

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petitions of SOUTHERN BELL) DOCKET NO. 880069-TL
 TELEPHONE COMPANY for rate stabilization) ORDER NO. 25697
 and implementation orders and other relief) ISSUED: 02/07/92
 _____)

Pursuant to Notice, a Prehearing Conference was held on January 28, 1992, in Tallahassee, Florida, before Commissioner Betty Easley, as Prehearing Officer.

APPEARANCES:

CHARLOTTE BRAYER, Esquire, American Association of Retired Persons (AARP), 275 John Knox Road, EE 102, Tallahassee, Florida 32303, on behalf of the American Association of Retired Persons.

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

MICHAEL B. TWOMEY, Esquire, Assistant Attorney General, Department of Legal Affairs, Suite 1601-The Capitol, Tallahassee, Florida 32399-1050, on behalf of the Attorney General of the State of Florida.

STEPHANIE K. WALSH, Esquire, Regulatory Law Office, Office of the Judge Advocate General, Department of the Army, Litigation Center, JALS-RL, Suite 400, 901 N. Stuart Street, Arlington, Virginia 22203, on behalf of The Department of Defense and All Other Federal Executive Agencies.

DOUGLAS S. METCALF, Communications Consultants, Inc., 1600 East Amelia Street, Orlando, Florida 32803-5505, on behalf of Florida Ad Hoc Telecommunications Users Committee.

KENNETH A. HOFFMAN and LAURA L. WILSON, Esquires, Messer, Vickers, Caparello, Madsen, Lewis, Goldman & Metz, P.A., Post Office Box 1876, Tallahassee, Florida 32302, on behalf of the Florida Pay Telephone Association.

RICHARD D. MELSON, Esquire, Post Office Box 6526, Tallahassee, Florida 32314, and MICHAEL J. HENRY, MCI Telecommunications Corp., MCI Center, Three Ravana Drive, Atlanta, Georgia 30346, on behalf of MCI Telecommunications Corporation.

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R. DOUGLAS LACKEY, Esquire, 4300 Southern Bell Center, 675 West Peachtree Street, N.E., Atlanta, Georgia 30375, and HARRIS R. ANTHONY and HARRY M. LIGHTSEY, III, Esquires, c/o Marshall M. Criser, III, 150 So. Monroe Street, Suite 400, Tallahassee, Florida 32301, on behalf Southern Bell Telephone and Telegraph Company.

FLOYD R. SELF, Esquire, Messer, Vickers, Caparello, Madsen, Lewis, Goldman & Metz, P.A., Post Office Box 1876, Tallahassee, Florida 21201-1876, on behalf of US Sprint Communications Company Limited Partnership and The Florida Cable Television Association.

HAROLD McLEAN, Assistant Public Counsel, Office of Public Counsel, c/o The Florida Legislature, 111 West Madison Street, Room 812, Tallahassee, Florida 32399-1400, on behalf of the Citizens of the State of Florida.

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

WILLIAM E. WYROUGH, JR., Esquire, Florida Public Service Commission, 101 E. Gaines Street, Tallahassee, Florida 32399-0862, Counsel to the Commissioners.

PREHEARING ORDER

I. BACKGROUND

By Order No. 20162, this Commission ruled on Southern Bell Telephone and Telegraph Company's (Southern Bell's or the Company's) petitions for rate stabilization and other relief. As a result of implementing a rate stabilization plan, the Commission expanded the Company's authorized range of return on equity (ROE) to a minimum of 11.5% and a maximum of 16%. The Commission also set rates for the Company targeted at a 13.2% ROE. Within the expanded range, the Commission also implemented an earnings sharing plan. Any earnings in excess of 14% are to be shared, with 60% being given to Southern Bell's ratepayers and the other 40% to be retained by the Company. All earnings in excess of 16% after sharing are returned to the ratepayers. In addition, earnings stemming from certain exogenous factors and the net of rate

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increases, except regrouping, and rate decreases, were excluded from the sharing process.

By Order No. 24066, the Commission extended Southern Bell's rate stabilization plan until December 31, 1992. In extending the plan, the Commission retained the original parameters of the plan. However, it did not reset rates. The Commission also set aside for subsequent disposition \$18,420,620 for 1991 and an additional \$21,868,551 for 1992. These amounts are in addition to the amounts previously identified for subsequent disposition relating to 1989 through 1990. Order No. 24861 set forth the final amounts available for disposition. By Order No. 25367, Southern Bell was directed to refund approximately \$100.8 million including interest through the end of February 1992. The \$100.8 million refund was based on amounts held for disposition for 1988 through the end of 1991. By Order No. 25558, the Commission required Southern Bell to implement credit on customers bills in order to end further accrual of excess earnings from the prior set asides.

