. A STATISTICALLY VALID SAMPLE OF RECENT ORDERS, BOTH MAINTENANCE AND INSTALLATION, IS PROVIDED AND EMPLOYEES OF THE CONTRACTOR CALL THE SELECTED CUSTOMERS. AS YOU WILL NOTE IN EXHIBIT AWT-1, OUR CUSTOMER SATISFACTION LEVELS HAVE BEEN EXCELLENT FOR THE PAST 4 YEARS. MR. HOELTKE WILL DISCUSS THE VALIDITY OF THE TELSAM PROCESS IN HIS TESTIMONY.

Q. DID YOU ATTEND THE LOCAL SERVICE HEARINGS CONDUCTED BY THE COMMISSION IN CONNECTION WITH THIS DOCKET, AND ARE YOU AWARE OF ANY MAINTENANCE OR INSTALLATION COMPLAINTS BY CUSTOMERS AT THOSE HEARINGS?

A. YES, I EITHER ATTENDED OR REVIEWED THE TRANSCRIPTS OF A NUMBER OF SERVICE HEARINGS HELD IN 1992 AND 1993.

THE OVERWHELMING MAJORITY OF THE CUSTOMERS WHO ADDRESSED SOUTHERN BELL'S SERVICE PERFORMANCE WERE EITHER SATISFIED OR MORE THAN SATISFIED WITH THE SERVICE PROVIDED. TO THE EXTENT MS. PRUITT'S TESTIMONY IS INTENDED TO INDICATE THAT SERVICE IS A PROBLEM, IT IS WRONG.

Q. HAVE YOU REVIEWED MR. DONALD MCDONALD'S PREFILED TESTIMONY?

A. YES.

Q. ON PAGE 4, AT LINES 10-17, MR. MCDONALD STATES THAT THERE HAS BEEN WHAT HE TERMS A "DISTURBING TREND" IN MEETING THE COMMISSION'S RULE REQUIREMENTS REGARDING SERVICE ORDER COMPLETION AND REPAIRING TROUBLES WITHIN TWENTY-FOUR HOURS. DO YOU AGREE?

A. NO. I SHOULD NOTE THAT THIS IS THE SAME COMMENT THAT MR. MCDONALD MADE IN HIS TESTIMONY FILED ON DECEMBER 15, 1992. WITH REGARD TO HIS COMMENTS

DEALING WITH 1991 AND 1992, MY RESPONSE THEN WOULD HAVE BEEN THAT WE FILE WITH EACH REPORT AN EXPLANATION OF THE REASONS FOR SPECIFIC EXCHANGE MISSES, IF ANY. UNTIL WE REVIEWED MR. MCDONALD'S TESTIMONY, WE HAD NOT BEEN TOLD THAT THE COMMISSION STAFF QUESTIONED ANY OF OUR REPORTED FAILURES OR THE REASONS FOR THE EXCHANGE MISSES. ALTHOUGH SOUTHERN BELL WOULD CLEARLY PREFER TO HAVE NO EXCHANGE MISSES, THE ONES THAT IT HAS EXPERIENCED DID NOT INDICATE ANY DETERIORATION IN SERVICE LEVELS.

NOW, MR. MCDONALD HAS ADDED TO HIS TESTIMONY FILED LAST YEAR, BY NOTING THAT OUR OUT-OF-SERVICE REPORTS HAVE GOTTEN WORSE. HOWEVER, MR. MCDONALD SHOULD KNOW THAT THE REASON THESE REPORTS ARE WORSE IS BECAUSE WE HAVE CHANGED THE WAY WE RECORD MISSES. PREVIOUSLY, OUR SERVICE TECHNICIANS WERE ALLOWED TO REPORT A "CLEAR" TIME DIFFERENT THAN THE COMPUTER GENERATED "CLOSE" TIME AND THE "CLEAR" TIME WAS USED TO CALCULATE THE TOTAL TIME THE CUSTOMER WAS OUT OF SERVICE. NATURALLY, IT WAS TO BE EXPECTED THAT A TROUBLE WOULD BE CLEARED BEFORE IT WAS CLOSED. NOW THE CLOSE TIME IS THE TIME USED TO CALCULATE THE TOTAL TIME THE CUSTOMER IS OUT OF SERVICE. CONSEQUENTLY, THE MISSES HAVE INCREASED, BUT THAT IS

NOT AN INDICATION OF DETERIORATING SERVICE.

I HAVE ADDRESSED, IN RESPONSE TO MS. PRUITT'S TESTIMONY, THE GENERAL ISSUE RELATED TO SERVICE ORDER COMPLAINTS, A POINT WHICH MR. MCDONALD ADDRESSES. HOWEVER, I SHOULD NOTE THAT, AS RECOGNIZED BY MR. MCDONALD, IN HIS TESTIMONY, ON PAGE 6 AT LINES 16-18, SOUTHERN BELL HAS BEEN SUCCESSFUL IN REDUCING DELAYED CONNECTION COMPLAINTS BY 52% WHEN COMPARING 1992 TO 1991. THIS IS A SIGNIFICANT REDUCTION IN COMPLAINTS AND WE BELIEVE THAT THIS TREND WILL CONTINUE. THIS IS INDICATIVE OF SOUTHERN BELL'S CONTINUING EFFORTS TO CORRECT POTENTIAL SERVICE PROBLEMS OF ANY SORT.

Q. IN ADDITION TO THE COMMENTS YOU HAVE ALREADY MADE REGARDING THE QUALITY OF SOUTHERN BELL'S SERVICE, DO YOU HAVE ANY FURTHER INFORMATION YOU FEEL THE COMMISSION SHOULD KNOW THAT AFFECTS OUR SERVICE RESULTS?

A. YES. SOUTHERN BELL IS MEASURED ON AN EXCHANGE BASIS FOR SERVICE ORDER ACTIVITY, REPEAT REPORTS, TROUBLE REPORTS CLEARED WITHIN SEVENTY TWO HOURS, AND OUT-OF-SERVICE TROUBLE REPORTS RESTORED WITHIN TWENTY

FOUR HOURS. SOUTHERN BELL HAS 102 EXCHANGES, 63% OF WHICH HAVE FEWER THAN 20,000 ACCESS LINES, AND 54% OF WHICH HAVE FEWER THAN 10,000 ACCESS LINES.

IN THESE SMALL EXCHANGES, EVEN ONE OR TWO MISSES IN THESE CATEGORIES CAN CAUSE US TO FAIL THE OBJECTIVE. WE HAVE BEEN TOLD BY BOTH THE COMMISSION AND STAFF THAT IF OUR EXPLANATION OF THE MISSED OBJECTIVE IS REASONABLE AND THE EXCHANGE IS NOT MISSED REGULARLY, NEITHER SOUTHERN BELL NOR ANY OTHER COMPANY WOULD BE CONSIDERED UNSATISFACTORY IN ITS SERVICE PERFORMANCE. MR. MCDONALD'S ANALYSIS DOES NOT MENTION OUR EXPLANATIONS FOR THE MISSES, WHETHER THEY ARE CONSIDERED REASONABLE, OR IF THERE IS A PATTERN OF MISSES IN ANY PARTICULAR EXCHANGE. I AM, THEREFORE, SURPRISED THAT THE PERIODIC REPORT ANALYSIS HAS BEEN RAISED AT THIS TIME.

Q. MR. MCDONALD ADDRESSES BOTH A 1992 AND A 1993 SERVICE EVALUATION THAT STAFF MADE REGARDING SOUTHERN BELL. CAN YOU COMMENT FIRST ON THE 1992 EVALUATION?

A. YES. IN THE 1992 EVALUATION, MR. MCDONALD STATES THAT THE STAFF MEASURED 71 STANDARDS AND THAT THE

COMPANY FAILED TO MEET 14 OF THE STANDARDS IN THIS SERVICE EVALUATION.

MR. MCDONALD INDICATES THAT 8 OR 57% OF HIS LESS THAN SATISFACTORY RESULTS ARE RELATED TO THE COMPANY'S PAY TELEPHONE OPERATION. THEY ARE:

	STANDARD	COMPANY RESULT
SERVICE ABILITY	100%	98.4%
NO CURRENT DIRECTORY	100%	98.3%
NO TELE. NUMBER LISTED	100%	99.7%
NO DIAL INSTRUCTIONS	100%	99.7%
INADEQUATE LIGHTING	100%	99.7%
NO ADDRESS ON PHONE	100%	97.3%
AUTOMATIC COIN RETURN	100%	97.3%
HANDICAPPED ACCESS	100%	78.4%

AS THE COMPANY EXPLAINED TO THE COMMISSION IN OUR RESPONSE DATED DECEMBER 18, 1992, TO THIS SERVICE EVALUATION,

> WITH REGARD TO THE PAY TELEPHONES THAT WERE OUT-OF-SERVICE, MISSING DIRECTORIES, OR WHICH WERE WITHOUT COMPLETE ADDRESS INFORMATION, WE BELIEVE THE SERVICE EVALUATION SHOWS THAT SOUTHERN BELL IS DOING AN

EXCELLENT JOB OF PROVIDING SERVICE. PAY TELEPHONES ARE CONSTANTLY ABUSED, YET IN SUBSTANTIALLY ALL INSTANCES WE WERE IN COMPLIANCE WITH RULES.

FOR INSTANCE, OF THE (304) PAY PHONES REVIEWED BY STAFF, ONLY FIVE WERE FOUND OUT-OF-SERVICE (SERVICEABILITY). OF THE (302) PAY PHONES REVIEWED BY THE STAFF FOR CURRENT DIRECTORIES ONLY FIVE WERE MISSING DIRECTORIES. OF THE (301) PAY PHONES REVIEWED BY THE STAFF FOR ADDRESS/LOCATION ALL HAD ADDRESS/LOCATION INFORMATION, HOWEVER, THE STAFF IDENTIFIED ONLY NINE THAT PURPORTEDLY NEEDED ADDITIONAL INFORMATION. WE WILL REDOUBLE OUR EFFORTS IN THIS AREA. HOWEVER, IT IS SIMPLY UNREASONABLE TO EXPECT A HIGHER LEVEL OF COMPLIANCE.

