

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of SOUTHERN BELL	)	DOCKET NO. 880069-TL
TELEPHONE AND TELEGRAPH COMPANY for	)	
rate stabilization and implementation	)	ORDER NO. 23813
orders and other relief.	)	
<hr/>		ISSUED: 11-27-90

Pursuant to Notice, a Prehearing Conference was held on November 7, 1990, in Tallahassee, Florida, before Commissioner Michael McK. Wilson, as Prehearing Officer.

APPEARANCES:

HARRIS R. ANTHONY, Esquire, Suite 1910, 150 West Flagler Street, Miami, Florida 33130 and R. DOUGLAS LACKEY and LEN S. ANTHONY, Esquires, 4300 Southern Bell Center, 675 West Peachtree Street, Atlanta, Georgia, 30375, on behalf of Southern Bell Telephone and Telegraph Company.

RICHARD FLETCHER, Class B, GTE Florida Incorporated, Post Office Box 110 MC 7, Tampa, Florida 33601-0110, on behalf of GTE Florida Incorporated.

MICHAEL W. TYE, Esquire, AT&T, 106 East College Avenue, Suite 1410, Tallahassee, Florida 32301, on behalf of AT&T Communications of the Southern States, Inc.

RICHARD D. MELSON, Esquire, Post Office Box 6526, 123 South Calhoun Street, Tallahassee, Florida 32314 and MICHAEL J. HENRY, Esquire, MCI Telecommunications Corp., 400 Perimeter Center Terrace, N.E., Suite 400, Atlanta, Georgia 30346, on behalf of MCI Telecommunications Corporation.

FLOYD R. SELF, Esquire, Messer, Vickers, Caparello, French, Madsen & Lewis, P.A., 215 South Monroe Street, Suite 701, Tallahassee, Florida 32302-1876, on behalf of US Sprint Communications Company Limited Partnership.

JOSEPH A. MCGLOTHLIN, Esquire, Lawson, McWhirter, Grandoff & Reeves, 522 East Park Avenue, Suite 200, Tallahassee, Florida 32301, on behalf of Florida Interexchange Carriers Association.

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STEPHANIE K. WALSH, Esquire, Regulatory Law Office, Office of The Judge Advocate General, Department of the Army, DAJA-RL 3657, 901 North Stuart Street, Arlington, Virginia 22203-1837, on behalf of The Department of Defense and All Other Federal Executive Agencies.

JACK SHREVE and CHARLES J. BECK, Esquires, Office of Public Counsel, c/o The Florida Legislature, 111 West Madison Street, Room 812, Tallahassee, Florida 32399-1400, on behalf of the Citizens of the State of Florida.

TRACY HATCH, Esquire, Florida Public Service Commission, 101 E. Gaines Street, Tallahassee, Florida 32399-0863, on behalf of the Commission Staff.

DAVID E. SMITH, Esquire, Florida Public Service Commission, 101 E. Gaines Street, Tallahassee, Florida 32399-0862, on behalf of the Commissioners.

#### PREHEARING ORDER

##### I. BACKGROUND

On January 13, 1988, Southern Bell Telephone and Telegraph Company (Southern Bell) filed two petitions with the Commission. The first, Petition for Rate Stabilization Order and Other Relief, summarized Southern Bell's proposal, and the second, Petition for Implementation Order and for Other Relief, detailed the actual rate changes and revenue impact of the proposed changes.

The petitions proposed certain new regulatory parameters for Southern Bell. Among the principal points, the Company proposed the following: 1) retain 50% of earnings between 15% (the midpoint of Southern Bell's then authorized return on equity) and Southern Bell's maximum authorized return on equity of 16%. (earnings above 16% after sharing would all inure to the ratepayers' benefit); 2) freeze local residential rates for 1988, 1989 and 1990; 3) implement a system of flexible pricing for discretionary or competitive services; 4) reduce access charges through reductions in the busy hour minutes of capacity (BHMOC) charge; 5) waive the statewide uniform toll rate rule and reduce message toll rates and WATS/800 service rates; 6) offer optional discounted toll plans on

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twenty-nine high-volume intraEAEA routes; and 7) implement the federal Link-Up Florida plan.

The pricing flexibility issue was deleted from consideration in this proceeding by Order No. 19070 and deferred to Docket No. 871254-TL, the Commission's investigation into regulatory flexibility for local exchange companies (LECs). Rule 25-4.034, Florida Administrative Code, was amended to remove the uniform toll rate requirement, thus obviating the need for a rule waiver.

By Order 20162 the Commission announced its decision on the issues raised by Southern Bell's rate stabilization petitions. The Commission expanded the authorized range of return on equity to a minimum of 11.5% and a maximum of 16%. Within the expanded range the Commission also implemented an earnings sharing plan. Any earnings in excess of 14% is to be shared with 60% being given to Southern Bell's ratepayers and the other 40% retained by the Company. All earnings in excess of 16% are returned to the ratepayers. In addition, earnings stemming from certain exogenous factors were excluded from the sharing process. In the course of resetting the authorized range of earnings we also established a new rate base, NOI and capital structure.

The Commission also reset certain of Southern Bell's rates at a level to achieve a 13.2% rate of return on equity. The 13.2% return was also intended to serve for other regulatory purposes including IDC calculations. The rate setting point was implemented through reductions to certain rates and the elimination of certain other rates. The rates for the BHMOC charge, OUTWATS, 800 Service, MTS and local residential service were reduced. We also restructured DID rates and eliminated station line lease charges, two- and four-party service and zone charges. In addition we also implemented the Company's optional extended area service (OEAS) plan on numerous routes.