On October 3, 1991, the Office of Public Counsel (Public Counsel), the Attorney General of the State of Florida (AG), and the American Association of Retired Persons (AARP) filed a Joint Petition requesting certain relief with respect to Southern Bell. The petition requested: the immediate, across-the-board refund of more than \$80 million of accumulated overcharges; the immediate reduction of Southern Bell's current rates by approximately \$18 million annually now and by \$39.8 million effective January 1, 1992; a permanent reduction of Southern Bell's approved rates of, at a minimum, \$105.6 now and \$127.4 million effective January 1, 1992; the immediate placement of an additional \$87.6 million of annual revenues subject to refund pending the establishment of permanent rates; the filing of Minimum Filing Requirements (MFRs) by Southern Bell; and, the reinstatement of full rate base regulation under Section 364.036(5), Florida Statutes. The United States Department of Defense on behalf of and All Other Federal Executive Agencies (DOD) filed a motion on October 15, 1991, in support of the Joint Petition.

At our December 6, 1991, Agenda Conference, the Commission disposed of the the Petition. Inter alia, the Commission found it appropriate to hold an expedited hearing to address the issue of whether Southern Bell's cost of capital has significantly changed beyond that which was contemplated by the rate stabilization plan such that a new ROE should be set; and if so, the amount to be

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placed subject to refund. See Order No. 25541, issued December 26, 1991. This proceeding stems from this decision.

II. TESTIMONY AND EXHIBITS

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

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

III. ORDER OF WITNESSES

<u>WITNESS</u>	<u>APPEARING FOR</u>	<u>DATE</u>	<u>ISSUES</u>
<u>DIRECT</u>			
James A. Rothschild	OPC	2/10	Southern Bell's cost of capital and cost of equity
Joseph P. Gillan	Ad Hoc, OPC	2/10	
Mark Cicchetti	AARP	2/10	Southern Bell's capital structure and cost of equity

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<u>WITNESS</u>	<u>APPEARING FOR</u>	<u>DATE</u>	<u>ISSUES</u>
David C. Parcell	Ad Hoc	2/10	Issues of an appropriate return on equity, as well as the recent fundamental change in the economy and cost of capital which justifies a significantly lower future return
Charles King	DOD	2/11	Issue Nos. 1 and 2
Steven F. Clinger	FPTA	2/10	Issue Nos. 1 and 2
Barry F. Davis	Staff	2/10	Limited purpose of establishing Southern Bell's current achieved earnings
Anthony M. Lombardo	So. Bell	2/10	Changes in the terms and conditions of Southern Bell's Rate Stabilization Plan
Dr. James M. Vander Weide	So. Bell	2/10	Cost of Equity Capital to Southern Bell
Dr. Willard T. Carleton	So. Bell	2/10	Cost of Equity Capital to Southern Bell
<u>REBUTTAL</u>			
Mark Cicchetti	So. Bell	2/11	
David C. Parcell	Ad Hoc	2/11	
Dr. James M. Vander Weide	So. Bell	2/11	
Dr. Willard T. Carleton	So. Bell	2/11	

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IV. BASIC POSITIONS

AARP'S BASIC POSITION: Southern Bell's appropriate return on equity is now drastically lower due to changed economic conditions. The Commission should protect Southern Bell's customers while this docket goes forward through a full a rate case proceeding by placing sufficient revenues subject to refund.

ATT-C'S BASIC POSITION: This is a limited proceeding to determine the amount of revenues, if any, which should be placed subject to refund. AT&T has no position on such issues at this time. AT&T's interests in this proceeding are more concerned with issues which will be addressed in later stages of the case. AT&T will state its positions with respect to such issues at the appropriate time.

ATTORNEY GENERAL'S BASIC POSITION: Consistent with the Joint Petition ("Joint Petition") filed by this office with the Office of Public Counsel and the American Association of Retired Persons on October 3, 1991, it is the Attorney General's position that Southern Bell Telephone and Telegraph Company's ("Southern Bell") currently approved rates and charges yield excessive compensation for the services provided and must, therefore, in accordance for the applicable law be reduced to just and reasonable levels.