ALL HANDICAP VARIANCES WERE

CORRECTED IMMEDIATELY. SOUTHERN BELL HAS AN ONGOING PROGRAM OF BRINGING ALL PUBLIC TELEPHONES INTO COMPLIANCE WITH HANDICAP REGULATIONS, INCLUDING EVEN THOSE THAT ARE GRANDFATHERED. WE ARE CORRECTING ALL THE GRANDFATHERED LOCATIONS AND ARE SIGNIFICANTLY AHEAD OF THE INDUSTRY IN BRINGING OUR COMPANY IN COMPLIANCE WITH THIS RULE.

THE LAKE CITY OPERATOR COIN RETURN TROUBLE WAS ISOLATED TO A SUBSCRIBER LOOP CARRIER (SLC) PROBLEM AND HAS BEEN CORRECTED.

WE REPLACE ALL MISSING DIRECTORIES AS SOON AS WE BECOME AWARE OF THE LACK OF A DIRECTORY IN A LOCATION REQUIRED TO HAVE ONE. THE LOSS OF THESE DIRECTORIES, AS WELL AS DAMAGE TO BOOTH LIGHTING, ARE GENERALLY A CASE OF VANDALISM.

ALL PHONES (100%) HAD ADDRESS LOCATION INFORMATION, HOWEVER, THE STAFF IDENTIFIED (9) WITH "INADEQUATE" INFORMATION. THESE HAVE BEEN AUGMENTED WITH THE ADDITIONAL LOCATION INFORMATION.

THE RESULTS OF THIS REVIEW WITH RESPECT TO SOUTHERN BELL'S PAY TELEPHONES, ALTHOUGH NOT PERFECT, WAS NONETHELESS EXCELLENT. IT IS HARD TO IMAGINE THAT ANY COMPANY'S RESULTS COULD BE BETTER. THEREFORE, SOUTHERN BELL'S RESULTS IN THIS AREA SHOULD BE CONSIDERED SATISFACTORY.

Q. YOU HAVE DESCRIBED 8 OF THE UNSATISFACTORY AREAS, CAN YOU ADDRESS THE REMAINING ONES?

A. YES. THE REMAINING AREAS ARE:

1. PERIODIC REPORTS
2. INCORRECTLY DIALED CALLS
3. REPAIR SERVICE-OOS RESTORAL-SAME DAY
4. 911 SERVICE
5. SAFETY-SAFE PLANT CONDITIONS-WITHIN PAST 12 MOS.
6. ANSWER TIME-REPAIR SERVICE
7. ANSWER TIME-BUSINESS OFFICE

8. REPAIR SERVICE-REBATES-OVER 24 HOURS

WHILE THESE REPRESENT A NUMBER OF AREAS OF CONCERN, WITHOUT THE LAST THREE, THE RESULTS OF OUR EVALUATION WOULD HAVE BEEN OVER 90%. WE BELIEVE THE STAFF'S CRITICISM OF US IN THESE THREE AREAS IS MISPLACED.

DURING THE PAST SEVERAL YEARS, SOUTHERN BELL DETERMINED THAT OUR ANSWER TIME PERFORMANCE FOR BOTH THE BUSINESS OFFICE AND REPAIR SERVICE WAS BECOMING HARDER TO MAINTAIN AT A SATISFACTORY LEVEL AS A RESULT OF INCREASES IN OUR CUSTOMER BASE, CREATING A HIGHER VOLUME OF CALLS. TO MEET THE NEEDS OF OUR CUSTOMERS, SOUTHERN BELL DEPLOYED AN AUTOMATED INTERACTIVE ANSWERING SYSTEM. THE FIRST TRIAL OF THIS DIGITAL VOICE MENU-DRIVEN SYSTEM FOR REPAIR SERVICE WAS IN 1988, AND IT WAS DEPLOYED STATE WIDE IN 1989. IN 1991, A BUSINESS OFFICE AUTOMATED "SCREENER," WHICH IS DESIGNED TO DIRECT THE CUSTOMER TO THE COMPANY GROUP OR DEPARTMENT MOST LIKELY TO HELP THE CUSTOMER WITH HIS PROBLEM, WAS IMPLEMENTED.

SOUTHERN BELL BELIEVED THAT IT MET THE REQUIREMENTS OF THE PREVIOUS VERSION OF COMMISSION RULE 25-4.073, WHICH REQUIRED THAT A CUSTOMER BE ANSWERED BY THE COMPANY

WITHIN 20 SECONDS OF THE FIRST AUDIBLE RING. THE AUTOMATED SYSTEMS FOR BOTH REPAIR SERVICE AND THE BUSINESS OFFICE MET THE CRITERION FOUND IN RULE 25-4.073 THAT STATED, "THE TERM ANSWERED AS USED IN SUBPARAGRAPHS A AND B ABOVE SHALL BE CONSTRUED TO MEAN MORE THAN AN ACKNOWLEDGMENT THAT THE CUSTOMER IS WAITING ON THE LINE." THESE SYSTEMS ALLOW THE CUSTOMER TO REPORT TROUBLES OR TO DIRECT HIS CALL TO THE GROUP RESPONSIBLE FOR RESOLVING HIS QUESTION OR PROBLEM. THE COMPANY WAS THUS IN 100% COMPLIANCE WITH THE COMMISSION'S PRIOR RULE. THE STAFF DISAGREED WITH SOUTHERN BELL'S INTERPRETATION OF THE RULE AND ULTIMATELY THE COMMISSION CHANGED THE ANSWER TIME RULE IN AN ATTEMPT TO RESOLVE THESE DIFFERENCES.

BECAUSE OF THE DIFFERENCE OF OPINION REGARDING THIS RULE, THE FAILURES IN THE 1992 EVALUATION RELATED TO THE ANSWER TIME FAILURES, IN OUR OPINION, RESULTED FROM AN INCORRECT INTERPRETATION OF THE RULE BY THE STAFF.

Q. CAN YOU NOW COMMENT ON THE REBATE ISSUE MR. MCDONALD RAISED IN THE 1992 EVALUATION?

A. WITH REGARD TO THE QUESTION OF REBATES, MR. MCDONALD FAILED TO MENTION THAT, OF THE 99 CUSTOMERS ELIGIBLE

FOR REBATES IN ORLANDO, WE WERE FOUND TO BE 100% SATISFACTORY. THE STAFF DID FIND THAT SOME CUSTOMERS IN GAINESVILLE DID NOT RECEIVE REBATES TO WHICH THE STAFF BELIEVED THEY WERE ENTITLED. AGAIN, SOUTHERN BELL ASSERTS THAT THIS IS A RESULT OF A RULE MISINTERPRETATION BY THE STAFF. AS EXPLAINED IN THE COMPANY'S RESPONSE TO THE SERVICE EVALUATION:

> IN THE ORLANDO REVIEW THE STAFF REQUESTED REBATE RECORDS ON (99) OUT-OF-SERVICE REPORTS. 100% OF THE REBATES WERE PROPERLY PROVIDED TO THE CUSTOMERS. IN GAINESVILLE, THE STAFF REQUESTED REBATE RECORDS ON (20) OUT-OF-SERVICE REPORTS. 100% OF THE CUSTOMER ELIGIBLE FOR A REBATE WERE PROVIDED A REBATE. EIGHT CUSTOMERS WERE IDENTIFIED AS NOT BEING ELIGIBLE FOR A REBATE. FOUR TROUBLE REPORTS WERE NOT TESTED OUT-OF-SERVICE AND DISCUSSIONS WITH THE CUSTOMER AFTER THE INITIAL REPORT SUPPORTED THAT DETERMINATION. FOUR TROUBLE REPORTS WERE A RESULT OF CPE (CUSTOMER PROVIDED EQUIPMENT) WIRE OR EQUIPMENT. WE ARE NOT REQUIRED BY THE COMMISSION'S RULE TO REBATE CPE CAUSED TROUBLES.

SOUTHERN BELL BASED ITS RESPONSE ON RULE 25-4.070(1)(b), WHICH STATES, "IN THE EVENT A SUBSCRIBER'S SERVICE IS INTERRUPTED OTHERWISE THAN BY NEGLIGENCE OR WILLFUL ACT OF THE SUBSCRIBER AND IT REMAINS OUT OF SERVICE IN EXCESS OF 24 HOURS AFTER BEING REPORTED TO THE COMPANY, AN APPROPRIATE ADJUSTMENT OR REFUND SHALL BE MADE TO THE SUBSCRIBER AUTOMATICALLY, PURSUANT TO RULE 25-4.110 (CUSTOMER BILLING). SERVICE INTERRUPTION TIME WILL BE COMPUTED ON A CONTINUOUS BASIS, SUNDAYS AND HOLIDAYS INCLUDED. ALSO, IF THE COMPANY FINDS THAT IT IS THE CUSTOMER'S RESPONSIBILITY TO CORRECT THE TROUBLE, IT MUST NOTIFY OR ATTEMPT TO NOTIFY THE CUSTOMER WITHIN 24 HOURS AFTER THE TROUBLE WAS REPORTED." THE RULE THUS REQUIRES ONLY THAT THE COMPANY NOTIFY A CUSTOMER WITHIN 24 HOURS THAT HIS PROBLEM IS IN HIS CPE OR OTHERWISE IS HIS RESPONSIBILITY. IT DOES NOT REQUIRE A REBATE IF THE COMPANY FAILS TO SO NOTIFY THE CUSTOMER.

Q. IN MR. MCDONALD'S TESTIMONY, (PAGE 12), HE INDICATES THAT HE PERFORMED A WEIGHTED INDEX MEASUREMENT TO EVALUATE THE COMPANY'S PERFORMANCE. DID YOU RECALCULATE THIS MEASUREMENT BASED ON THE COMPANY'S BELIEF THAT IT MET THE ANSWER TIME RULE?

A. YES. IN MR. MCDONALD'S ATTACHMENT DBM-6, WHERE MR. MCDONALD USED THE NEW RULE AND COMPUTED THE OVERALL SCORE, HE DETERMINED THE COMPANY'S OVERALL SCORE TO BE 68.38. SINCE OUR MEASUREMENT OF OUR ANSWER TIME PERFORMANCE HAS BEEN 100% UNDER THE RULE, I RECALCULATED THE OVERALL SCORE USING A 100% RESULT FOR BOTH REPAIR SERVICE AND BUSINESS OFFICE ANSWER TIME. THE OVERALL SCORE WOULD THEN BE 90.62, SUBSTANTIALLY ABOVE THE 75 MINIMUM SCORE FOR SATISFACTORY PERFORMANCE.