In the rate setting process we set aside approximately \$10 million to cover the implementation of OEAS. We also set aside approximately \$17.1 million of 1989 earnings and \$147.7 million of 1990 revenues to fund depreciation. OEAS has been implemented on numerous routes listed in Order No. 20162 as well as others coming to our attention since. The final resolution as to the appropriate amount of depreciation expense for 1989 and 1990 is pending.

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By Order No. 20162 the rate stabilization plan is set to expire on December 31, 1990. By Order No. 23193 the Commission determined to reexamine whether the rate stabilization plan should be continued and set the issues set forth in detail below for hearing. Public Counsel filed a notice of appeal of Order No. 23193. On November , 1990, Public Counsel filed a motion of dismissal of appeal.

## II. TESTIMONY AND EXHIBITS

Upon insertion of a witness's testimony, exhibits appended thereto may be marked for identification. After opportunity for opposing parties to object and cross-examine, the document may be moved into the record. All other exhibits will be similarly identified and entered at the appropriate time during hearing. Exhibits shall be moved into the record by exhibit number at the conclusion of a witness's testimony.

Witnesses are reminded that on cross-examination, responses to questions calling for a yes or no answer shall be answered yes or no first, after which the witness may explain the answer.

## III. ORDER OF WITNESSES

<u>WITNESS</u>	<u>APPEARING FOR</u>	<u>DATE</u>	<u>ITEM</u>
David B. Denton	So. Bell	11/30	Issues 1, 2, 3, 4 and 7
Walter S. Reid	So. Bell	11/30	Issues 5 and 6. Mr. Reid will also rebuttal to witness Hugh Larkin and witness Charles King
Charles W. King	DOD/FEA	11/30	Issues 1, 3, 4, 7
Mike Guedel	AT&T	11/30	Issues 1 and 8

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<u>WITNESS</u>	<u>APPEARING FOR</u>	<u>DATE</u>	<u>ITEM</u>
Joseph Gillan	FIXCA	11/30	Issues 1, 2, 5, 6, 7 and 8
Hugh Larkin, Jr.	OPC	11/30	Issues 2-4
James Vander Weide	So. Bell	11/30	Issue 2
Mark Cicchetti	OPC	11/30	Issue 2

#### IV. BASIC POSITIONS

SO. BELL'S BASIC POSITION: In Order No. 20162 the Florida Public Service Commission recognized that:

The telecommunications industry has been and continues 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.

As a result, the Commission granted, with certain modifications, Southern Bell's petition filed on January 13, 1988, to adopt a new regulatory plan (the Plan) involving the stabilization of residential local exchange rates and a rate of return sharing incentive plan.

Southern Bell, when it filed the Plan, anticipated the duration of the Plan to be a three-year period ending December 31, 1990. However, due to the fact that Order No. 20162 was not issued until October of 1988, the Plan as currently constituted will not be effective for the full period requested but rather, by December 31, 1990, will only have been in effect for a period of approximately two years. This abbreviated version of the Plan has neither fully provided Southern Bell with the time needed to "adapt to the new competitive world in which it finds itself" (i.e. change its operations, structure and culture to reflect the incentives of the Plan) nor allowed Southern Bell and the Commission to gather

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sufficient information to determine the effects the Plan has had. Thus, it is imperative that the Commission allow the Plan to continue until the operational and financial results for three full years under the Plan are available.

Given the fact that the Plan must be extended in order for the Commission, the ratepayers and Southern Bell to realize fully the benefits of incentive regulation, the question arises as to whether the Plan should be modified in any manner prior to its extension. Since the circumstances existing at the time the Plan was adopted have not changed and since altering the Plan prior to its conclusion would distort and cloud the effects it has had upon Southern Bell's operations, no modifications are required.

Southern Bell's cost of equity capital has not changed since the Plan was instituted in October of 1988. Companies similar to Southern Bell with comparable risk have expected rates of return on equity capital within the range established by the Commission in Order No. 20162. Therefore, the existing return on equity, floor and ceiling, the rate setting point and the sharing point should not be changed.

Similarly, nothing has occurred which would justify changing the Commission's treatment of what are known as exogenous earning factors. In general, earnings resulting from exogenous factors are earnings which were not the result of the Company's efforts. In Order No. 20162 the Commission determined that earnings resulting from exogenous factors should be excluded from the earnings sharing calculations. Under the terms of the Order, if the net total revenue requirement impact of all exogenous factors results in a increase in reported earnings, 100% of this increase will be used by the Commission to benefit the ratepayer and is entirely excluded from the sharing process. Conversely, if the net total revenue requirement impact results in a decrease in reported earnings, Southern Bell absorbs 100% of the reduced earnings. This procedure

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<sup>1</sup> Specifically, the Commission defined exogenous factors as "all rate changes other than regroupings; changes resulting from significant governmental actions, such as tax changes, separation changes and depreciation changes, with a minimum impact of \$3 million on revenue requirements; refinancing of higher cost debt instruments and major technological changes."

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adequately and fairly addresses the treatment of earnings resulting from exogenous factors. With the extension of the Plan, this treatment of exogenous factors will continue and ratepayers will continue to receive all the benefits which can be attributed to these factors at the point in time when the extent of the benefits can be determined. Therefore, the existing treatment of exogenous factors should not be changed.