The unaudited surveillance report of Southern Bell for the twelve month period ending July, 1991 shows that the telecommunications company earned an achieved rate of return on equity of 13.6%. The affidavit of James A. Rothschild attached to the Joint Petition stated that the required rate of return on equity for Southern Bell was no more than 11.0%, and could be reasonably be determined to be 10.75%. The affidavit of Mr. Rothschild was prepared in late September, 1991 and it is likely that his current required equity return for Southern Bell would be lower since the relevant financial and economic indicators have continued to decline. Additional evidence that Southern Bell's current earned return on equity is dramatically excessive is the most recent Quarterly Report on equity Cost Rates prepared by the Commission's Division of Auditing and Financial Analysis. This report (copy attached) is dated December 12, 1991 and shows an equity cost rate for Southern Bell of 11.3% from the Discounted Cash Flow methodology and a 11.1% rate from the ex ante risk premium methodology. The relevant financial and economic inputs to these methodologies have declined since December 12, 1991 and it is

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likely that a current Commission staff analysis of Southern Bell's required rate of return on equity would result in lower numbers.

The affidavit of Billy D. Smith attached to the Joint Petition shows Southern Bell's revenues would be approximately \$87.6 million annually in excess of the revenues required to produce a return on 11.0%. Absent countervailing increase in legitimate expenses, declining financial and economic indicators since October, 1991, would result in more than \$87.6 million of annual revenues being excessive.

It is the Attorney General's position that Southern Bell's current compensation for the regulated telecommunications services it provides is clearly statutorily excessive and, therefore, unlawful. The purpose of the expedited hearing scheduled for February 10-11, 1992 is to more precisely determine, through an administrative evidentiary hearing, what a current reasonable return is and to place subject to refund all revenues in excess of that number.

DOD'S BASIC POSITION: The Commission should set aside revenues to reflect the decline in Southern Bell's required Return on Equity since 1988.

AD HOC'S BASIC POSITION: Ad Hoc believes that an appropriate allowed rate of return on common equity for Southern Bell Telephone for the purposes of this limited proceeding is 10.75%. While rates are not expected to change as an immediate result of this hearing, the revenue difference between the currently authorized 13.2% midpoint and Ad Hoc's recommended 10.75%, or 2.45%, should be placed subject to refund until the final order of the MFR hearings currently scheduled for November, 1992.

FCTA'S BASIC POSITION: The current rates of Southern Bell Telephone and Telegraph Company ("Southern Bell") yield excessive compensation for the regulated telecommunications services provided by the Company. The most recent unaudited surveillance report of Southern Bell shows that the Company earned an achieved return on equity of 13.60% during the twelve (12) month period from July, 1990, through July, 1991. The affidavit of James A. Rothschild annexed as Attachment 1 to the Joint Petition filed by the Office of Public Counsel, the Department of Legal Affairs and the American Association of Retired Persons seeking an immediate refund and other relief on October 3, 1991 ("Joint Petition") shows that the

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current cost of equity to Southern Bell is no more than 11.0%, and could reasonably be determined to be 10.75%. The affidavit of Bill D. Smith annexed as Attachment 2 to the Joint Petition shows that Southern Bell's surveillance report reflects revenues at least \$87.6 million per year in excess of the highest reasonable return on equity of 11.0%.

In accordance with Section 364.055, Florida Statutes, Southern Bell's rates are outside the range of reasonableness on the allowed rate of return, said rates are statutorily unreasonable and said rates should be reduced.

FCAN'S BASIC POSITION: Dramatically changed economic conditions should be reflected by adjusting Southern Bell's return on equity to a more appropriate level. The Commission should place sufficient revenues subject to refund so as to protect Southern Bell's customers while this docket goes forward through a full a rate case proceeding.

FIXCA'S BASIC POSITION: No position.

FPTA'S BASIC POSITION: The current rates of Southern Bell Telephone and Telegraph Company ("Southern Bell") yield excessive compensation for the regulated telecommunications services provided by the Company. The most recent unaudited surveillance report of Southern Bell shows that the Company earned an achieved return on equity of 13.60% during the twelve (12) month period from July, 1990, through July, 1991. The testimony of Steven F. Clinger indicates a cost of equity for Southern Bell of not more than 11.25%. Thus, a substantial rate reduction is in order.

In accordance with Section 364.055, Florida Statutes, Southern Bell's rates are outside the range of reasonableness on the allowed rate of return, said rates are statutorily unreasonable and said rates should be reduced.

MCI'S BASIC POSITION: The Commission should determine in this case whether Southern Bell's cost of capital has changed significantly beyond what was contemplated by the rate stabilization plan. If so, a new return on equity should be set for purposes of calculating an amount of revenues to be held subject to refund pending this outcome of Southern Bell's upcoming rate case.