THUS, IF MR. MCDONALD HAD USED THE CORRECT ANSWER TIME RESULT, HE WOULD HAVE DETERMINED THAT THE COMPANY WAS MORE THAN SATISFACTORY WITH A 90.62 RESULT FOR 1992. THIS DEMONSTRATES THAT THE COMPANY'S SERVICE WAS SATISFACTORY.

Q. CAN YOU DISCUSS MR. MCDONALD'S 1993 SERVICE EVALUATION?

A. YES. IN HIS 1993 EVALUATION, MR. MCDONALD FOUND 14 FAILURES TO MEET THE SERVICE STANDARDS THE STAFF USED IN THE EVALUATION. AGAIN, EIGHT OF THE FAILURES RELATED TO PAY TELEPHONES. MY SAME COMMENTS MADE IN RESPONSE TO THE PAY TELEPHONE FAILURES IN THE 1992 EVALUATION, ALSO APPLY HERE.

THE OTHER FAILURES INCLUDED:

1. OUT-OF-SERVICE RESULTS.
2. THE ANSWER TIME RESULTS FOR 911-TDD SERVICE
3. BILLING DA CALLS.
4. ORIGINAL PROVISION OF SERVICE RESULTS.
5. REBATES.

WE BELIEVE THE ANSWER TIME RESULTS FOR 911-TDD SERVICE CANNOT BE CHARGED TO US, SINCE WE DO NOT PROVIDE THAT SERVICE. THE BILLING OF DA CALLS INVOLVED OUR FAILURE, APPARENTLY, TO BILL FOR ALL THE DA CALLS THAT COULD HAVE BEEN BILLED. THE FAILURE TO PROVIDE INITIAL SERVICE INVOLVED OUR MISSING THE SERVICE STANDARD BY ONE-HALF OF ONE PERCENTAGE POINT. WHILE THESE MISSES ARE OF CONCERN TO SOUTHERN BELL, WE DO NOT BELIEVE THAT OUR RESULTS HERE INDICATE BAD SERVICE. INDEED, MR. MCDONALD, AS HE POINTS OUT AT PAGE 10, LINES 1-4 OF HIS TESTIMONY, CONSIDERS THE MAJOR CONCERNS TO BE OUR OUT-OF-SERVICE RESULTS AND OUR REBATE POLICY.

FROM OUR EVALUATION OF THE REBATE ISSUE, IT APPEARS THAT THE STAFF HAS RAISED THE SAME ALLEGED PROBLEM THAT WAS IDENTIFIED IN THE 1992 EVALUATION. THE STAFF AND SOUTHERN BELL CONTINUE TO DISAGREE AS TO WHETHER CUSTOMERS WHO HAVE CPE PROBLEMS ARE ENTITLED TO A

REBATE. UNTIL THE COMMISSION RESOLVES THIS DISAGREEMENT, WE NO DOUBT WILL CONTINUE TO MISS THIS STANDARD ON STAFF EVALUATIONS. HOWEVER, AS NOTED BEFORE, WE DO NOT CONSIDERED THIS TO BE A MISS.

WITH REGARD TO THE OUT-OF-SERVICE STANDARD, AS I HAVE NOTED EARLIER IN MY TESTIMONY, SOUTHERN BELL HAS CHANGED THE WAY IT REPORTS AND MEASURES OUT-OF-SERVICE CONDITIONS. WHILE WE CANNOT REPLICATE THE STAFF'S RESULTS WITHOUT FURTHER INFORMATION, WE SUSPECT THAT THE RESULTS THAT THE STAFF REACHED MAY BE A RESULT OF THE WAY WE HAVE CHANGED THE REPORTING OF "CLEAR" TIMES. IN ADDITION, AND AS I HAVE PREVIOUSLY STATED, WE OBVIOUSLY HAVE HAD SEVERE WEATHER PROBLEMS AND THE BACKLOG OF PROBLEMS CONTINUES TO MAKE IT DIFFICULT FOR US TO MEET THESE STANDARDS. NEVERTHELESS, WE CONTINUE TO ADD PERSONNEL IN ORDER TO IMPROVE IN THIS AREA. OF COURSE, AND IN ANY EVENT, WE PASSED THE 1993 SERVICE EVALUATION.

Q. MR. MCDONALD BELIEVES THE COMMISSION SHOULD IMPOSE A PENALTY AS A RESULT OF THE COMPANY'S SERVICE PERFORMANCE. DO YOU AGREE?

A. I ABSOLUTELY DISAGREE. SOUTHERN BELL'S SERVICE

PERFORMANCE HAS BEEN CONSISTENTLY SATISFACTORY OVER THE PAST THREE YEARS. AS SHOWN BY TELSAM, OUR CUSTOMERS BELIEVE THAT WE ARE PROVIDING SATISFACTORY OR BETTER SERVICE. AS I HAVE SHOWN, MR. MCDONALD'S CONCERNS WITH REPAIR SERVICE AND BUSINESS OFFICE ANSWER TIMES, AND REBATES PROVIDED WHEN CUSTOMER PROVIDED EQUIPMENT IS THE CAUSE OF A TROUBLE, ARE MISPLACED.

Q. CAN YOU SUMMARIZE YOUR COMMENTS REGARDING SERVICE EVALUATIONS?

A. YES. WHILE OUR SERVICE HAS NOT BEEN PERFECT, WE HAVE BY MOST STANDARDS PROVIDED GOOD SERVICE. WHEN A COMPANY LIKE SOUTHERN BELL IS VISITED BY CATASTROPHES, LIKE HURRICANE ANDREW IN AUGUST OF 1992 AND "THE STORM OF THE CENTURY" IN MARCH OF 1993, THE PROBLEMS DO NOT CORRECT THEMSELVES OVERNIGHT, BUT ARE A LONG-TERM ENDEAVOR.

WE MOVED MANPOWER AND MACHINERY TO SOUTH FLORIDA TO ASSIST IN THE RECOVERY FROM HURRICANE ANDREW. RESOURCES FROM BOTH OUTSIDE THE STATE AND INSIDES INCLUDING SERVICE TECHNICIANS, FACILITY TECHNICIANS, EQUIPMENT TECHNICIANS, ETC., WERE TEMPORARILY TRANSFERRED TO SOUTH FLORIDA. THE LAST OF THE LOANED

FLORIDA FORCES DID NOT RETURN TO THEIR HOME LOCATIONS UNTIL JUNE OF 1993. SOUTHERN BELL CONTINUES ITS RESTORATION EFFORTS IN SOUTH FLORIDA WITH OUT-OF-STATE RESOURCES.

ADDITIONALLY, WE ADVISED THE STAFF IN OUR QUARTERLY QUALITY OF SERVICE REPORTS THAT WE WERE ADDING PERMANENT SERVICE PERSONNEL TO ENSURE THAT WE CONTINUE TO PROVIDE THE TYPE OF SERVICE OUR CUSTOMERS TELL US THEY EXPECT. HOWEVER, IT TAKES TIME, TRAINING AND EXPERIENCE FOR THE NEW SERVICE PERSONNEL TO BECOME EFFECTIVE.

I WOULD CONCLUDE BY NOTING THAT OUR CUSTOMERS BELIEVE WE ARE PROVIDING SATISFACTORY OR BETTER THAN SATISFACTORY SERVICE AS DEMONSTRATED IN OUR CUSTOMERS RESPONSES TO THE CUSTOMER SATISFACTION POLLS, AND IN THEIR COMMENTS DURING THE PUBLIC HEARINGS CONDUCTED IN THIS DOCKET.

Q. ON PAGES 40 AND 41 OF MR. POUCHER'S TESTIMONY HE STATES THAT OPC RECEIVED LESS THAN CANDID RESPONSES FROM MOST OF THE SOUTHERN BELL MANAGERS THAT WERE INTERVIEWED AND A LARGE NUMBER OF EMPLOYEES TOOK THE FIFTH AMENDMENT AS A RESULT OF AN INNATE FEAR OF RETRIBUTION OR REPRISALS

BY BELLSOUTH. DO YOU AGREE WITH THIS ASSESSMENT?

A. NO. THE COMPANY TOOK APPROPRIATE STEPS IN AN EFFORT TO ENSURE THAT ALL OF OUR EMPLOYEES WOULD COOPERATE IN GOOD FAITH WITH ALL INVESTIGATORY EFFORTS. IN A LETTER TO ALL EMPLOYEES, THE PRESIDENT OF SOUTHERN BELL FLORIDA ADVISED THE EMPLOYEE BODY THAT THEY SHOULD COOPERATE WITH THOSE AGENCIES CONDUCTING INVESTIGATIONS OF SOUTHERN BELL. HE STATED THAT AS LONG AS EACH PERSON TOLD THE TRUTH NO DISCIPLINARY ACTION WOULD BE IMPOSED. ADDITIONALLY, I PERSONALLY SPOKE TO EVERY EMPLOYEE WHO WAS SCHEDULED FOR DEPOSITION AND I ADVISED EACH OF THEM THAT THE LEGAL DEPARTMENT AND THE PRESIDENT OF FLORIDA HAD GIVEN ASSURANCES THAT NO EMPLOYEE WOULD BE DISCIPLINED FOR TELLING THE TRUTH. A COMPANY ATTORNEY ALSO ADVISED EACH EMPLOYEE PRIOR TO THEIR DEPOSITION THAT DISCIPLINARY ACTION WOULD NOT BE TAKEN AGAINST THEM PROVIDED THEY TOLD THE TRUTH.