Furthermore, in addition to the reasons set forth above, there is an even more important and fundamental reason why the Plan should not be modified prior to its extension. The two primary purposes for extending the Plan are to:

- 1) Allow sufficient time for the full impact of the Plan to be reflected in Southern Bell's operations; and
- 2) Provide the Commission and Southern Bell with sufficient data to evaluate the effects of the Plan on Southern Bell.

Any modifications to the Plan prior to its conclusion would defeat both of these purposes. If the Plan is modified prior to extension, the impact of the original Plan will be diluted and the operational results misleading. It will be difficult, if not impossible, to determine whether operational results are attributable to the original Plan, the modifications, or a mixture of both.

Thus, the original Plan must remain intact throughout the extension. There should be no change in Southern Bell's rates, rate structure or return on equity.

GTEFL'S BASIC POSITION: GTEFL's basic position in this proceeding is that Southern Bell's incentive regulation plan should be extended as requested in order to allow the Commission the necessary time to review the benefits associated with this matter of regulation.

ATT-C'S BASIC POSITION: AT&T supports the extension of Southern Bell's rate stabilization plan. To the extent that the Commission finds, through investigation of the relevant issues in this docket, that additional revenues are available for rate reductions, AT&T

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submits that such excess revenues should be utilized to reduce switched access rates.

MCI'S BASIC POSITION: Consistent with the Commission's Order No. 23193, the Commission should only permit the extension of Southern Bell's Regulatory Incentive Plan for a period sufficient to permit the Commission to re-examine the Company's operations in mid-to-late 1991. Given that this will result in the duration of the plan extending one year beyond that initially established in Order No. 20162, the Commission should, at this time, adjust (decrease) rates and revenues for calendar year 1991 on the same basis that rates and revenues for calendar years 1988 through 1990 were adjusted in Order No. 20162.

The rate decreases ordered should be targeted to reduce the remaining non-cost based elements of access charges - the carrier common line charge (CCLC).

SPRINT'S BASIC POSITION: Southern Bell's incentive regulation plan should be continued, but the Commission must make appropriate adjustments in revenues and rates and reflect the most current planning data available. Any rate decreases should first be targeted to the non-traffic sensitive carrier common line charge element of access charges to bring this rate into alignment with Southern Bell's interstate CCL charge.

FIXCA'S BASIC POSITION: If the Commission decides to extend Southern Bell's incentive program, it must do so in a way that incorporates and reflects the premise and objective of the program. The objective is to provide an incentive to Southern Bell to attempt to exceed expected performance. This would require that rates be calibrated to Southern Bell's projections of results for 1991 and 1992. Because those projections indicate a surplus of revenues, a reduction in rates is a necessary component of an extension of the program. Since the surrogate-penalty mechanism is inimical to the creation of an incentive program, and since it is not needed to protect Southern Bell's revenues, Southern Bell's surrogate-penalty rate should be eliminated. In any event, the revenues associated with the surrogate-penalty mechanism are a government-created revenue stream, and as such fall within the definition of those monies which must be refunded under the terms of the incentive program.

DOD/FEA'S BASIC POSITION: See specific issues.



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OPC'S BASIC POSITION: Commission order no. 23193 issued July 16, 1990 limits the issues in this case in a way that makes it difficult, and perhaps impossible, for the Commission to continue the process of rate reductions, credits, and set asides used by the Commission in 1988. During 1988 the Commission used Southern Bell's 1988 commitment view, and the associated planning views for 1989 and 1990, as a basis for setting Southern Bell's rates during 1988, 1989, and 1990. No information about Southern Bell's expected results for 1991 and 1992 was placed into evidence at that time because Southern Bell purged all such information from the documents that were used in the 1988 hearings. If the Commission wishes to pursue the same process that brought about rate reductions, credits, and set asides benefiting Southern Bell's customers, the Commission must once again review Southern Bell's forecasts, but this time for 1991 and 1992. These forecasts should be used as a basis for resetting rates in 1991 and 1992. Failure to do this will abandon, not extend, the "incentive regulation" process used by the Commission in 1988.

Southern Bell's planning view of 1991 associated with Southern Bell's 1990 commitment view shows that the company anticipates earning a return on equity of 16.35% before sharing during 1991. However, even this projected return on equity is understated because it includes large depreciation expenses not granted by the Commission. In order to reduce Southern Bell's projected earnings in 1991 to a 12% return on equity, the Commission should reduce Southern Bell's rates by \$180,315,000 in 1991. The company's planning view for 1992 associated with its 1990 commitment view projects earnings of a 16.53% return on equity before sharing, but this projection, too, includes depreciation expenses not allowed by the Commission. Additionally, the projected 16.53% return on equity reflects \$32 million of rate reductions and even more depreciation expenses not granted by the Commission. In order to reduce Southern Bell's projection to a 12% return on equity, the Commission should reduce Southern Bell's rates by \$266,670,000 in 1992.

Even if the Commission only uses the information that existed, but was not presented, to the Commission during the 1988 hearings, there are still rate reductions required. Using this older information, the Commission should reduce rates by \$83,288,000 during 1991 and \$110,334,000 in 1992 to bring Southern Bell's rates to the rate setting point of 13.2% return on equity used by the Commission during 1988.

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V. ISSUES AND POSITIONS:

ISSUE 1: Should the regulatory incentive plan for Southern Bell be extended until the earlier of eighteen months or the conclusion of the periodic earnings review required by the new revisions to Chapter 364, Florida Statutes?