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SOUTHERN BELL'S BASIC POSITION: The Southern Bell Rate Stabilization Plan ("the Plan") as approved by the Commission in 1988 and extended in 1990 does not contemplate that any proceeding will be instituted during the pendency of the Plan to review Southern Bell's cost of capital. The Plan permits a downward change in the rate setting and sharing points only if an unforeseen, significant improvement in the earnings of the Company occurs. Southern Bell is earning well within the range approved in the Plan and thus there has been no such improvement in the Company's earnings. In any event, there has not been a significant change in the cost of capital to Southern Bell since the adoption of the Plan. Indeed, the cost of capital remains above the Plan's rate setting point. Thus, even if such a change were allowed under the Plan, which it is not, the current cost of capital to Southern Bell would not justify any alteration in the terms of the Plan.

US SPRINT'S BASIC POSITION: If the Commission orders a reduction in Southern Bell's return on equity resulting in excess earnings, such revenues should be applied to further reduce access charges.

OPC'S BASIS POSITION: Southern Bell's return on equity is now drastically lower due to changed economic conditions. The Commission should place \$103,800,000 revenues per year subject to refund in order to protect Southern Bell's customers while this docket goes forward through a full a rate case proceeding.

STAFF'S BASIC POSITION: In view of the range of testimony offered by the participating parties, Staff takes no position.

V. ISSUES AND POSITIONS:

ISSUE 1: What is an appropriate allowed return on common equity for Southern Bell Telephone and Telegraph Company for the purposes of this limited proceeding?

AARP'S POSITION: Southern Bell's capital structure contains too much equity. At a more reasonable equity ratio of 58%, Southern Bell's cost of equity is 11.4%. At its present equity ratio its cost of equity is less. (Cicchetti)

ATT-C'S POSITION: AT&T has no position.

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ATTORNEY GENERAL'S POSITION: Based on the affidavit of James A. Rothschild, as of October, 1991, the appropriate rate of return on common equity for Southern Bell for the purpose setting rates was 11.0%. In view of the decline of relevant financial and economic indicators since the preparation of Mr. Rothschild's affidavit, it is likely that the current required equity return for Southern Bell would be marginally lower than 11.0%.

DOD'S POSITION: DOD/FEA believes that the ROE should be re-established, that revenues for calendar year 1991 and prospectively for calendar year 1992 should be held subject to refund; and finally, that the four rate of return on equity thresholds established by Commission order 20162 should be revised downwards by 150 basis points (1.5%). (King)

AD HOC'S POSITION: 10.75%

FCTA'S POSITION: As a matter of law and policy, the Commission should allow only a fair and reasonable return on Southern Bell's honest and prudent investment in property used and useful in providing regulated telecommunications services. Rates should be set allowing a return on common equity of no more than 11.0 percent.

FCAN'S POSITION: We support the position of Public Counsel, which places Southern Bell's cost of equity at 10.5%.

FIXCA'S POSITION: No position.

FPTA'S POSITION: Interim rates should be set allowing a return on common equity of no more than 11.25 percent, and allowing a common equity ratio of no more than 50%.

MCI'S POSITION: MCI has no position.

SOUTHERN BELL'S POSITION: Southern Bell's current cost of capital remains above the rate setting point approved by the Commission in 1988 and 1990. Thus, no change in the terms of the Plan is warranted. Southern Bell's earnings remain in the same range as they were when the Commission originally approved the Plan and when the Commission extended the Plan for the years 1991 and 1992. The Company's current cost of capital is in the range from 13.58% to 15.5%. This range places the Company's cost of capital above the

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rate-setting point of 13.2% and well within the allowable range from 11.5% to 16% originally established in 1988.

US SPRINT'S POSITION: US Sprint has no position.

OPC'S POSITION: 10.5% (Rothschild).

STAFF'S POSITION: No position.

ISSUE 2: How should the revenue to be placed subject to refund, if any, be calculated?

AARP'S POSITION: The Commission should place sufficient revenues subject to refund in order to fully protect Southern Bell's customers from overcharges while this case is pending.

ATT-C'S POSITION: AT&T has no position.

ATTORNEY GENERAL'S POSITION: The Commission should place the difference between Southern Bell's currently achieved earnings and the rate found currently reasonable, as a result of the expedited hearings, subject to refund pending the completion of the full rate proceeding. It is the Attorney General's position that these excessive revenues, whatever the amount, must be held subject to refund and the Commission's jurisdiction if the customers are to avoid the potential of being irreparably harmed.

DOD'S POSITION: The revenues for refunds should be computed as though those rates of return had been in effect during 1991 and will be in effect during 1992.

AD HOC'S POSITION: The difference between the currently authorized return of 13.2% and Ad Hoc's recommended 10.75% is 2.45%. Subtracting 2.45% from Southern Bell's current earnings will provide an amount of revenue which should be placed subject to refund at the conclusion of the November, 1992 hearings.