TO UNDERSTAND WHY SOME EMPLOYEES TOOK THE FIFTH AMENDMENT, ONE MUST UNDERSTAND THE ENVIRONMENT THAT EXISTED DURING THE TIME THE DEPOSITIONS WERE TAKING PLACE. PRIOR TO THE BEGINNING OF THE DEPOSITIONS, THE ATTORNEY GENERAL AND THE OFFICE OF STATEWIDE PROSECUTION HAD ANNOUNCED A CRIMINAL INVESTIGATION OF

THE COMPANY AND ITS EMPLOYEES; THE STATEWIDE GRAND JURY HAD INTERVIEWED EMPLOYEES; AND THE OPC AND THE FPSC WERE CONDUCTING AN INVESTIGATION. EMPLOYEES, ON THE ADVICE OF THEIR ATTORNEYS, APPARENTLY CONSIDERED WHETHER THEY WOULD BE CALLED TO TESTIFY OR BE DEPOSED BY ANY ONE OR ALL OF THESE ENTITIES AND WHETHER PROVIDING A STATEMENT MIGHT PROVE TO BE CONTRARY TO THEIR INTERESTS. ALTHOUGH SOUTHERN BELL ENCOURAGED EACH OF ITS EMPLOYEES TO COOPERATE, PRUDENCE AND RESPECT FOR OUR EMPLOYEES' LEGAL RIGHTS REQUIRED THAT WE, ALONG WITH PUBLIC COUNSEL AND PSC LEGAL STAFF, ABSTAIN FROM INTERFERING WITH THE ADVICE OBTAINED FROM THEIR RESPECTIVE ATTORNEYS. ACCORDINGLY, WHAT MR. POUCHER REFERS TO AS EMPLOYEES' FEAR OF RETRIBUTION AND REPRISAL, IS ACTUALLY NOTHING MORE THAN A RELUCTANCE TO GET INVOLVED BASED UPON THE ADVICE OF THEIR COUNSEL. OPC'S CONCERN ABOUT OUR EMPLOYEES FEAR OF RETRIBUTION AND REPRISAL IS ACTUALLY ASTONISHING WHEN ONE CONSIDERS THE FEAR SOME EMPLOYEES EXPERIENCED DURING THE DEPOSITION WHEN OPC ASKED "HAS ANYONE ADVISED YOU OF THE POSSIBLE CRIMINAL PENALTY THAT COULD APPLY IF YOU PERJURE YOUR TESTIMONY HERE TODAY?"

Q. ON PAGE 47 OF MR. POUCHER'S TESTIMONY HE ASSERTS THAT THE COMPANY HAS FILED REPORTS WITH THE COMMISSION WHICH

ARE ERRONEOUS, OVERSTATED, AND SELF-SERVING. WOULD YOU COMMENT?

A. YES. SOUTHERN BELL HAS NEVER INTENTIONALLY OR KNOWINGLY FILED WITH THE COMMISSION ANY REPORT OR OTHER DOCUMENT THAT WAS LESS THEN 100% CORRECT. WE HAVE ALWAYS TAKEN GREAT PAINS TO ENSURE THAT THE INTEGRITY OF SOUTHERN BELL'S RELATIONSHIP WITH THIS COMMISSION REMAINS INTACT AND UNTARNISHED EVEN THOUGH AN OCCASIONAL PROBLEM IN OUR COMPANY MIGHT CAUSE OTHERS TO QUESTION OUR MOTIVES. SOUTHERN BELL'S MOTIVES ARE CURRENTLY BEING QUESTIONED BY MR. POUCHER DUE TO A FEW INSTANCES IN WHICH EMPLOYEES ATTEMPTED TO MANIPULATE RESULTS. WE BELIEVE THAT MR. POUCHER'S CONCLUSION IS UNFAIR AND UNFOUNDED. WHERE WE HAVE DETERMINED THAT EMPLOYEES HAVE FALSIFIED TROUBLE REPORTS AND THAT THE FALSIFICATION OCCURRED AT A SPECIFIC DATE AND TIME, WE WILL CORRECT THE REPORTS. HOWEVER, IN MOST INSTANCES WHERE THE EMPLOYEE SAYS THAT THIS TYPE OF ACTIVITY OCCURRED OR THAT THEY HEARD OF SIMILAR ACTIVITIES TAKING PLACE, THE LACK OF SPECIFICITY REGARDING THE FALSIFICATION MADE IT IMPOSSIBLE TO CORRECT THE REPORTS. WE MUST REMEMBER, HOWEVER, THAT THESE FEW REPORTS ARE ONLY A SMALL PORTION OF THE MILLIONS OF TROUBLE REPORTS THAT ARE PROCESSED EACH YEAR.

ACCORDINGLY, I BELIEVE THAT THE REPORTS ARE GENERALLY CORRECT.

Q. ON PAGE 47 OF MR. POUCHER'S TESTIMONY, HE ALSO STATES THAT THE RECENT SERVICE EVALUATION REPORTED UNSATISFACTORY RESULTS IN THE OUT-OF-SERVICE OVER TWENTY-FOUR HOUR OBJECTIVE AND THE OUT-OF-SERVICE SAME DAY RESTORAL OBJECTIVE. WOULD YOU COMMENT?

A. YES. MR. POUCHER IS PREMATURE IN REACHING THE CONCLUSION THAT SOUTHERN BELL'S PERFORMANCE ON THE SERVICE EVALUATION WAS UNSATISFACTORY. WITHOUT FIRST REVIEWING SOUTHERN BELL'S RESPONSE TO THE COMMISSION STAFF'S REPORT TO DETERMINE WHETHER SOUTHERN BELL HAS AN EXPLANATION FOR THE DEFICIENCIES, MR. POUCHER'S CRITICISM IS AT LEAST, UNTIMELY. ALSO, MR. POUCHER DOES NOT TELL YOU THAT THE COMPANY RECEIVED AN OVERALL RATING OF SATISFACTORY IN THE WEIGHTED RESULTS OBJECTIVES.

SOUTHERN BELL HAS RECENTLY IMPLEMENTED DRAMATIC CHANGES IN THE METHOD BY WHICH WE PROCESS TROUBLE REPORTS. AS REPORTED IN THE TESTIMONY OF OTHER SOUTHERN BELL WITNESSES, SUCH AS APRIL IVY, SEVERAL OF THESE CHANGES INFLUENCE HOW THE TIME IS CALCULATED ON TROUBLES THAT

ARE OUT-OF-SERVICE OVER 24 HOURS, THE TOTAL NUMBER OF OUT-OF-SERVICE REPORTS, AND THE TIME CALCULATED ON NO ACCESS REPORTS AND CARRIED OVER NO ("CON") REPORTS. THESE CHANGES HAVE CAUSED A SUBSTANTIAL INCREASE IN THE NUMBER OF OUT-OF-SERVICE REPORTS THAT HAVE EXCEEDED 24 HOURS; THEY HAVE INCREASED THE NUMBER OF OUT-OF-SERVICE REPORTS ENTERING THE SYSTEM; AND THEY HAVE PENALIZED THE COMPANY BY INCREASING THE DURATION OF TROUBLE REPORTS BECAUSE THE CUSTOMER WAS EITHER NOT AT HOME OR WAS UNAVAILABLE AT THE TIME WHEN THE COMPANY HAS SCHEDULED REPAIRS.

THESE CHANGES WERE MADE TO IMPROVE THE QUALITY OF OUR SERVICE AND TO ENSURE THAT THERE IS NO PERCEPTION OF IMPROPRIETY IN OUR RESULTS. HOWEVER, THE IMPACT ON OUR REPORTS TO THE COMMISSION HAS BEEN SUBSTANTIAL. CONSEQUENTLY, THE COMPANY MISSES MORE EXCHANGE RESULTS THAN EVER BEFORE. TO OUR CREDIT, HOWEVER, SOUTHERN BELL RECENTLY SCORED AN 85.2% ON THE OUT-OF-SERVICE OBJECTIVE OF 95% EVEN THOUGH WE HAVE MADE THE CHANGES DESCRIBED ABOVE. MR. POUCHER, OF COURSE, FAILS TO MENTION THIS FACT.

ALTHOUGH WE RECOGNIZE THE IMPORTANCE OF THESE INDICES, IT IS IMPERATIVE THAT WE REMEMBER THAT THE TRUE TEST OF

WHETHER WE PROVIDE QUALITY SERVICE IS WHAT OUR CUSTOMERS TELL US. AND WE ARE PROUD OF THE FACT THAT IN RESPONSE TO OUR CUSTOMER SURVEYS, OUR CUSTOMERS TELL US THAT OUR SERVICE IS GOOD.

MR. POUCHER ALSO STATES THAT WE FAILED TO MEET THE OUT-OF-SERVICE RESTORAL SAME DAY OBJECTIVE. AS YOU KNOW, THIS IS NOT A COMMISSION RULE BUT A RECOMMENDED OBJECTIVE. WE HAVE OBJECTED TO THIS BEING INCLUDED IN THE WEIGHTED RESULTS OF THE SERVICE EVALUATION UNTIL THE RECOMMENDATION BECOMES A RULE. IN A LETTER TO MR. ALAN TAYLOR, EXHIBIT-AWT2, I ADVISED THAT THE RECOMMENDATION SHOULD NOT BECOME A RULE BECAUSE IT DUPLICATES THE REPORTING OBJECTIVE THAT IS THE FOCUS OF THE OUT-OF-SERVICE RULE.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

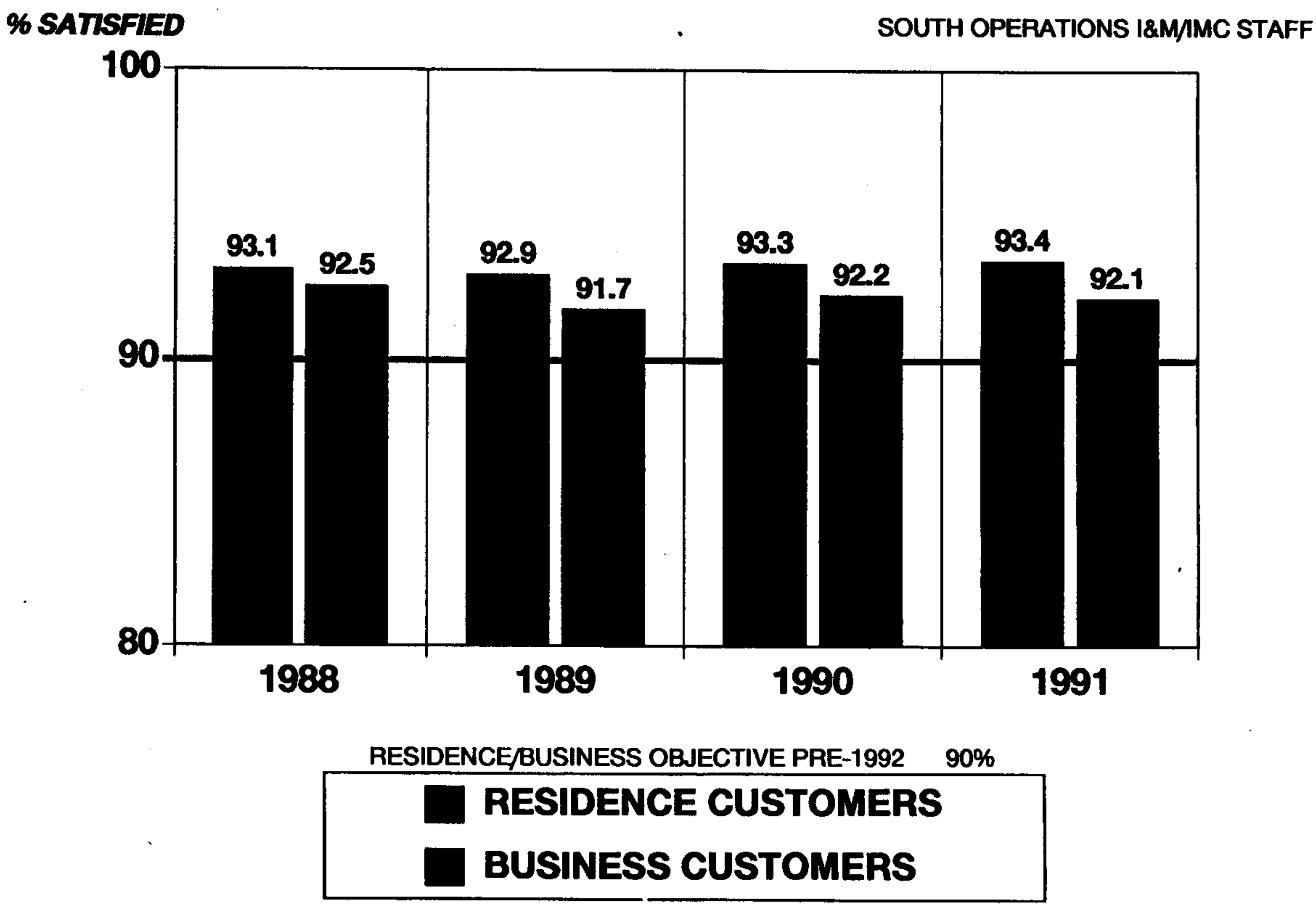
A. YES.