SO. BELL'S POSITION: Southern Bell's regulatory incentive plan should be extended for a minimum of 18 months, until July 1, 1992. Unless the Plan is extended, upon its expiration on December 31, 1990, it will only have been in effect for a period of approximately two years. This abbreviated version of the Plan has neither provided Southern Bell with the time needed to change fully its operations, structure and culture to reflect the incentives of the Plan, nor has it allowed Southern Bell and the Commission to gather sufficient information to determine the effects the Plan has already had. In order for the Commission and Southern Bell to have sufficient data available to evaluate the effects of the Plan, it is imperative that the Commission extend its term to three full years.

Importantly, although extending the Plan until December 31, 1991, will provide Southern Bell with three full years of operation under the Plan, it will not give the Commission three full years of financial results. The financial results for 1991 will not be available until March of 1992. Extending the Plan to allow Southern Bell to experience three years of incentive regulation is of little use if the financial results for the third year are not available to be considered at the time the Commission evaluates the effects of the Plan. Thus, the Plan should be extended until July 1, 1992.

There is an additional reason why the Plan should be extended rather than allow Southern Bell to revert back to traditional rate of return regulation. As mentioned earlier, the Commission recognized in Order No. 20162 that the telecommunications industry is rapidly transitioning to a competitive environment and Southern Bell must be allowed to adopt to the new competitive world. The Plan represents the Commission's first efforts to establish a more appropriate means of regulating local exchange companies in today's environment. A failure to extend the Plan would represent a "step backward." It would also severely impair Southern Bell's ability to provide the ratepayers of Florida with the services they demand and its ability to compete in the new telecommunications market.

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GTEFL'S POSITION: GTEFL supports Southern Bell's request.

ATT-C'S POSITION: AT&T does not oppose the limited extension of the regulatory incentive plan for Southern Bell.

MCI'S POSITION: Yes, provided that in conjunction with the extension the Commission adjusts the rates and revenues for 1991 and 1992 as if revenue projections for those years had been available at the outset of Docket 880069-TL. See Issue No. 6.

SPRINT'S POSITION: Southern Bell's plan can be extended, but rates should be adjusted.

FIXCA'S POSITION: If it is continued it must be continued in its complete forms which involves a calibration of rates to projected revenues to ensure that any rewards are received through exceeding expected performance.

DOD/FEA'S POSITION: DOD/FEA has some question as to how this decision can be made with figures from 1988. We believe that the procedure of examining forecast results must continue. DOD/FEA's position is that forecasts of the Company's rate base, revenues, and expenses are intrinsic to the operation of the plan because the targeting of the rate of return is the principal means by which the incentive for efficiency is conveyed. These forecasts can only be completed by Southern Bell's disclosure of its five year forecasts of expenses, investments, and revenues in a similar fashion to those submitted during the previous investigation.

OPC'S POSITION: The regulatory incentive plan for Southern Bell should be extended for a period of two years using Southern Bell's projections of its earnings for 1991 and 1992 associated with its 1990 commitment view. This extension of the plan could be set to expire before the end of a two year period if the Commission were to conclude the periodic earnings review required by the new revisions to Chapter 364, Fla. Stat., before the end of the two year period. To actually extend the plan, the Commission should reset Southern Bell's rates using a new rate setting point and Southern Bell's projections of earnings during 1991 and 1992 associated with its 1990 commitment view. Alternatively, if the Commission only uses the information that existed, but was not presented, to the Commission during the 1988 hearings, the Commission should reduce rates by \$83,288,000 during 1991 and \$110,334,000 in 1992 to bring Southern Bell's rates to the rate

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setting point of 13.2% return on equity used by the Commission during 1988.

STAFF'S POSITION: Yes. The regulatory incentive plan for Southern Bell should be extended to allow the Commission adequate time to review the plan thoroughly.

ISSUE 2: If Southern Bell's regulatory incentive plan is extended, what should be the authorized floor and ceiling for the return on equity?

SO. BELL'S POSITION: Southern Bell's cost of equity capital has not changed since July of 1988 when the Commission established the Rate Stabilization/Incentive Regulation Plan. A range of 14-16% is still justified in today's economic environment. Thus, the authorized floor and ceiling for the return on equity should not be changed.

GTEFL'S POSITION: GTEFL takes no position at this time.

ATT-C'S POSITION: AT&T has no position on this issue at this time.

MCI'S POSITION: MCI does not have a position on this issue at this time.

SPRINT'S POSITION: No position at this time.

FIXCA'S POSITION: FIXCA recommends no change from the present 13.2%

DOD/FEA'S POSITION: It is DOD/FEA's position that symmetry - the ability to enjoy overearnings, but only by also risking the absorption of underearnings - should be seriously considered. In Order No. 20162, the Commission established 170 basis points below the rate setting point as the floor. To ensure symmetry, the effective ceiling, after sharing, should be 170 points above the rate setting point.

OPC'S POSITION: During 1988, when the Commission used a 13.2% return on equity rate setting point, the Commission set a return on equity floor of 11.5% and a return on equity ceiling of 16%. With a more current return on equity, the Commission should use a 12% return on equity rate setting point. If the same spread used by the Commission in 1988 were used now, this would lead to a

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authorized floor of a 10.3% return on equity and an authorized ceiling of a 14.8% return on equity.

STAFF'S POSITION: The ceiling should be 280 basis points above the rate setting point and the floor should be 170 basis points below.

ISSUE 3: If Southern Bell's regulatory incentive plan is extended, at what return on equity should rates be set?

SO. BELL'S POSITION: In light of the fact that Southern Bell's cost of equity capital has not changed since the Plan was instituted, no changes should be made in the return on equity at which rates are set.