FCTA'S POSITION: First the Commission must establish the overall cost of capital, including the cost of equity as established in Issue 1. In determining cost of capital, capital structure must be adjusted to balance with regulated ratebase. Allocations to nonregulated investment must be allocated solely from equity or prorated as the Commission deems appropriate for construction work

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rate-setting point of 13.2% and well within the allowable range from 11.5% to 16% originally established in 1988.

US SPRINT'S POSITION: US Sprint has no position.

OPC'S POSITION: 10.5% (Rothschild).

STAFF'S POSITION: No position.

ISSUE 2: How should the revenue to be placed subject to refund, if any, be calculated?

AARP'S POSITION: The Commission should place sufficient revenues subject to refund in order to fully protect Southern Bell's customers from overcharges while this case is pending.

ATT-C'S POSITION: AT&T has no position.

ATTORNEY GENERAL'S POSITION: The Commission should place the difference between Southern Bell's currently achieved earnings and the rate found currently reasonable, as a result of the expedited hearings, subject to refund pending the completion of the full rate proceeding. It is the Attorney General's position that these excessive revenues, whatever the amount, must be held subject to refund and the Commission's jurisdiction if the customers are to avoid the potential of being irreparably harmed.

DOD'S POSITION: The revenues for refunds should be computed as though those rates of return had been in effect during 1991 and will be in effect during 1992.

AD HOC'S POSITION: The difference between the currently authorized return of 13.2% and Ad Hoc's recommended 10.75% is 2.45%. Subtracting 2.45% from Southern Bell's current earnings will provide an amount of revenue which should be placed subject to refund at the conclusion of the November, 1992 hearings.

FCTA'S POSITION: First the Commission must establish the overall cost of capital, including the cost of equity as established in Issue 1. In determining cost of capital, capital structure must be adjusted to balance with regulated ratebase. Allocations to nonregulated investment must be allocated solely from equity or prorated as the Commission deems appropriate for construction work

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in progress. To prevent cross-subsidization, the rate of return must be determined on monopoly services as distinguished from competitive services pursuant to section 364.3381, Florida Statutes (1991), then any excess revenue above the fair rate of return on monopoly services can be determined.

FCAN'S POSITION: The Commission should place the difference between Southern Bell's reported earnings of 13.58% and a current, reasonable return on equity of 10.5% subject to refund. The Commission should place sufficient revenues subject to refund so as to fully protect Southern Bell's customers from overcharges while this case remains pending.

FIXCA'S POSITION: No position.

FPTA'S POSITION: First the Commission must establish the overall cost of capital, including the cost of equity as established in Issue 1. In determining cost of capital, capital structure must be adjusted to balance with regulated ratebase. Allocations to nonregulated investment must be allocated solely from equity or prorated as the Commission deems appropriate for construction work in progress. To prevent cross-subsidization, the rate of return must be determined on monopoly services as distinguished from competitive services pursuant to Section 364.3381, Florida Statutes (1991), then any excess revenue above the fair rate of return on monopoly services can be determined.

MCI'S POSITION: MCI has no position.

SOUTHERN BELL'S POSITION: The Company's earnings remain in the range approved by the Commission and its cost of capital is above the current rate setting point. Therefore, there are no revenues to be placed subject to refund.

US SPRINT'S POSITION: US Sprint has no position on this issue at this time.

OPC'S POSITION: The Commission should place the difference between Southern Bell's reported earnings of 13.58% and a current, reasonable return on equity of 10.5% subject to refund. To accomplish this, the Commission should place \$103,800,000 per year to refund.

STAFF'S POSITION: No position.

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ISSUE 3: Does the Plan contemplate that the Company or the Commission will institute proceedings during the pendency of the Plan for the purpose of making adjustments solely because of alleged changes in the Company's cost of capital?

DOD'S POSITION: Southern Bell argues that the Plan requires significant, unforeseen improvements in earnings before it can be modified. (Southern Bell Prehearing Statement, Pg. 5). DOD/FEA believes that the Plan can be modified without "significant, unforeseen improvements;" however, even in the Commission requires such a standard, it has indeed been met. It is highly questionable that the Commission contemplated a change in the economy would occur to the extent that it has in the past 12 months. It is because of this change, in conjunction with other factors, that Southern Bell's cost of capital has declined so significantly. The testimony of a majority of Intervenors asserts that Southern Bell's cost of capital has declined to 11.0% or less. This is significantly less than the cost of capital in place both when the Plan was initiated and when it was extended.