Southern Bell Tel. & Tel. Co.
FPSC Docket 920260-TL
Exhibit No. AWT-1
Page 1 of 1

TELSAM RESIDENCE AND BUSINESS

OVERALL SATISFIED

SOUTHERN BELL 1988 TO 1991



Southern Bell

Suite 400
150 South Monroe Street
Tallahassee, Florida 32301
(904) 222-1201

A. W. "Wayne" Tubaugh
Manager - Network

November 11, 1993

Mr. Alan Taylor, Chief
Bureau of Service Evaluation
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 23299-0850

Dear Mr. Taylor:

During our discussion of the recent service evaluation of BellSouth Telecommunications, Inc., d/b/a Southern Bell in Florida and the associated Weighted Measurement of Quality of Service, I advised you that it was my belief that the items that were not rules, but recommended objectives of the staff, should not be included. In particular I informed you of my concern regarding a specific recommended objective relating to 80% of Out-of-Service (OOS) troubles received before three p.m., cleared the same day.

I have attached a copy of the transcript from the July 21, 1992, agenda session dealing with the Weighted Measurement of Quality of Service Rule, 25-4.080. Although the Commission passed the proposed Rule 25-4.080, F.A.C., it was stated by Mr. McDonald; "That one item, certainly we can go back in the original data and take a look at it, but as far as making it an interim thing, or whatever, until we change the rules, we have got the other docket with the rule changes coming up sometime this year, and then if those rules are approved, we will go back and modify the index." (page 10)

On page 5, I stated that "we thought" we could concur if the measurement included only those OOS troubles received prior to 3 p.m. the same day. As I have stated in correspondence to you since that agenda session we do not believe that the measurement is reasonable and the FPSC already has an OOS measurement to gage a LEC's performance.

The "other docket" considering changes to the current rule and making the FPSC recommended objectives rules, is still on going. My company did not protest the Commissioner's decision because we believed we would have input to the final version of changes to the current rules prior to having to "pass" or "fail" a service evaluation. It would appear from a review of the transcript of the agenda session this was the Commissioner's understanding also.

For the reasons stated above, it is my firm belief that the inclusion of the 50% measurement of OOS troubles received before 3 p.m., cleared the same day, (in the Weighted Measurement portion) as part of staff's current service evaluations inappropriate.

Should you have questions concerning this matter or wish to discuss it further, please contact me at (904) 224-5128.

Sincerely,

Attachment

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
TALLAHASSEE, FLORIDA

IN RE: Proposed Rule 25-4.080, F.A.C, Weighted Measurement of Quality of Service.

DOCKET NO. 910749-TL

BEFORE:	CHAIRMAN THOMAS M. BEARD COMMISSIONER BETTY EASLEY COMMISSIONER J. TERRY DEASON COMMISSIONER SUSAN F. CLARK COMMISSIONER LUIS J. LAUREDO
PROCEEDING:	AGENDA CONFERENCE
ITEM NUMBER:	34**
DATE:	July 21, 1992
PLACE:	106 Fletcher Building Tallahassee, Florida
REPORTED BY:	JANE FAUROT Notary Public in and for the State of Florida at Large

ACCURATE STENOTYPE REPORTERS, INC.
100 SALEM COURT
TALLAHASSEE, FLORIDA 32301
(904) 878-2221

PARTICIPATING:

Wayne Tuba (phonetic), Southern Bell

* * * * * *

STAFF RECOMMENDATIONS

Issue 1: Recommendation that the Commission should propose new Rule 25-4.080, F.A.C., titled Weighted Measurement of Quality of Service and modifications to Rule 25-4.071 titled Adequacy of Service.

Issue 2: Recommendation that this rule should be filed with the Secretary of State for adoption without further Commission consideration if no hearing is requested or comments filed.

Issue 3: Recommendation that after this rule has been filed with the Department of State and becomes effective, this docket should be closed.

P R O C E E D I N G S

CHAIRMAN BEARD: Item 34. The full Commission.

MR. TAYLOR: Good morning, Commissioners, I would like to take this opportunity to introduce Don McDonald. He has been with us sometime, but I believe this is his first agenda presentation to introduce the weighted measurement system.

MR. McDONALD: The weighted measurement system was requested by the Commissioners several years ago, and we contracted with PURC in Gainesville to come up with this index. And what they did, they surveyed the people in the PSC industry, as well as General Services, to determine which of our 66 items that we measure when we do an evaluation are the most important to the customer. And then they assigned a weight to that and based this study on a basic point of 75, which means that if you got every objective right on the money, not above it or below it, you would get 75 points. And then if your results were above or below you would either have points added to that, or points taken away. We have done an analysis of the previous companies that we have evaluated over the last couple of years, and I believe there is two that would fall below the 75 points, one being ALLTEL, and the other one being Northeast. Everybody else fell above that.

We have before you here a copy of the actual index and how we worked it up, and we won't put that in the actual rule, we basically made up a company and showed you what, you can either adjust it upwards or downwards on the thing.

CHAIRMAN BEARD: Do we have parties to be heard, too? Go ahead, I'm sorry.

COMMISSION STAFF: I just want to point out that the index that will actually be noticed in the Florida Administrative Weekly will not have any company results included. And I just want to make sure that -- if you look at the index in your recommendation, just imagine that the company results column is blank, and that is what will actually be published and incorporated by reference.

CHAIRMAN BEARD: Briefly.

MR. TUBA: Yes, sir. My name is Wayne Tuba (phonetic), I represent Southern Bell. At a previous agenda session when this item came up, Office of Public Counsel talked to the Staff and said they had a few problems that they needed to discuss. They did that, and worked them out, it looks like to me a couple of the weightings got tightened up a little bit, which we' really don't have a big problem with, I guess. And the Staff worked real hard with PURC and us in this thing, and we had input to it. One is that we feel that possibly this should be substituted through some other regulation. This is an additional regulation, and we don't have a proposal at this time, but maybe we ought to look at this being a substitute for something that is already out there. Two, they have an out-of-service received, 80 percent of the out-of-service received in a single day should be cleared. We find that a little bit almost impossible to meet. We would think that if out-of-service is received before 3:00 p.m., we would concur that that 80 percent or right around that range would be reachable. I talked to Mr. Taylor about it, and he said he would look into it. In addition, down the road with competition and everything, maybe now would be the time to consider a measurement by the customer to determine whether or not the Company's performance in how we are doing our job and serving them, and that is all our comments.

CHAIRMAN BEARD: Go ahead.

MR. POUCHER: Commissioners, my name is Earl Poucher, Office of Public Counsel. We had originally worked with the Staff on the revisions of this index to solve some of the major problems that were inherent in the first index that we received from PURC. The major problem of the first index was that there was such a gap between the existing Commission rule for central office performance, and that is the top group of categories on the first page of the weighted index. Typically, we went back to the late '70s, and since 1970 not a single company review has resulted in a less dial tone delay than a 99; 99 was the lowest. And every index since the late '70s produced 99 or better for dial tone delay. Dial tone delay is the major indicator in this entire index. It carries a larger weight than any other one item. And our position was that one single measurement ought not to allow a company to pass on this weighted index, while all of the other key measurements might be allowed to fail. We have proposed and agreed with Staff, and there is currently a rule change out in the hands of the companies to increase the dial tone delay standard from 95 to 98.5. This is well within the range of existing performance in dial tone delay.

Also the call completions category has been moved from 95 to 98. Because of the delay in getting that rule implemented, it's not presented to you in this weighted index today. However, the Staff has produced it. It is available, it does not skew the index as the current proposal does, and as previous ones have done.

The modifications that have been made by Staff are in the right direction, but they don't totally solve the problem.

There are basically three problems with this index still. The first one is the weighted index needs to use the proposed measurements which are in the hands of the companies for dial tone performance and central office performance.

Secondly, service availability apparently has a problem that we discovered last Friday, in that the penalty for failure to deliver service within three days is four times less than the penalty or the bonus for a company to make the appointment. We think there is probably a generic error in the program and it simply needs to be reversed. It doesn't make sense that the companies get more credit for making an appointment as opposed to delivering the service.

The third problem, and I think that this will surface when the companies begin to use it, is that just as a single weighted index on the bonus side allows the Company to pass, while perhaps failing in many, many critical areas, a failure in a fairly innocuous measurement could cause the company to fail. As the companies use this index, what they are going to find out is if you have a 95 index goal, you have five points potential for bonus, but you have 95 points potential for penalties. And one single index item could fail the entire company. And that is not really reflective, and it may not be reflective of the overall service of the company. There are only those three changes. And we think that the Staff ought to work on those, there is a current rule change in the works right now. I would suggest that you adopt this proposal on a trial basis, ask the Staff to implement the plan under the proposed new rules for central office performance on a trial basis, and then when these three items are cleared up, then adopt the rule.