GTEFL'S POSITION: GTEFL takes no position at this time.

ATT-C'S POSITION: AT&T has no position on this issue at this time.

MCI'S POSITION: MCI does not have a position on this issue at this time.

SPRINT'S POSITION: No position at this time.

FIXCA'S POSITION: No position at this time.

DOD/FEA'S POSITION: Based upon generally accepted regulatory principles and investment theory, the return required on an investment is directly related to the investors perceived risk associated with that investment. Southern Bell's securities, as a whole, are known to have relatively low risk. Southern Bell's debt is currently rated at the highest rating issued by S&P and Moody's, ratings which are generally accepted indicators of composite business and financial risks and are known to affect a company's cost of capital. Such ratings are also indicative of risk to Southern Bell's equity investors. The direct relationship between the riskiness of a firm's debt and equity should be obvious, since indicators of the strength and predictability of earnings to equity are the primary bases for the credit ratings assigned to debt. Since Southern Bell is wholly owned by Bell South, we cannot observe directly the perceived risk of Southern Bell's equity capital, but only its parent. Based upon Bell South's safety Range of "1" from Value Line's July 20, 1990 report, its common equity is less risky than 91 percent of the firms followed by Value Line. Publications from a variety of investment community representatives indicate reasonable current expectations

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for annual returns on U.S. equities falls between 11.0 percent and 12.5 percent. The reasonableness of this range is further confirmed both by historical experience of investors and by the returns actually earned on book equity by large corporations. DOD/FEA believes that the equity return requirement for Southern Bell is less than 12.5 percent. However, DOD/FEA recommends that the Commission establish rates to target on a return to equity of 12.5% percent, rather than the current 13.2 percent.

OPC'S POSITION: 12%.

STAFF'S POSITION: No position.

ISSUE 4: If Southern Bell's regulatory incentive plan is extended, at what return on equity should sharing begin?

SO. BELL'S POSITION: In light of the fact that Southern Bell's cost of equity capital has not changed since the Plan was instituted, the return on equity at which sharing begins should not be changed.

GTEFL'S POSITION: GTEFL takes no position at this time.

ATT-C'S POSITION: AT&T has no position on this issue at this time.

MCI'S POSITION: MCI does not have a position on this issue at this time.

SPRINT'S POSITION: No position at this time.

FIXCA'S POSITION: No position at this time.

DOD/FEA'S POSITION: In Order No. 20162, the Commission established 80 basis points (.8 percentage points) as the point at which sharing would begin. If the Commission established rate of equity return at the recommended 12.5 percent, then the point at which sharing would begin would be 13.3 percent.

OPC'S POSITION: During 1988 the Commission began sharing 80 basis points higher than the rate setting point. Since Southern Bell's new rate setting point should be 12%, Southern Bell's sharing point should be set at a 12.8% return on equity.

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STAFF'S POSITION: Sharing should begin at a point eighty basis points above the return on equity at which rates are set.

ISSUE 5: If Southern Bell's regulatory incentive plan is extended, should any adjustment be made to rates to reflect the annual impact of rate changes, exogenous factors and debt refinancings which have occurred since January 1, 1988?

SO. BELL'S POSITION: No adjustments should be made to Southern Bell's rates to reflect the annual impact of exogenous factors (including rate changes and debt financing) which have occurred since January 1, 1988. In Order No. 20162 the Commission held that earnings derived from exogenous factors which do not "result from the Company's efforts" should be excluded from the sharing process. The Commission recognized when it established the Plan that exogenous factors would both increase and decrease Southern Bell's earnings and that the most fair and equitable means of addressing the situation was to net the increases and the decreases. If the net total revenue requirement impact of all exogenous factors is an increase in reported earnings, this increase will be used by the Commission to benefit the ratepayers and will be excluded from the earnings which would otherwise be subject to the sharing process. Conversely, if the net total revenue requirement impact results in a decrease of reported earnings, Southern Bell absorbs the reduced earnings and the sharing calculations proceed with no adjustments. With the extension of the Plan, a similar review of 1991 earnings impacts can be conducted in 1992. In this way, ratepayers can receive all of the benefits which can be attributed to these factors at the point in time when the extent of the benefits can be determined. Thus, the existing treatment of exogenous factors should not be changed.

Furthermore, if the Plan is modified and then extended, the impact of the original Plan will be diluted and the operational results misleading. It will be difficult, if not impossible, to determine whether operational results are attributable to the original Plan, the modifications, or mixture of both.

GTEFL'S POSITION: GTEFL takes no position at this time.

ATT-C'S POSITION: AT&T has no position on this issue at this time.

MCI'S POSITION: Yes. Adjustments to Southern Bell's rates should be made to reflect the annual impact of rate changes, exogenous

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factors and debt refinancings that have occurred since January 1, 1988.

SPRINT'S POSITION: If the plan is continued, the Commission should use the most currently available planning data to determine the amount of the necessary rate reductions.

FIXCA'S POSITION: Revenues received by Southern Bell from interexchange carriers through the application of the surrogate-penalty program constitute a revenue stream created by government action, and as such fall beyond the categories of monies which can be retained by Southern Bell.

DOD/FEA'S POSITION: Although we do not have available the data necessary to quantify them there may be various exogenous changes that Southern Bell has not recognized that reduce its costs, thereby increasing its rate of return. Retrospectively, for the years 1988, 1989 and 1990, the data are, or shortly will be available to quantify these exogenous effects. Beyond January 1, 1991, no data are available to permit quantification of these charges since Southern Bell has refused to furnish the forecasts of revenues, expenses, and investments for 1991 and 1992 that permitted the Commission in 1988 to target the rate of return for the years 1988, 1989 and 1990.