Additionally, as pointed out in Mr. King's testimony on page 12, the Commission's commentary on the so-called "escape clause" in the Plan indicates that the Commission did contemplate the possible continuation of the Plan if there were reasons which warranted such action. (Order No. 21062). The state of the economy is analogous to an "exogenous factor" in that the Company has no control over its status. Had the opposite situation occurred, Southern Bell might be knocking on the Commission's door to discontinue the Plan because of a "significant unforeseen" decline which would place Southern Bell in financial jeopardy.

In summary, DOD/FEA believes that the decline in the required equity return because of the state of the economy and related factors is a significant unforeseen decline, such that it is a condition contemplated by the Plan. DOD/FEA believes that modification of Southern Bell's return on equity will not abrogate the other parameters of the Plan. The remaining thresholds should be adjusted downward to correlate with the reduced cost of capital finally decided upon by the Commission.

AD HOC'S POSITION: The Commission is not precluded from instituting proceedings for any purpose when situations not considered at the inception of the Plan become apparent.

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FCTA'S POSITION: Yes, further, this is a legal issue which the Commission will resolve in response to Southern Bell's Request for Reconsideration of Section II(C) of Order No. 25541.

MCI'S POSITION: As stated in response to Issue 5, MCI believes that the Commission has an obligation to review Southern Bell's cost of capital irrespective of what may have been contemplated by the Plan. Assuming arguendo that the Plan is controlling, Order No. 24066, which extended the Plan for two years, contemplated that adjustments would not be made to the Company's cost of capital before December 31, 1991, when three years of data had been collected under the Plan. Nothing in the Plan contemplates that the Commission would be precluded from examining the cost of capital to be applied during calendar 1992.

SOUTHERN BELL'S POSITION: The Plan was originally approved with a term of three years and subsequently extended for two years. The Plan was designed so that, absent major unforeseeable circumstances during its pendency, there would not be any rate proceeding instituted by the Company or the Commission. The sole provision in the Plan that allows for the institution of any proceeding by the Commission is if the Company experiences significant unforeseen improvements in its earnings. Thus, the Plan does not contemplate the institution of any proceeding by the Company or by the Commission solely because of a purported change in the Company's cost of capital.

US SPRINT'S POSITION: US Sprint has not taken a position on this issue at this time.

ISSUE 4: Should the Commission institute proceedings during the pendency of the Plan solely because of alleged changes in Southern Bell's cost of capital?

DOD'S POSITION: Yes. If the decline in the cost of capital is the reason why Southern Bell is and has been earning excessive profits since the extension of the Plan, then it is a proper reason for proceedings to be instituted by the Commission. Indeed, cost of capital cannot be viewed in a vacuum. Changes in this factor also cause changes in other parameters of the Plan. For example, as noted above, a change in cost of capital also affects the sharing threshold and the authorized floor and ceiling originally decided in 1988. Therefore, this proceeding, while originally instituted

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to review the cost of capital, will ultimately affect other thresholds of the Plan.

AD HOC'S POSITION: The Commission has that opinion.

FCTA'S POSITION: Yes, further, this is a legal issue which the Commission will resolve in response to Southern Bell's Request for Reconsideration of Section II(C) of Order No. 25541.

MCI'S POSITION: Yes.

SOUTHERN BELL'S POSITION: No. The Plan was approved by the Commission as an experiment in recognition of the rapidly changing dynamics in the telecommunications industry in Florida. As the Commission stated in Order No. 24066, in which it extended the Plan for the years 1991 and 1992, there is a need for complete data on the totality of the Plan in order to evaluate whether the Plan has achieved the desired results. In addition, as recently as December 17, 1992, Order No. 25482, which denied the Office of Public Counsel's and the Department of Defense's Motions for Reconsideration of Order No. 24066, recognized that to adjust downward the earnings range allowed to Southern Bell under the Plan would deprive the Company of the benefits it has achieved as a result of increased efficiency and the introduction of new services during the time the Plan has been in effect.

US SPRINT'S POSITION: US Sprint has no position on this issue at this time.

ISSUE 5: Is the Commission compelled, as a matter of law, to set rates for Southern Bell which are fair, just and reasonable and not excessive, irrespective of the provisions of any Plan, experiment or the like, approved by the Commission in the past?