COMMISSIONER EASLEY: How do we adopt a rule on a trial basis?

MR. POUCHER: Well, I think that there is a good reason to leave the docket open.

COMMISSIONER EASLEY: How do I adopt a rule on a trial basis and say, okay, you are going to follow this, and then when we get it worked out then propose the rule on a permanent basis? I don't understand how I'm going to do that.

MR. POUCHER: The only other option is to not do anything until the rule and the index is appropriate.

MR. McDONALD: Within the context of how we have to adopt rules, we need to stick with one standard and go ahead and adopt the rule that way. Now, if in another rulemaking proceeding we want to change some of the quality of service standards, of course in that we can also change this rule, again, but it goes through another proceeding.

CHAIRMAN BEARD: Well, I think the actual intent of what Public Counsel is saying, because once we adopt this rule, typically we look at it and things get published, okay, here is the standard that the company is measured by, and they failed. When, in fact, there may be some mechanical problem within the rule that we can repair, and we simply identify at this stage of the game that we are adopting the rule, but there are a couple of areas that need to be looked at, and may need to be cleaned up, maybe a mechanical error somewhere in there that we can fix as part of this second rulemaking proceeding.

MR. McDONALD: I would agree that we can make changes with the index, with the weight factors, but as far as the standards go, the standards that are in this index should be the same standards that are --

CHAIRMAN BEARD: The mechanics are what I think we are talking about here, some potential mechanical problems. I don't know if there are, I don't know if there is a mechanical problem in this, what we talking about, the penalty is four times less if you were late as opposed to making the appointment. That is either an error in the way the calculation is done, or they made an error in the way they did the calculation, I don't know. But it certainly needs to be looked at, because if that is the case, I don't think that is probably the intent but it bears scrutiny.

MR. McDONALD: That one item, certainly we can go back in the original data and take a look at it, but as far as making it an interim thing, or whatever, until we change the rules, we have got the other docket with the rule changes coming up sometime this year, and then if those rules are approved, we will go back and modify the index.

COMMISSIONER BEARD: Sure.

MR. McDONALD: And that has been adjusted to take care of some of the problems that Public Counsel has mentioned in that we have reduced the weighting factors for those central offices.

CHAIRMAN BEARD: I think Public Counsel is trying to bring some things to our attention that they see as potential, and they have already said that some of them look like they are being corrected, if they come through that process.

MR. McDONALD: We don't doubt --

CHAIRMAN BEARD: I don't think we have any disagreement here at all, at least not in this docket. Now we may when we get to the next one on the standards, I don't know.

COMMISSIONER CLARK: Is it appropriate to move Staff, then?

CHAIRMAN BEARD: I would think so.

COMMISSIONER CLARK: Okay. I so move.

CHAIRMAN BEARD: We have a motion. Any objections? Hearing none, Item Number 34 is approved.

* * * * * * * * * *

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, JANE FAUROT, Court Reporter, Notary Public in and for the State of Florida at Large:

DO HEREBY CERTIFY that the foregoing proceedings was taken before me at the time and place therein designated; that before testimony was taken the witness/witnesses were duly sworn; that my shorthand notes were thereafter reduced to typewriting; and the foregoing pages numbered 1 through 11 are a true and correct record of the proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor relative or employee of such attorney or counsel, or financially interested in the foregoing action.

WITNESS MY HAND AND SEAL this 27th day of July, 1992, in the City of Tallahassee, County of Leon, State of Florida.

Jane Faurot

JANE FAUROT, Court Reporter
Notary Public in and for the
State of Florida at Large

My Commission Expires: July 16, 1993

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY

TESTIMONY OF WILLIAM P. ZARAKAS

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

DECEMBER 10, 1993

Q: **Please state your name, title, employer, and address.**

A: My name is William P. Zarakas. I am a Director with the management consulting firm of Theodore Barry & Associates (TB&A). My business address is 50 Rockefeller Plaza, Suite 1035, New York, New York 10020.

Q. **Please state your education and related professional experience.**

A. I have a bachelor's degree with a concentration in economics from the State University of New York and a master's degree in economics from New York University. I also have completed courses and seminars in utility regulation, including the annual program and the advanced course in regulation sponsored by the National Association of Regulatory Utility Commissioners (NARUC), and have been an instructor for courses and seminars on various aspects of utility planning and regulation, including NARUC training sessions.

I have been employed by TB&A since 1988, becoming a Managing Associate in 1990, and a Director in 1993. At TB&A, I have provided consulting services to regulatory commissions and electric, gas, and telecommunications companies on a variety of management issues. I was TB&A's lead consultant and project manager on the incentive regulation-focused management audits of Alabama Power Company and Alabama Gas Corporation conducted for the Alabama Public Service Commission. I was also TB&A's lead consultant responsible for assessing whether the South Central Bell - Kentucky incentive regulation plan had met the objectives of the Kentucky Public Service Commission. I was TB&A's lead consultant responsible for assessing business planning for the potential performance gains study of New York Telephone Company that was conducted for the New York Public Service Commission. Last year, I testified before the Tennessee Public Service Commission concerning trends and issues in alternative forms of LEC regulation.

Prior to my employment with TB&A, I was employed as an economist by the New York Power Authority (NYPA), a wholesale power provider. At NYPA, I was involved in the regulation of 51 municipal and cooperative wholesale power customers. Prior to my employment with NYPA, I was a consultant for Ebasco Business Consulting Company (EBCC), a wholly owned subsidiary of Ebasco Services, Inc.

Q. **Please describe TB&A's qualifications in the area of regulatory policy analysis and alternative regulatory frameworks.**

A. TB&A is a general management consulting firm founded in 1954. The majority of TB&A's practice areas are focused on management issues pertaining to regulated utilities in the telecommunications, electric, gas, and water industries. TB&A has conducted over 1,600 engagements, including engagements for regulatory authorities, such as public service commissions, and regulated service providers. Our engagements have addressed numerous management issues, and typically involve regulatory policy analyses, strategic planning and marketing studies, organizational effectiveness reviews, management audits, and operational improvement studies.

TB&A conducts ongoing research and analyses regarding the evolution of regulatory policy and practices in the utility industry and has performed extensive reviews of alternative forms of regulation applicable to telecommunications and energy matters. In telecommunications, TB&A has conducted reviews of the state-specific incentive regulation plans used by the Alabama and Kentucky Public Service Commissions in regulating South Central Bell. These analyses were undertaken by the Commissions in order to better understand the impacts of "experimental" alternative regulation plans and to consider the framework for a renewal of these plans. TB&A has also recently addressed various issues related to alternative regulatory frameworks on behalf of BellSouth before the Louisiana and Tennessee Public Service Commissions.

Q. **Please state the purpose of your testimony.**

A. The purpose of my testimony is to rebut portions of the testimony filed by witnesses who testified on behalf of the Florida Office of Public Counsel (OPC) recommending that the Florida Commission abandon the alternative regulatory framework applied to BellSouth Telecommunications, Inc. ("Southern Bell").

Q. **Please summarize your testimony.**

A. The Florida Commission should not abandon the earnings sharing plan applied to Southern Bell. The OPC's witnesses based their conclusions on a coincidental correlation between the introduction of an alternative regulatory framework and Southern Bell performance, in general, and the conduct of a few Southern Bell employees, in particular. The relationships that they cited are more casual than causal and should not be used as the basis for abandoning the current earnings sharing plan.

The four key points of my testimony can be summarized as follows:

- First, comparative analysis shows that alternative regulatory frameworks applied to local exchange companies are rapidly becoming the regulatory norm, rather than the exception. Among such alternative regulatory frameworks, earnings sharing plans, similar to the Florida plan, represent a relatively conservative approach.

- Second, after the expiration of the initial plan, the vast majority of commissions have elected to continue the application of an alternative regulatory framework, rather than abandon the concept and return to traditional rate-of-return regulation. On balance, any concerns that commissions have had regarding alternative regulation have been outweighed by the associated benefits, and commissions have opted to continue the application of these plans.

- Third, in theory, alternative forms of regulation represent an approach to regulating an industry in transition, somewhere in-between full monopoly service, under which traditional rate-of-return regulation is typically applied, and a competitive environment, in which the market determines fair prices and returns reflect performance. An alternative form of regulation more closely mirrors the effects of the current, transitionally competitive, environment than does traditional cost-plus regulation and as such is a more appropriate regulatory framework today.

- Fourth, the correlation of a single management action -- positive or negative -- with the regulatory framework is subject to considerable debate and should not be used as the basis for abandoning earnings sharing regulation. Empirical studies of the impact of alternative forms of regulation on a local exchange company's (LEC's) management decisions suggest that it is difficult to separate the individual effects of the various key driving factors -- such as competition, technology, and regulatory framework -- underlying the LEC's management processes and results.

Q. **Please describe the organization of your testimony.**

A. My testimony is organized into three sections, summarized as follows:

- The first section of my testimony presents an overview of trends in the regulation of LECs by state regulatory commissions. Included in this overview are:

- TB&A's classification of alternative forms of regulation and a summary of the types of regulation adopted by the various state regulatory commissions

- A discussion of the regulatory framework issues and decisions made by commissions when alternative regulatory plans have come up for review

- Conclusions regarding trends in the regulation of LECs.

• The second section of my testimony addresses the theoretical and empirical effects of alternative regulatory frameworks on LEC management and performance.

• The third section of my testimony provides a summary and my recommendation that the Florida Commission not abandon the application of an alternative regulatory framework to Southern Bell.

REGULATORY TRENDS

Q. What are your primary findings regarding regulatory frameworks applied by state commissions to LECs ?

A. In general, state regulatory commissions have recognized that the telecommunications industry is in a transitional stage. A clear majority of state regulatory commissions have consequently adopted alternative regulatory frameworks as the basis for their regulation of the major LECs under their jurisdiction. Since their introduction, alternative regulation plans have become the norm, rather than the exception.

I base this conclusion on a review of the empirical evidence. A clear majority of commissions have adopted alternative regulatory frameworks and, when the plans were up for review after the initial trial period, the majority of commissions elected to continue applying an alternative form of regulation. When assessing the success of the plan, commissions found that, on balance, the plans were successful and advanced commission objectives.