OPC'S POSITION: Yes. The Commission should use Southern Bell's 1990 commitment view, and the associated planning views of 1991 and 1992, to reset rates. These forecasts should then be adjusted to account for more recent known changes, such as rate changes, exogenous factors, and debt refinancing. If the Commission should choose to use the planning views of 1991 and 1992 associated with Southern Bell's 1988 commitment view, the Commission should take into account the annual impact of rate changes, exogenous factors, and debt refinancings.

STAFF'S POSITION: Yes. Adjustments to rates should be made to reflect the annual impact of rate changes, exogenous factors and debt refinancings which have occurred since January 1, 1988 including the falloff of amortization schedules and the effect on rate base of additional depreciation approved in Order No. 23132.

ISSUE 6: Would an extension of the Rate Stabilization/Incentive Regulation Plan necessitate a recalibration of rates to



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reflect Southern Bell's 1991 and 1992 projections? If so, by what amount?

SO. BELL'S POSITION: It is Southern Bell's position that if the Plan is extended Southern Bell's rates should not be recalibrated to reflect Southern Bell's 1991 and 1992 earnings projections. In fact, to recalibrate rates based upon these forecasts would defeat the purpose of the Plan. Southern Bell's 1991 and 1992 earnings forecasts include the effects of productivity improvements. To set rates using these projections would prohibit Southern Bell from sharing in the productivity improvements which the Company has generated. In Commission Order No. 20162, the Commission explained that it was approving the Incentive Regulation Plan to encourage efficiency and innovation by Southern Bell. To use Southern Bell's 1991 and 1992 revenue and income forecasts to reduce Southern Bell's earnings to a targeted return on equity would completely eliminate for Southern Bell and benefits it is receiving from the efficiencies, new services and innovations it has been able to achieve since 1988. In effect, this would eliminate the incentives which this regulatory approach is designed to generate.

GTEFL'S POSITION: No position at this time.

ATT-C'S POSITION: No position at this time.

MCI'S POSITION: Yes. Southern Bell's regulatory incentive plan was initially approved in October, 1988 on the basis of three year's worth of projected operations data. On the basis of this data, certain revenue and rate adjustments were ordered over a three-year period. The plan was scheduled to expire on December 30, 1990, which also constituted the end date of the date examined.

If the Commission had initially set out to establish a plan to expire at a later date, it would also have been necessary to examine projected operations data for the period ending at that later date. Thus, in order to continue the plan for 1991 and all or part of 1992, the Commission should examine Southern Bell's forecast of operations for the period of the proposed extension and order appropriate rate and revenue decreases.

SPRINT'S POSITION: Based upon the most currently available planning data, Public Counsel's evaluation indicates significant revenues that are available for rate changes.

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FIXCA'S POSITION: Yes. The calibration of rates to projections needed to establish a base line of expected performance in an integral part of the plan itself. By definition, an extension must incorporate such a calibration. To fail to do so would be to abandon the plan, not to extend it. This would result in a windfall for Southern Bell.

FIXCA's position is that the calibration would require a \$140 million reductions in annual revenues. This is based on Public Counsel's analysis of Southern Bell's February 5 planning view, adjusted to retain Southern Bell's current authorized return on equity of 13.2%.

DOD/FEA'S POSITION: No position at this time.

OPC'S POSITION: Yes. Failure to recalibrate rates would amount to an abandonment of the plan, not an extension of it. During 1988 the Commission used Southern Bell's 1988 commitment view, and the associated planning view for 1989 and 1990, as a basis for setting Southern Bell's rates during 1988, 1989, and 1990. No information about Southern Bell's expected results form 1991 and 1992 was placed into evidence at that time because Southern Bell purged all such information from the documents that were used during the 1988 hearings. If the Commission wishes to pursue the same process that brought about rate reductions, credits, and set asides benefitting Southern Bell's customers, the Commission must once again review Southern Bell's forecast, but this time for 1991 and 1992.

During the hearings held during 1988 the Commission used Southern Bell's commitment view to calibrate rates for 1988, 1989, and 1990. The Commission rejected updates to the view that existed during the 1988 hearings, such as Southern Bell's "best view." In order to follow the same procedure used during 1988, the Commission this time should use Southern Bell's 1990 commitment view, and its associated planning views of 1991 and 1992, for the purpose of calibrating rates during 1991 and 1992.

Southern Bell's planning view of 1991 associated with Southern Bell's 1990 commitment view shows the company anticipates earning a return on equity of 16.35% before sharing during 1991. However, even this projected return on equity is understated because it includes large depreciation expenses not granted by the Commission. In order to reduce Southern Bell's projected earnings in 1991 to a

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12% return on equity, the Commission should reduce Southern Bell's rates by \$180,315,000 in 1991.

The company's planning view for 1992 associated with the 1990 commitment view projects earnings of a 16.53% before sharing, but this projection, too, includes depreciation expenses not allowed by the Commission. Additionally, the projected 16.53% return on equity reflects \$32 million of rate reductions and even more depreciation expenses not approved by the Commission. In order to reduce Southern Bell's projection to a 12% return on equity, the Commission should reduce Southern Bell's rates by \$266,670,000 in 1992.

Alternatively, even if the Commission only uses the information that existed, but was not presented, to the Commission during the 1988 hearings, there are still rate reductions required. Using this older information, the Commission should reduce rates by \$83,288,000 during 1991 and \$110,334,000 in 1992 to bring Southern Bell's rates to the rate setting point of 13.2% return on equity used by the Commission during 1988.