ATTORNEY GENERAL'S OPINION: Yes. The Florida Statutes are replete with language idrecting the Commission to only allow monopoly telecommunication services rates and charges that are fair, just, reasonable, and which do not yield excessive compensation. Section 364.03(1), F.S., for example, provides that "[a]ll rates...of...telecommunications companies...shall be fair, just, reasonable, and sufficient..." Section 364.035(3), F.S., provides, in part, that [i]t is the legislative intent in requiring

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the mandatory filing of the minimum filing requirements that the Public Counsel and other substantially affected persons be assured...the rates and charges of a local exchange telecommunications company are just, reasonable, not unjustly discriminatory, not in violation of law, and not yielding excessive compensation for the service rendered. Section 364.14(1), F.S., places a statutory burden and responsibility on the Commission, stating "[w]henver the commission finds, upon its own motion or upon complaint, that...[s]uch rates, charges, tolls, or rentals yield excessive compensation for the service rendered, the commission shall determine the just and reasonable rates...and fix the same by order.

It is clear that the Florida Statutes, as a matter of law, will only tolerate telecommunications rates that yield reasonable compensation. It is likewise clear that the Commission has no discretion to allow otherwise. However, what is "reasonable" or "excessive" compensation is a question of fact which must be answered by the application of evidence to certain well-established judicial criteria. These criteria, which were established by the Supreme Court of the United States in Bluefield Waterworks and Improvement Company v. Public Service Commission of West Virginia, 262 U.S. 679 (1923) and Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944) and have been followed by state courts and utility commissions, provide that the equity portion of the compensation to a regulated utility should be commensurate with returns on investments having corresponding risks and should be sufficient to assure confidence in the financial integrity of the utility so that its credit is maintained and so that it may attract capital.

It is the Attorney General's position that the Commission's orders establishing and extending the term of the so-called incentive rate plan for Southern Bell were not intended to, and cannot; be read to allow Southern Bell to achieve compensation at a certain level or range of established earnings without regard to the conditions currently being experienced in this nation's economic and financial markets. Even if the Commission fully intended such a result in its prior orders, it would still be statutorily bound to determine just and reasonable rates at a level which were neither insufficient to yield reasonable compensation nor which yielded excessive compensation.

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DOD'S POSITION: Yes. As noted in the Attorney General's position to its original Issue of Law presented at the Prehearing Conference, the Commission has a statutory obligation to ensure that Southern Bell's rates allow it to earn a "reasonable" return on equity given the present economic and financial conditions. Section 364, Florida Statutes (1991), does not contain a requirement of significantly changed circumstances before authorizing the Commission to perform its duty to set reasonable rates. Indeed, the statutes require the Commission to determine just and reasonable rates when it appears that the Company may be earning excessive compensation. The Commission Order in this docket extending the Plan may not violate this statutory duty. If the Plan (as argued by Southern Bell) does not contemplate modification based upon a change in the cost of capital unless it is considered a "significant, unforeseen circumstance," it must be overturned in that one respect if following that language allows excessive compensation in violation of Florida Statutes.

AD HOC'S POSITION: Yes.

FCTA'S POSITION: Yes, under Section 364.14(1)(c), Florida Statutes (1991), if the Commission finds that Southern Bell's rates and charges yield excessive compensation for the services rendered, the Commission is then compelled to set rates for Southern Bell which are fair, just, reasonable and not excessive. This statutory mandate cannot be abrogated by prior Commission order.

MCI'S POSITION: Yes.

SOUTHERN BELL'S POSITION: Any final decision of the Commission is binding upon the Commission and the other parties to the decision in the absence of significantly changed circumstances. The doctrine of administrative res judicata does apply in Florida Peoples Gas System, Inc. v. Mason, 187 So.2d 335 (Fla. 1966) Under this doctrine, the Commission should not alter a decision unless significantly changed circumstances justify the change. Peoples Gas System, supra; Austin Tupler Trucking, Inc. v. Hawkins, 377 So.2d 679 (Fla. 1979) Having approved the terms of the Southern Bell incentive plan, and having committed to refrain from any alteration of those terms absent a significant improvement in the earnings of Southern Bell, the Commission should not alter those terms unless there have been significant changed circumstances. Since the evidence will prove that Southern Bell's cost of equity

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is still within the range of 11.5% to 16%, no change in circumstances has occurred.

US SPRINT'S POSITION: US Sprint has no position on this issue at this time.

