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. DIRECTORY EXPENSES NOT RECORDED IN ACCOUNT 6622.1

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. <u>REALLOCATION OF INSURANCE PROCEEDS BETWEEN FLORIDA AND LOUISIANA</u>

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. <u>CORPORATE RE-ENGINEERING COST - FORCE REDUCTIONS</u>

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. <u>INCENTIVE COMPENSATION</u>

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. <u>EMPLOYEE BENEFITS</u>

1. CONCESSION REVENUES

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. <u>BOND REFINANCING COSTS</u>

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. <u>EXTRAORDINARY RETIREMENT EXPENSE</u>

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. <u>INTRACOMPANY INVESTMENT COMPENSATION</u>

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. <u>SEPARATIONS</u>

1. <u>CORPORATE OPERATIONS SEPARATIONS FACTOR</u>

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. <u>TAXES, OTHER THAN INCOME - SEPARATION FACTORS</u>

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. UNIVERSAL SERVICE FUND

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. INAPPROPRIATE EXPENSES FOR RATEMAKING PURPOSES

1. MISCELLANEOUS EXPENSES

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	2,492,605	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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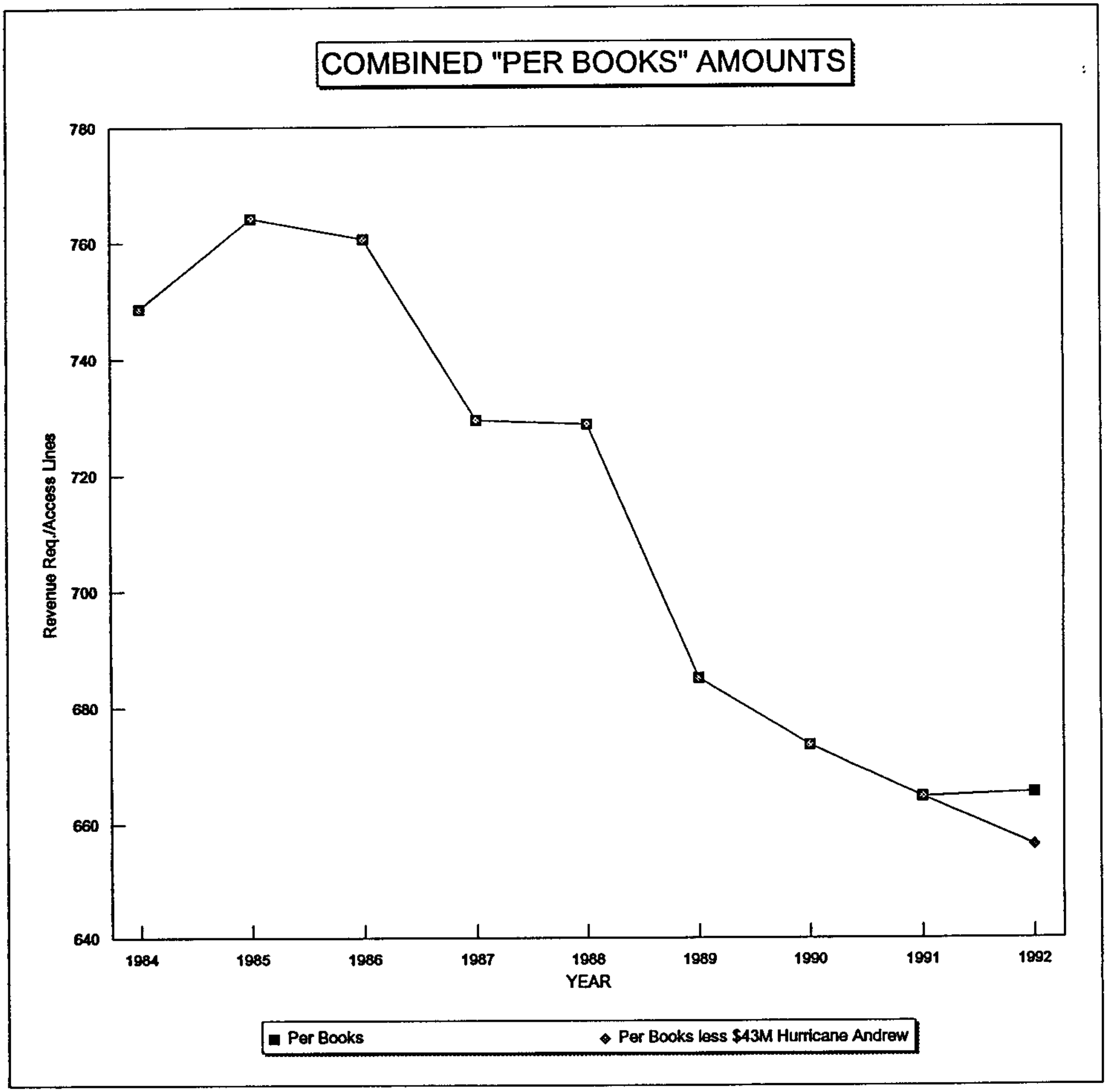
FLORIDA COMBINED REVENUE REQUIREMENT PER AVG ACCESS LINE



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M E M O R A N D U M

July 25, 1985

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."

All Other Companies: 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.

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

RECOMMENDATION: 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

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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.

4699G

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Reid Exhibit WSR-6
Page 18 of 20

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.	36,435
Central Telephone Company of Florida	142,828
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.

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 4395; CGL 6360; s. 3, ch. 76-168; s. 1, ch. 77-457; ss. 3, 22, 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. 83-73.
[1]Note.—Expires October 1, 1989, pursuant to s. 7, ch. 83-73, 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. Stavey
WBB

DEC 31 1985

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 <u>requires</u> 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
Tallahassee, Florida 32301
(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 <u>(as shown in Section (3) below)</u> 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 = <u>Annual average CPI-U for test year</u>
289.1 <u>(or equivalent)</u>

(f) Each local exchange company shall record its directory advertising revenues in revenue account 523 (Directory Revenues) and shall record ~~its-directory-advertising-expenses~~ <u>the expenses incurred in furnishing directories</u> 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) <u>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.</u>

<u>New</u>

(h) <u>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.</u>

¹364.037 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.
¹Note.— [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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Post Office Box 759
Mariana, Florida 32446

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MacClenny, Florida 32063

Lila D. Corbin
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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	

FPSC EXHIBIT NUMBER _____
FPSC DOCKET 920260-TL
REID EXHIBIT WSR - 9
PAGE 2 OF 2

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	X3586	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