Q. **How many state jurisdictions currently apply alternative regulation to the LECs under their jurisdiction?**

A. Based on our review, 30 state regulatory commissions currently have a form of alternative regulation that is applied to one or more local exchange carriers under their jurisdiction. In addition, nine state commissions which currently apply traditional rate-of-return regulation are considering proposals to apply alternative regulatory frameworks to LECs.

Q. **Briefly describe TB&A's classification of alternative regulatory frameworks.**

A. Although any classification methodology risks over-simplifying the differences among the various alternative regulatory frameworks, we have observed four types of plans, ranging from plans that allow some level of tariff pricing flexibility in combination with continued earnings regulation, to price regulation plans that regulate prices alone rather than earnings.

PRICE FLEXIBILITY

The price flexibility plan typically offers the LEC the opportunity to price certain non-basic or discretionary services with varying degrees of flexibility, often in combination with a "freeze" on the rates for basic services. In theory, the addition of pricing flexibility to earnings regulation permits the LEC to respond to competition in certain service offerings. In the price flexibility category, TB&A has also included rate stabilization plans when these plans do not provide earnings sharing mechanisms, and Vermont's "social contract" plan. The financial incentives associated with these plans are usually not different from those found under traditional rate-of-return regulation, with the commission regulating earnings.

EARNINGS SHARING

Under an earnings sharing plan, the commission continues to regulate earnings. Using this approach, the commission typically determines a target rate-of-return and sets a range of returns called a neutral range. At predetermined dates of review (points of test), the LEC's return is calculated, with earnings above or below this range being "shared" between the company and the customers. The percentage and disposition of sharing is also determined by the commission.

Under an earnings sharing plan, operating efficiencies and successful new service introductions implemented by LEC management are rewarded by sharing earnings above the target range of returns with the customer. Thus, a company that responds innovatively to changing business conditions has the opportunity to earn additional returns. Likewise, when a LEC earns below the target range, the LEC and customers share in making up the deficiency.

The earnings sharing plan, such as the current Florida plan, is the most widely adopted alternative form of regulation.

PRICE REGULATION / PARTIAL DEREGULATION

The third type of alternative regulatory framework includes price regulation plans and plans under which the commission has deregulated the pricing of certain telecommunications services. Under price regulation plans, commissions regulate prices of certain telecommunications services rather than earnings, usually setting a starting point for the price of a service (often the existing price) and adjusting prices over time through a predetermined formula incorporated in a price cap mechanism. The formula varies across jurisdictions; however, it usually includes factors for inflation, productivity, and other exogenous economic events. When commissions partially deregulate telecommunication services, the LEC is typically given pricing discretion for services which are considered "competitive." In both of these approaches, the commissions continue to regulate other aspects of LEC operations, notably service levels.

HYBRID

The fourth type of alternative regulatory framework is a "hybrid" of an earnings sharing plan and price regulation. In these cases, although certain classes of service are governed by the provisions of a price regulation plan, commissions have incorporated an earnings sharing overlay as a regulatory "safeguard." As discussed above, price regulation adjusts the prices of services over time, while the earnings sharing overlay shares the results between the customer and the company.

Q. **How do the various state plans fit into TB&A's classification system?**

A. A state-by-state summary is included as Exhibit WPZ-1. At present, the earnings sharing plan is the most commonly adopted alternative regulatory framework, with 17 plans currently in place. Additionally, ten commissions have adopted price regulation or hybrid plans or have partially deregulated the provision of telecommunication services.

Q. **In how many instances has a state regulatory commission reviewed an alternative regulatory framework at the conclusion of its initial term and what action did they chose to take?**

A. In 19 cases, including Florida's plan, the initial term of an alternative regulatory framework has elapsed. This is shown in Exhibit WPZ-2. The clear majority of these plans have been renewed either as is, or with minor modifications, or the commission has adopted a revised form of alternative regulation. To date, commissions have elected to continue application of an alternative regulatory framework in 14 of the 19 cases. In one of the 14 -- New York Telephone -- rate-of-return regulation was reapplied after the initial plan expired; subsequently, the Commission applied an alternative regulatory plan, which is in effect today.

Two jurisdictions have neither renewed nor terminated their alternative regulatory frameworks. In those cases -- Maine and Florida -- LECs continue to operate under an alternative regulatory framework, as the commissions consider renewal. In Maine the plan technically has expired, while in Florida this Commission temporarily extended the plan pending the results of this proceeding. Commissions have elected to terminate alternative regulatory plans in only three cases.

In two additional cases not included in the 19 cases that I identified earlier -- South Carolina and Illinois -- state courts have ruled that existing laws did not authorize the Commissions to pursue alternative regulatory frameworks. In both cases, although neither the Commission nor the company opted to terminate the plan, the court decision nullified the plan. In the case of Illinois, subsequent legislation granted the Illinois Commerce Commission (ICC) authority to approve alternative regulatory plans. The ICC is currently considering a price regulation proposal applicable to Ameritech. To date, to my knowledge there has been no related legislative activity in South Carolina.

Q. **Please comment on the instances when commissions opted to terminate their alternative regulatory framework and go back to traditional rate-of-return regulation.**

A. As I stated earlier, commissions have elected to terminate alternative regulatory plans in only three cases: Connecticut, Delaware, and New Mexico. In all three cases, the facts would suggest that the commissions have not abandoned the concept of alternative regulation.

In Delaware, Bell Atlantic operated under an alternative regulatory plan from 1988 to 1990, and at present is operating under traditional rate-of-return regulation. Currently, the Delaware Commission is considering a price regulation plan.

In Connecticut, Southern New England Telephone recently returned to rate-of-return regulation after operating under an earnings sharing plan since 1987. However, in its July 1993 orders, the Connecticut Department of Public Utility Control found that the development of price regulation in Connecticut was warranted and endorsed "the concept of price cap regulation," but left the implementation of such a framework to a future proceeding.

In New Mexico, US West has recently chosen to return to traditional rate-of-return regulation after its alternative regulatory plan expired.

Arguably, there is a fourth case of termination. In New York, NYNEX did not pursue renewal of the 1987 alternative regulatory framework when the plan expired. I have included this case as one of the 14 instances in which an alternative regulatory framework was renewed because subsequently, in 1992, the Commission adopted an interim earnings sharing plan for NYNEX while the Commission considers other alternatives.

Q. **What benefits associated with alternative regulatory frameworks have commissions generally cited during the review of a plan's initiation or renewal?**

A. Commissions in general have looked to the alternative regulatory framework as a means to achieve an orderly transition to an industry increasingly characterized by growing competition. In most alternative regulatory frameworks, the LEC's financial success is tied to the cost effectiveness of its operations, investments, and marketing. Under this framework, the LEC bears the risk of increased costs as well as shares in the rewards of enhanced productivity, prudent investments, and effective response to customers. Commissions have recognized numerous specific areas of benefit resulting from the application of alternative regulation to LEC(s) under their jurisdiction. Primarily, commissions have anticipated that alternative regulatory frameworks will, in part, alleviate the economic disincentives inherent in traditional rate-of-return regulation, including: the disincentive for optimal (from a ratepayer perspective) investment; the disincentive to improve operating efficiencies; and the disincentive to enhance service offerings to meet customer needs. Thus, commissions anticipate that the benefits of an incentive regulation plan will include:

- Reduced rates due to LEC cost reductions
- Smaller and more timely rate adjustments
- Enhanced service offerings and responsiveness to customers
- Capital investment based on current and future customer needs, as opposed to building rate base
- Acceleration of technology and network improvements
- Enhanced regulatory efficiencies and resource allocations on the part of LECs and commission staff

- Enhanced communications between staff and the company by removing the litigious and sometimes confrontational atmosphere surrounding rate cases

- Improved staff knowledge of LEC operations and financial performance, resulting in more effective regulation

- Promotion of a competitive LEC culture.

Q. **Are there clear trends regarding the regulatory framework applied to LECs?**

A. Yes. With respect to their application to LECs, alternative regulation plans have become the regulatory norm rather than the exception, with earnings sharing plans now a relatively conservative alternative regulatory framework. Additionally, price regulation plans are increasingly on the agendas of commissions. As shown in Exhibit WPZ-3, eight commissions which are operating under traditional rate-of-return regulation are reviewing price regulation plans, compared to one that is considering an earnings sharing plan.

Recognizing that improving the regulatory framework is a continuous process, commissions are currently seeking to balance the various elements of alternative regulation in a framework that matches the particular needs of their jurisdiction. Rather than abandoning trial plans, commissions have made these plans part of the regulatory structure. In most cases, plans have routinely been renewed with only minor modification. In other cases, plans more akin to price regulation plans have replaced original earnings-based incentive plans. Particular concerns that commissions may have, whether triggered by the economy, industry structure, or company-specific issues, are most frequently addressed within the context of the alternative regulatory framework rather than by returning to traditional rate-of-return regulation.

THEORETICAL AND EMPIRICAL IMPACTS

Q. To your knowledge, have any commissions conducted focused analyses regarding the impact that an alternative regulation plan has had on LEC performance?

A. Yes, to my knowledge, at least two Commissions -- Alabama and Kentucky -- conducted focused analyses of the impact of their earnings sharing plans on LEC performance. Both of these studies were conducted by TB&A on behalf of the Commissions. Although performance data were reviewed, it was our opinion -- and that of the sponsoring Commissions -- that econometric analyses would be interesting but suspect, due to the multiple potential causal factors beyond the regulatory framework.

The approach chosen in both of these engagements was to review the LEC management decision-making process. Understanding how decisions were made allowed us to determine the key factors driving LEC management, including the regulatory framework. In fact, numerous drivers were identified, ranging from short-term performance targets to drivers associated with competition, many of which were closely inter-related. Although the company pointed to isolated improvements, which arguably could have resulted from a change in regulatory framework, we found it difficult to separate the impact of alternative regulation from other factors affecting management decision-making in those cases. In both of these studies, TB&A found no indication that the alternative regulatory framework resulted in management responses that were detrimental to ratepayers.

Lack of empirical evidence does not imply that alternative regulatory frameworks should be abandoned. As I discuss below, adoption of an alternative framework is theoretically sound. It is interesting to note that the two Commissions that conducted management audits focusing on the impact of alternative regulatory frameworks on LEC management performance -- Alabama and Kentucky -- elected to continue applying the plans. Both Commissions considered the results of the management audits, which could identify no clearly attributable positive or negative impacts, together with the opinions, comments, and concerns of staff, the LEC, and intervenors. In supporting the renewal of these plans, the Commissions cited both concern over the suitability and effectiveness of rate-of-return regulation in the increasingly complex telecommunications environment and the opportunity afforded by the alternative regulation plans to enhance the long-run interests of ratepayers and the company.