STAFF'S POSITION: No position.

ISSUE 7: What is the amount of revenue change for 1991, necessary to implement the Commission's decisions in Issues 1 through 6?

SO. BELL'S POSITION: In light of the fact that Southern Bell's cost of equity capital has not changed since the Plan was instituted and that no adjustment should be made to Southern Bell's rates to reflect the annual impact of exogenous factors, there is no revenue change for 1991 necessary to implement the Commission's decisions in Issues 1-6.

GTEFL'S POSITION: GTEFL takes no position at this time.

ATT-C'S POSITION: AT&T has no position on this issue at this time.

MCI'S POSITION: The amount of revenue change for 1991 will depend on whether the Commission uses the Company's 12/87 projections of its 1991 operations, as it did in the original hearings in this docket, or whether the Commission uses a more recent Company budget for calendar year 1991 projected operations. Additionally, the amount of revenue change for 1991 will depend on whether the

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Commission chooses to establish a different "target" return on equity (other than 13.2% ROE) for purposes of setting rates.

In any event, it is clear that substantial rate/revenue reductions are warranted for calendar year 1991. At a minimum, as suggested by Public Counsel based on the Company's 12/87 budget forecast for 1991, approximately \$42 million in revenues needs to be returned to the ratepayers. Using more recent data concerning the Company's projected operations and cost of capital, Public Counsel suggests approximately \$180 million in rate reductions are warranted.

SPRINT'S POSITION: Consistent with Commission policy, non-traffic sensitive access changes should continue to be reduced. At a minimum, Southern Bell's CCL element should be reduced to the level of the interstate CCL charge.

FIXCA'S POSITION: FIXCA adopts Public Counsel's analysis of Southern Bell's February 5 planning view of 1991-1992 projections, but recommends utilizing the current 13.2% return on equity in the determination. This would result in approximately a \$140 million revenue reduction.

DOD/FEA'S POSITION: DOD/FEA does not have the information available to compute this figure. However, any change should reflect the reduction in the target rate of return of the present 13.2 percent to 12.5 percent. It should also reflect the exclusion of the 1990 depreciation rate increase and all changes in separations factors since 1988.

OPC'S POSITION: Using the planning views for 1991 and 1992 associated with Southern Bell's 1990 commitment view, the Commission should reduce Southern Bell's rates by \$180,315,000 in 1991 and by \$266,670,000 in 1992 to reduce Southern Bell's rates to a rate setting point of 12%. Alternatively, if the Commission were to use the older information which existed during the 1988 hearings, but which was purged by Southern Bell from of its documents, other rate reductions would result. Using the information that existed during 1988, and accounting for changes such as rate changes, exogenous factors, and debt refinancings which have occurred since January 1, 1988, the Commission should reduce Southern Bell's rates by \$83,288,000 in 1991 and \$110,334,000 in 1992 to bring Southern Bell's rates down to the rate setting point of 13.2% used by the Commission during 1988.

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STAFF'S POSITION: No position.

ISSUE 8: In what services and to what extent should rate changes be made?

SO. BELL'S POSITION: Again, as explained in response to Issue 6, since no changes are required in order to extend the Plan for an additional 18 months, no rate changes are warranted at this time.

GTEFL'S POSITION: GTEFL takes no position at this time.

ATT-C'S POSITION: To the extent that revenue is available to lower rates, access charges should be further reduced. Even though Southern Bell's BHMOC charge has been eliminated, Southern Bell's intrastate switched access rates remain at twice the level that Southern Bell charges for like services in the interstate jurisdiction, and interstate rates more than cover incremental costs. The Commission should continue to reduce access charges to levels which at least reach parity with interstate rates. The first initiative should be to reduce the originating carrier common line charge to one cent. Further reductions should then be applied to the terminating carrier common line charge, with subsequent reductions being applied to traffic sensitive access rates.

MCI'S POSITION: It is apparent that some amount of revenues will be available for rate reductions for calendar year 1991. The Commission should continue to move intrastate access charge rates to levels at parity with Southern Bell's interstate rates. With the revenues available for rate reductions as a result of this docket, as well as the revenues available in Docket 890505 (Private Line Restructure), the Commission will have the opportunity to reduce Southern Bell's intrastate CCLC to the same rate level as Southern Bell's interstate CCLC.

FIXCA'S POSITION: The surrogate-penalty rate charged IXCs by Southern Bell is inimical to the creation of an incentive program, and is obviously not needed to protect Southern Bell's revenues. Since the amount of revenues associated with the program is small (\$3.5 million) relative to the amount of revenue reduction needed to extend the program (\$140 million), and since the revenues should not be retained by Southern Bell under the terms of the program in any event, the Commission should eliminate Southern Bell's penalty-surrogate rate. In addition, Southern Bell's carrier common line

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charge component of access charges should be reduced to a level equal to the effective level of the interstate CCLC. After these reductions are accomplished, significant revenues will still be available for toll reductions or other charges.

DOD/FEA'S POSITION: If rate reductions flow from the incentive sharing plan, they should be directed to those services which generate revenue greater than cost. They should not be directed at residential exchange access service which is known to be offered at rates less than cost.

OPC'S POSITION: Both local and toll rates should be reduced.

STAFF'S POSITION: No position.

