IN THE SUPREME COURT OF FLORIDA

GENERAL TELEPHONE COMPANY OF FLORIDA, Appellant, v. JOHN R. MARKS, et al., in the official capacity as and constituting the FLORIDA PUBLIC SERVICE COMMISSION, Appellee.	)	CASE NO. 68,691

ANSWER BRIEF OF APPELLEE FLORIDA PUBLIC SERVICE COMMISSION

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CITATION OF AUTHORITIES

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DESIGNATIONS

1. Appellant, General Telephone Company of Florida, will be referred to as "General."

2. Appellee, the Florida Public Service Commission, will be referred to as "the Commission."

3. References to Appellant's Brief will appear as (App. Br. ___).

4. References to the Record on Appeal will appear as (R. ____).

5. References to the Hearing Transcript will appear as (Tr. ___).

6. Rule 25-4.405, Florida Administrative Code, is referred to as "Rule 25-4.405" or as "the rule."

7. Section 364.037, Florida Statutes (1985), is referred to as "section 364.037" or as "the statute."

8. Southern Bell Telephone and Telegraph Company will be referred to as "Southern Bell."

STATEMENT OF THE CASE AND FACTS

The Statement of the Facts and Case set forth in the initial Brief of General is argumentative, misleading and inaccurate, and it omits relevant facts. Therefore, a Statement of the Case and Facts is provided below.

This proceeding involves a challenge to a newly adopted rule of the Public Service Commission, Rule 25-4.405, Florida Administrative Code. The rule is intended to implement section 364.037, Florida Statutes, enacted in 1983.

The statute divides post-1982 gross profits derived from directory advertising by telephone companies between ratepayers and stockholders. Rule 25-4.405, adopted April 1, 1986, implements this allocation by defining directory revenues and directory expenses and specifying that gross profits are calculated by subtracting these expenses from these revenues. Using this procedure, it establishes 1982 Gross Profit Bases for all local exchange telephone companies in the State of Florida. The rule sets General's 1982 Gross Profit Base at $22,371,496. (R. 65).

The sole issue presented by this case is whether the rule properly included the directory expense of furnishing white pages in computing gross profits from directory advertising as directed by the statute.

Southern Bell argued in a rate increase case that yellow page operations should be excluded from ratemaking because they are competitive and as such the need for regulation disappears. The Commission rejected this proposal and applied its long-standing practice of including both revenues and expenses for ratemaking purposes. This decision was a consistent application of the Commission's policy calling for including all telephone directory revenues and expenses in the ratemaking procedure as a fully regulated undertaking. In re: Petition of Southern Bell Telephone and Telegraph Company for a Rate Increase, 81 F.P.S.C. 12:59 (1981) ("Rate Increase Order").

Southern Bell appealed, and while this appeal was pending, the Legislature addressed generally the treatment of directory revenues and directory expenses in enacting the statute in 1983. This answered Southern Bell's narrow question relating to yellow page operations then under appeal. Following the legislation's passage, this Court ruled that the yellow page issue raised in Southern Bell's appeal had been rendered moot. Southern Bell Telephone and Telegraph Co. v. Florida Public Service Commission, 443 So.2d 92 (Fla. 1983)("the Southern Bell decision").

The statute directed that the gross profit earned by telephone companies from directory advertising be allocated between ratepayers and stockholders. One portion is to be considered by the Commission in ratemaking, which will benefit

customers by reducing the companies' revenue requirements. This will serve to keep telephone rates lower. The balance is to remain for the exclusive benefit of stockholders.

The statute sets forth a mechanism for determining the part of post-1982 gross profits to be included in setting a company's telephone rates. Actual gross profit for 1982 is to be used in this calculation unless the expense of furnishing directories exceeds 40 percent of the gross revenues derived from directory advertising. If this expense cap is exceeded, an adjusted gross profit figure for 1982 will be used. It is found by reducing the actual expense to 40 percent, thereby increasing 1982 gross profits.

The relevant 1982 gross profit figure is then adjusted by the Consumer Price Index and by customer growth. The product becomes the portion of a test year's gross profit to be included in the ratemaking procedure. However, the statute requires that a minimum of two-thirds of the gross profit for the test year be included.

If a test year's gross profit exceeds the above portion, then the excess is allocated by the statute to the company. The company is then free to use this amount for the good of its stockholders. Therefore, when a company increases its gross profit from directory advertising sales beyond the rise in the Consumer Price Index and customer growth, its stockholders are rewarded. Under this incentive, companies are

encouraged to enhance their marketing efforts for directory advertising in order to accrue benefits for their stockholders and for customers.