VI. EXHIBIT LIST

<u>WITNESS</u>	<u>PROFFERING PARTY</u>	<u>EXH. NO.</u>	<u>TITLE</u>
Mark Cicchetti	AARP	MC-1	
		MC-2	
		MC-3	
		MC-4	
		MC-5	
Mark Cicchetti	AARP	MC-6	
		MC-7	
		MC-8	
		MC-9	
		MC-10	
		MC-11	
		MC-12	
		MC-13	
Charles King	DOD	CK-1	Trends in Interest Rates, 1988-91
		CK-2	Trends in Stock Market Prices, 1988-91
		CK-3	Trends in Corporate Prices, 1988-91
		CK-4	<u>Business Week Index, January 20, 1992</u>

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<u>WITNESS</u>	<u>PROFFERING PARTY</u>	<u>EXH. NO.</u>	<u>TITLE</u>
Steven F. Clinger	FPTA	SFC-1	Telephone Holding Company Index
		SFC-2	Discounted Cash Flow Model
		SFC-3	Risk Premium Model
		SFC-4	Capital Asset Pricing Model
		SFC-5	Southern Bell's Cost of Equity
		SFC-6	Market to Book Ratio Analysis
		SFC-7	Bonds vs. Utility Common Stocks
		SFC-8	Public Utility Bond Yields
		SFC-9	Consumer Price Index
		SFC-10	Moody's Corporate Bond Rating
J.H. Vander Weide	So. Bell	JHV-1	Summary of Discounted Cash Flow Analysis for Comparable Company Group
		JHV-2	Comparative Returns on S&P 500 Stock Index and Moody's Aa- Rated Bonds 1937-1991
		JHV-3	Actions of the FCC and the Federal Courts to Increase Competition in the Telecommunications Industry

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<u>WITNESS</u>	<u>PROFFERING PARTY</u>	<u>EXH. NO.</u>	<u>TITLE</u>
J.H. Vander Weide	So. Bell	JHV-4	Derivation of the Quarterly DCF Model
		JHV-5	Cluster Analysis
		JHV-6	Risk Premium Approach--Stock and Bond Calculation
W. T. Carleton	So. Bell	WTC-1	Percent of Stock Price Attributed to Cellular
		WTC-2	Estimated Impact of Cellular on 1990 Earnings
		WTC-3	Impact of Cellular Operations on BRHC Equity Values and Earnings
		WTC-4	S&P 500 Index DCF Cost of Equity, Bond Yields and Risk Premiums
		WTC-5	Percent of Stock Price Attributed to Cellular (Updated)
		WTC-6	Average Cost of Equity for the BRHCs Using a Cellular- Adjusted DCF
James Rothschild	OPC	JAR-1	
Joseph Gillan	OPC	JG-1	
Barry F. Davis	Staff	BFD-1	Southern Bell's most current quarterly surveillance report

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VII. STIPULATIONS:

No issues have been stipulated at this time.

VIII. PENDING MOTIONS:

1. Southern Bell's Motion for Review of Order No. 25524
2. Southern Bell's Motion for Reconsideration of Order No. 25541

NOTE: These motions were heard and disposed of by the Commission at the February 4, 1992 Agenda Conference.

IX. RULINGS:

1. Southern Bell's Motion to Strike portions of testimony of witnesses Parcell, Rothschild, Cicchetti, and Clinger regarding Southern Bell's Capital Structure is deferred for ruling by the full Commission.
2. The request of the Florida Interexchange Carriers Association to be excused from participation in this proceeding is granted.
3. Public Counsel's request to withdraw the testimony of Billy D. Smith is granted.
4. Due to the possibility of a Bench Ruling, parties should be prepared to make opening and closing statements.

X. PROCEDURE FOR HANDLING CONFIDENTIAL INFORMATION:

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

1. The Party utilizing the confidential material during cross examination shall provide copies to the Commissioners and the Court Reporter in envelopes clearly marked with the nature of the contents. Any party wishing to examine the confidential material shall be provided a copy in the same fashion as provided to the Commissioners subject to execution of any appropriate protective agreement with the owner of the material.

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2. Counsel and witnesses should state when a question or answer contains confidential information.
3. Counsel and witnesses should make a reasonable attempt to avoid verbalizing confidential information and, if possible, should make only indirect reference to the confidential information.
4. Confidential information should be presented by written exhibit when reasonably convenient to do so.
5. At the conclusion of that portion of the hearing that involves confidential information, all copies of confidential exhibits shall be returned to the owner of the information. If a confidential exhibit has been admitted into evidence, the copy provided to the Court Reporter shall be retained in the Commission Clerk's confidential files.

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

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

The testimony and evidence we are about to receive is proprietary confidential business information and shall be kept confidential pursuant to Section 364.183, Florida Statutes. The testimony and evidence shall be received by the Commissioners in executive session with only the following persons present:

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

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

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

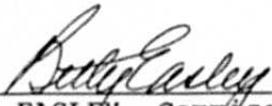
(AFTER THE ROOM HAS BEEN CLOSED)

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

It is therefore,

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

By ORDER of Commissioner Betty Easley, as Prehearing Officer, this 7th day of FEBRUARY, 1992.



BETTY EASLEY, Commissioner
and Prehearing Officer

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