Q. **In your opinion, do incentive regulation plans, like the current plan in Florida, promote operating efficiencies on the part of LECs?**

A. Yes. As I discussed earlier, there is no clear empirical evidence on which to base a conclusion, so any analysis must rely on theory and common sense. Both suggest that when a regulatory incentive is congruent with other drivers of management behavior that also encourage efficiencies -- most notably competition in selected markets at present and the threat of broad-based competition in the near future -- management efficiencies will be promoted.

Conversely, if a regulatory framework conflicts with such long-term drivers, inefficiencies will be encouraged. The issue is largely one of congruency. Optimally, short-term objectives should complement long-term objectives -- in this case, to become more competitive. With traditional rate-of-return regulation providing disincentives to management efficiency as well as an impetus for the uneconomic growth of rate base, a company is encouraged, in the short-term, to act in a manner inconsistent with its long-term objectives. Under an alternative regulatory framework, incentives reward, to varying degrees, the management behavior necessary to effectively compete. This finding is no surprise, as traditional rate-of-return regulation was designed to regulate a monopoly, not an industry in transition.

Q. **How are the incentives included in Florida's earnings sharing plan congruent with long-term objectives?**

A. In general, the incentives in the Florida earnings sharing plan are congruent with both the Commission's and the company's objectives of increased operational efficiencies, responsiveness to customers, marketing effectiveness, and more focused investment. By expanding the rate of return range, the Florida plan rewards such management behavior as responsiveness to customer wants and needs and implementation of related investment strategies, not just building of rate base, irrespective of customer needs. Thus, the Florida plan benefits both customers and the company. By continuing to apply an alternative regulatory framework, the Commission will be sending a consistent signal to the company, enhancing the ability of Southern Bell to operate more efficiently and responsively to the marketplace in the near and long-term. Customers benefit by receiving the services that are demanded at prices reflecting cost effective operations; the company benefits by being able to more effectively respond to customer needs and position itself to meet current and future competitive threats.

Q. **Have Messrs. Poucher's and Stewart's testimony demonstrated the impact of incentive regulation on Southern Bell?**

A. No. Messrs. Poucher and Stewart both recommend that the Florida plan be abandoned by the Commission, but come to their conclusion from different angles. Mr. Poucher attempts to show a relationship between inappropriate management actions and the introduction of the incentive plan, while Mr. Stewart shows that there is no relationship between Southern Bell performance and the introduction of the plan. It appears that their conclusions are somewhat at odds rather than being complementary. Mr. Poucher believes that the earnings sharing plan caused inappropriate management actions and deterioration of service quality. The occurrences cited in Mr. Poucher's testimony do not demonstrate a correlation between these events and the introduction of an alternative regulatory framework, and certainly do not demonstrate cause and effect.

Mr. Stewart concluded that he sees no causal effect between the introduction of an alternative regulatory framework and Southern Bell operating efficiencies. I have not reviewed Mr. Stewart's data and calculations. However, assuming that his calculations are correct, which I understand are disputed by Southern Bell's witness Walter Reid, I still must disagree with Mr. Stewart's conclusion and ultimately his recommendation. While Mr. Stewart attempted to normalize for regional factors by using a Florida-specific industry panel, his analysis is simply a comparison of who's doing the best job with respect to the specific benchmarks chosen. It does not represent cause and effect. A causal analysis would require inclusion of the many factors driving management decisions and isolating the specific impact of the earnings sharing plan. By drawing a conclusion based on his peer comparison, Mr. Stewart has misrepresented the effectiveness of the Florida earnings sharing plan. Even assuming his analysis was appropriate, I disagree with Mr. Stewart's recommendation that the Commission abandon the Florida plan.

Q. Do you agree with Mr. Poucher's assertion that the introduction of incentive regulation by the Florida Commission, in 1988, resulted in inappropriate Southern Bell management actions in order to optimize the benefits that could accrue to the company under the earnings sharing plan?

A. No. Prior to answering this question, I must note that I have no knowledge whether or not the basic underpinnings of Mr. Poucher's testimony are true. However, even if I assume that Mr. Poucher is correct in his allegations regarding the actions of several Southern Bell managers, I must still disagree with his conclusion. First, the timing cited by Mr. Poucher does not corroborate his conclusion. Mr. Poucher correlates inappropriate management actions on the part of Southern Bell employees with the introduction of incentive regulation while he shows (on page 5 of his testimony) that both falsification of repair records and fraudulent and abusive sales were taking place as early as 1985, years before the introduction of incentive regulation. Second, as I discussed earlier, many factors are influencing management decisions in telecommunications today. Regulatory concerns reflect only one factor among many, including technological advances and competitive threats and alliances. It is difficult to determine whether any management action - positive or negative - is the result of any single factor.

Third, as is the case in most large organizations, cultural change at Southern Bell cannot be accomplished instantaneously. It would certainly take Southern Bell management time to determine how to act to optimize the benefits to the company under an alternative regulatory framework and, once they had determined how to act, to implement their decisions throughout the organization. With such a considerable "ramp-up" time, it is highly unlikely that negative management actions would occur simultaneously with the implementation of the earnings sharing plan, irrespective of the plan's incentives.

SUMMARY & CONCLUSION

Q. **Please summarize your testimony.**

A. The witnesses for the OPC showed only a coincidental and imperfect relationship between the application of an alternative regulatory framework and Southern Bell management performance. Their evidence is not grounds for the Florida Commission to abandon the current earnings sharing plan.

Alternative regulatory frameworks are generally accepted by commissions as an appropriate regulatory response in the current transition to a competitive telecommunications industry, and Florida's earnings sharing plan represents a relatively conservative form. Empirically assessing the impact of a regulatory framework on performance is indeed difficult. To a large extent, however, separating the numerous factors driving Southern Bell's management decisions is an academic exercise. As a practical matter, the incentives incorporated in the earnings sharing framework acknowledge the changing telecommunications operating environment and reward or penalize management in the near-term for actions they take. These incentives are congruent with both this Commission's and Southern Bell's long-term objectives of preparing the LEC to becoming increasing competitive. In my opinion, the Florida Commission should continue its application of an alternative regulatory framework, addressing its concerns, if any, within the context of the plan, rather than abandoning the earnings sharing plan.

Q. **Does this conclude your testimony?**

A. Yes.

Alternative Regulatory Frameworks Currently Applied
(November 1993)

Regulatory Plan	*Number*	*State*	*Company*
PRICE FLEXIBILITY	4	KANSAS	SOUTHWESTERN BELL
		VERMONT	NYNEX
		VIRGINIA	BELL ATLANTIC
		WISCONSIN	AMERITECH
EARNINGS SHARING	17	ALABAMA	BELLSOUTH
		COLORADO	US WEST
		DIST COLUMBIA	BELL ATLANTIC
		FLORIDA	BELLSOUTH
		GEORGIA	BELLSOUTH
		IDAHO [1]	US WEST
		KENTUCKY	BELLSOUTH
		LOUISIANA	BELLSOUTH
		MARYLAND	BELL ATLANTIC
		MINNESOTA	US WEST
		MISSOURI	US WEST
		MISSISSIPPI	BELLSOUTH
		NEVADA	US WEST
		NEW YORK [2]	NYNEX
		TENNESSEE	BELLSOUTH / GTE
		TEXAS	SOUTHWESTERN BELL
		WASHINGTON	US WEST
PRICE REGULATION / PARTIAL DEREGULATION	5	MICHIGAN	AMERITECH
		NEBRASKA	US WEST
		NORTH DAKOTA	US WEST
		SOUTH DAKOTA	US WEST
		WEST VIRGINIA	BELL ATLANTIC
HYBRID	5	CALIFORNIA	PACIFIC TELESIS / GTE
		NEW JERSEY	BELL ATLANTIC
		NEW YORK [2]	ROCHESTER TELEPHONE
		OREGON	US WEST
		RHODE ISLAND	NYNEX
Total -- Commissions Applying Alternative Regulatory Frameworks	30 [2]		

1 The Idaho plan is a "revenue sharing" plan, similar to the more commonly applied earnings sharing plans.

2 The New York Commission currently applies different alternative frameworks to two LECs in its jurisdiction: an earnings sharing plan is applied to New York Telephone and a hybrid plan is applied to Rochester Telephone, resulting in a sum of 31 plans in 30 jurisdictions.

Exhibit WPZ-2

Renewal Actions
Alternative Regulatory Frameworks
(November 1993)

Regulatory Plan	*Number*	*State*	*Company*
PLAN RENEWALS	14	ALABAMA	BELLSOUTH
		IDAHO	US WEST
		KENTUCKY	BELLSOUTH
		MARYLAND	BELL ATLANTIC
		MICHIGAN	AMERITECH
		MISSOURI	US WEST
		MISSISSIPPI	BELLSOUTH
		NEW JERSEY	BELL ATLANTIC
		NEW YORK	NYNEX
		RHODE ISLAND	NYNEX
		TENNESSEE	BELLSOUTH / GTE
		VERMONT	NYNEX
		WEST VIRGINIA	BELL ATLANTIC
		WISCONSIN	AMERITECH
TEMPORARY RENEWAL	2	FLORIDA	BELLSOUTH
		MAINE	NYNEX
PLAN TERMINATION	3	CONNECTICUT	SNET
		DELAWARE	BELL ATLANTIC
		NEW MEXICO	US WEST
Total -- Commission Renewal Action	**19**		

Exhibit WPZ-3

Proposed Alternative Regulatory Frameworks
(November 1993)

Regulatory Plan	*Number*	*State*	*Company*
PROPOSED PRICE REGULATION / PARTIAL DEREGULATION	10	ARIZONA	US WEST
		ARKANSAS	SOUTHWESTERN BELL
		CONNECTICUT	SNET
		DELAWARE	BELL ATLANTIC
		ILLINOIS	AMERITECH
		INDIANA	AMERITECH
		OHIO	AMERITECH
		PENNSYLVANIA	BELL ATLANTIC
		WISCONSIN [1]	AMERITECH
		VERMONT [1]	NYNEX
PROPOSED EARNINGS SHARING	1	IOWA	US WEST

1 Wisconsin and Vermont currently apply an alternative regulatory framework to Ameritech and NYNEX, respectively. These proposals represent changes to the current framework.