General participated in the Commission hearing held December 11, 1985, to consider adopting a regulation for implementing the statute. Mr. Barry A. Johnson, General's witness, offered testimony that the directory expenses of furnishing white pages should be excluded from the calculation of gross profit under the statute. He claimed that General's 1982 gross profit should be $22,981,401. (Tr. 21-37). However, Mr. Johnson also testified that white page expenses are included in Account 649 and are expenses incurred in furnishing directories, as contemplated by section (3) of the statute. (Tr. 34 & 35). At the conclusion of this proceeding, General filed pleadings with the Commission which reasserted this claim. (R. 17 & 55).

The Commission Staff witness, Mr. Bob Livingston, testified that white page expenses should be included in computing gross profits derived from directory advertising. (Tr. 19 & 20). He stated that the Commission would otherwise have to rely upon allocation procedures for separating directory expenses between white and yellow pages that would vary by company. (Tr. 15 & 18).

SUMMARY OF ARGUMENT

Rule 25-4.405, which implements section 364.037 to divide post-1982 gross profits derived from directory advertising by telephone companies between ratepayers and stockholders, is reasonably related to the legislative purposes of the statute.

The rule reflects a reasonable interpretation of the intent of the Legislature in enacting the statute. At the time of enactment, the Legislature was aware of the Commission's long-standing practice of including white page expenses in the ratemaking procedure. This presumption is based upon its 1982 reenactment of Chapter 364, Florida Statutes, during its sunset review. The Legislature intended for the Commission to continue its application of this policy.

Gross profits, calculated in accordance with the Commission's practice of routinely applying this policy, were directed by the statute to be allocated between stockholders and ratepayers. Thus, stockholders would receive a direct benefit from directory advertising for the first time.

In acting to implement the statute, the Commission was justifiably concerned with protecting customers of monopoly services from subsidizing a competitive service, directory advertising. The promulgation of the rule was neither an arbitrary nor a capricious exercise of the Commission's discretion.

?
yellow page operations have always subsidized local rate

ARGUMENT

THE RULE IS REASONABLY RELATED TO THE PURPOSES OF THE ENABLING LEGISLATION AND IS NEITHER ARBITRARY NOR CAPRICIOUS.

The standard adopted by this Court for assessing the validity of a regulation is whether the rule is reasonably related to the purposes of the enabling legislation and is not arbitrary or capricious. General Telephone Co. v. Florida Public Service Commission, 446 So.2d 1063 (Fla. 1984) ("the General decision"). A heavy burden is clearly placed upon General to overcome the presumption of validity exacted by this standard. General has not sustained this burden.

General has failed to demonstrate that the rule bears no reasonable relationship to the statute's purposes. Nor has General shown it to be either an arbitrary or capricious exercise of the Commission's discretion.

General's strained effort to convince this Court that the Commission misinterpreted legislative intent is a markedly unpersuasive attempt to meet the first test of this standard. With regard to the second test, General presses no claim that the Commission acted arbitrarily or capriciously in promulgating the rule. General offered a proposal which the Commission rejected in adopting the rule; however, General availed itself of an abundant opportunity to be heard on this issue by the Commission before this action was taken.

A. The Commission promulgated a valid rule that reasonably interprets the legislative purposes of section 364.037, Florida Statutes.

In the General decision, this Court adopted the First District Court of Appeal's explanation of the correct standard for judicial review of a rule adopted by an agency in accordance with an empowering statute. This standard was fully expressed in Agrico Chemical Co. v. State, Department of Environmental Regulation, 365 So.2d 759 (Fla. 1st DCA 1978), cert. denied, 376 So.2d 74 (Fla. 1979), where the Court said:

> Rulemaking by an agency is a quasi-legislative action and must be considered with deference to that function. In Florida Beverage Corporation v. Wynne, 306 So.2d 200 (Fla. 1st DCA 1975), this Court said:
>
> > Where the empowering provision of a statute states simply that an agency may make such rules and regulations as may be necessary to carry out the provisions of this Act, the validity of the regulations promulgated thereunder will be sustained as long as they are reasonably related to the purposes of the enabling legislation, and are not arbitrary or capricious.

365 So.2d at 762.

This Court recognized in the General decision a more limited review standard for quasi-legislative proceedings than for quasi-judicial proceedings. The standard of competent and substantial evidence of record which serves as the review standard in quasi-judicial proceedings was deemed inapplicable to rulemaking proceedings.