VI. EXHIBIT LIST

<u>WITNESS</u>	<u>PROFFERING PARTY</u>	<u>EXH. NO.</u>	<u>TITLE</u>
David B. Denton	So. Bell		David B. Denton State Docket Activity- all state regulatory proceedings in which Mr. Denton has presented testimony
Walter S. Reid	So. Bell		Exogenous Factors rate changes and governmental - This exhibit describes all exogenous factors affecting Southern Bell's earnings for the time period 1988- 1990

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<u>WITNESS</u>	<u>PROFFERING PARTY</u>	<u>EXH. NO.</u>	<u>TITLE</u>
James Vander Weide	So. Bell		<p>1) List of Schedules and Appendices- index of Vander Weide's exhibits; 2) Summary of Discounted Cash Flow Analysis for Comparable Companies; 3) Comparative Returns on S&amp;P 500 Stock and Moody's Aa-Rated Public Utility Bonds 1937-1990; 4) Comparative Returns on S&amp;P 40 Utilities and Moody's Aa-Rated Utility Bonds 1937-1990; 4) Actions of the FCC and Federal Courts to Increase Competition in the Tele-communications Industry; 5) The Quarterly DCF Model; 6) Cluster Analysis; 7) Summary of Risk Premium Studies relied upon by Mr. Vander Weide</p>

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<u>WITNESS</u>	<u>PROFFERING PARTY</u>	<u>EXH. NO.</u>	<u>TITLE</u>
Charles W. King	DOD/FEA		Summary of qualifications and experience and appearances before various regulatory agencies.
Mark Cicchetti	OPC		Testimony Schedules.
Hugh Larkin, Jr.	OPC		Testimony Schedules and Appendix.

VII. STIPULATIONS:

1. The Parties have agreed to a proposed stipulation of all cost of capital testimony into the evidentiary record including depositions and related exhibits in lieu of a live appearance by the witness and cross examination.

VIII. PENDING MATTERS:

There are no pending matters at this time.

IX. RULINGS:

1. The Prehearing Officer recommends that the Commission approve the parties stipulation that cost of capital testimony including depositions and related exhibits be admitted into the evidentiary record.

X. PROCEDURE FOR HANDLING CONFIDENTIAL INFORMATION:

In the event it becomes necessary to handle confidential information, the following procedure will be followed:



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1. The Party utilizing the confidential material during cross examination shall provide copies to the Commissioners and the Court Reporter in envelopes clearly marked with the nature of the contents. Any party wishing to examine the confidential material shall be provided a copy in the same fashion as provided to the Commissioners subject to execution of any appropriate protective agreement with the owner of the material.
2. Counsel and witnesses should state when a question or answer contains confidential information.
3. Counsel and witnesses should make a reasonable attempt to avoid verbalizing confidential information and, if possible, should make only indirect reference to the confidential information.
4. Confidential information should be presented by written exhibit when reasonably convenient to do so.
5. At the conclusion of that portion of the hearing that involves confidential information, all copies of confidential exhibits shall be returned to the owner of the information. If a confidential exhibit has been admitted into evidence, the copy provided to the Court Reporter shall be retained in the Commission Clerk's confidential files.

If it is necessary to discuss confidential information during the hearing the following procedure shall be utilized.

After a ruling has been made assigning confidential status to material to be used or admitted into evidence, it is suggested that the presiding Commissioner read into the record a statement such as the following:

The testimony and evidence we are about to receive is proprietary confidential business information and shall be kept confidential pursuant to Section 364.093, Florida Statutes. The testimony and evidence shall be received by the Commissioners in executive session with only the following persons present:

- a) The Commissioners
- b) The Counsel for the Commissioners

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- c) The Public Service Commission staff and staff counsel
- d) Representatives from the office of public counsel and the court reporter
- e) Counsel for the parties
- f) The necessary witnesses for the parties
- g) Counsel for all intervenors and all necessary witnesses for the intervenors.

All other persons must leave the hearing room at this time. I will be cutting off the telephone ties to the testimony presented in this room. The doors to this chamber are to be locked to the outside. No one is to enter or leave this room without the consent of the chairman.

The transcript of this portion of the hearing and the discussion related thereto shall be prepared and filed under seal, to be opened only by order of this Commission. The transcript is and shall be non-public record exempt from Section 119.07(1), Florida Statutes. Only the attorneys for the participating parties, Public Counsel, the Commission staff and the Commissioners shall receive a copy of the sealed transcript.

(AFTER THE ROOM HAS BEEN CLOSED)

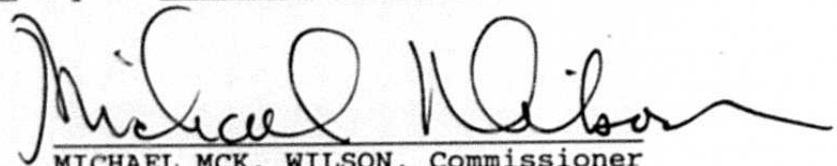
Everyone remaining in this room is instructed that the testimony and evidence that is about to be received is proprietary confidential business information, which shall be kept confidential. No one is to reveal the contents or substance of this testimony or evidence to anyone not present in this room at this time. The court reporter shall now record the names and affiliations of all persons present in the hearing room at this time.

It is therefore,

ORDERED by Commissioner Michael McK. Wilson, as Prehearing Officer, that this Prehearing Order shall govern the conduct of these proceedings as set forth above unless modified by the Commission.

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By ORDER of Commissioner Michael Mck. Wilson, as Prehearing  
Officer, this 27th day of NOVEMBER, 1990.



MICHAEL MCK. WILSON, Commissioner  
and Prehearing Officer

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