The Commission's promulgation of the rule complied with each provision of this test. The statute broadly outlined the process of dividing post-1982 gross profits between ratepayers and stockholders. It left the formulation of precise methodology to the discretion of the Commission. In doing so, the Legislature relied upon the expertise of the Commission for the construction of an allocation procedure, following the statute's blueprint in building on the carefully crafted foundation of accounting practices and policies. Fogarty Bros. Transfer, Inc. v. Boyd, 109 So.2d 883 (Fla. 1959)("Fogarty"); and State v. Atlantic Coast Line R. Co., 54 So. 900 (Fla. 1911). In Fogarty, this Court adopted the following language of the Supreme Court of the United States from American Trucking Ass'n v. United States, 344 U.S. 298 (1952):

> As a matter of principle, we might agree with appellants' contentions if we thought it a reasonable canon of interpretation that the draftsmen of acts delegating agency powers, as a practical and realistic matter, can or do include specific consideration of every evil sought to be corrected. But no great acquaintance with practical affairs is required to know that such prescience, either in fact or in the minds of Congress, does not exist. Its very absence, moreover, is precisely one of the reasons why regulatory agencies such as the Commission are created, for it is the fond hope of their authors that they bring to their work the expert's familiarity with industry conditions which members of the delegating legislatures cannot be expected to possess. [Citations omitted].

109 So.2d at 886.

Viewed against this backdrop, there was no need for the Legislature to define words and phrases in common usage by the Commission in carrying out its duties. The Legislature reasonably expected that the Commission possessed a sufficient understanding of accounting principles to permit it to calculate the 1982 gross profits of each telephone company. Therefore, detailed explanations in the statute were unnecessary. Citizens of State v. Florida Public Service Commission, 425 So.2d 534 (Fla. 1982).

The rule gives effect to legislative intent by specifying the exact revenues and expenses to be employed under the statutory framework. Further, it describes how they will be used in subsequent test years. The rule also sets each company's 1982 gross profit. This figure will serve as a base line to be adjusted during a subsequent test year. After adjustment for Consumer Price Index changes and customer growth, the 1982 gross profit is the regulated portion for ratemaking purposes.

In carrying out this legislative intent, the Commission's interpretation of the statute is consistent with the Southern Bell decision. In that case, this Court was asked to resolve the issue of whether yellow page revenues and expenses should be included in ratemaking. This Court was not presented the larger issue of the proper accounting for directory operations in general. Therefore, the Southern Bell decision speaks

exclusively of yellow page operations in ruling that the passage of the statute rendered moot this narrow issue.

General's view of this Court's holding in that case conflicts profoundly with ours and is unsupportable. General focuses narrowly on this Court's language regarding the publication of the yellow pages and charges that a substantive ruling on white page expenses was rendered. (App. Br. 11 & 12). In holding the yellow page issue moot, this Court ruled only on the procedural point raised by the passage of legislation and rendered no interpretation of that legislation.

General alleges further that the rule violates Section 6, Article III, of the Florida Constitution, which states, in pertinent part:

> Every law shall embrace but one subject and matter properly connected therewith, and the subject shall be briefly expressed in the title. . . .

The purpose of this provision is to assure adequate notice to legislators and to the public with respect to impending legislation. United Gas Pipe Line Co. v. Bevis, 336 So.2d 560 (Fla. 1976).

The relevent portion of the title of the act whose passage created the statute provides:

> An act relating to telephone companies; creating s. 364.037, Florida Statutes, requiring the Public Service Commission to consider certain directory advertising revenues in establishing rates . . ..

Ch. 83-73, Title, Laws of Fla.

General admits that the act creating the statute complies with this notice provision of the Florida Constitution but claims that the rule does not.

The public's right to notice was fully protected through the notice procedures employed by the Commission in the rulemaking proceeding. Order No. 15347, issued November 12, 1985 (R. 1), gave notice of the commencement of this proceeding, specifying that the accounting for directory revenues and expenses would be an issue considered there. This notice was published on November 22, 1985, at page 4439 of Vol. 11, No. 47, of the Florida Administrative Weekly. Thus, the Commission made certain that the public was given adequate notice of what the rulemaking entailed.

The adoption of the rule was a reasonable exercise of the broad discretion accorded to the Commission by the Legislature under the statute. General has fallen far short of meeting its burden of showing that the rule is not reasonably related to legislative purposes of the statute or is arbitrary or capricious.

B. The Commission has consistently charged all directory expenses against directory advertising revenues in calculating gross profits in the ratemaking procedure within the authority of section 364.037.

The Commission consistently and routinely includes all revenues and all expenses relating to directories, both the white and yellow page sections, in setting telephone rates. This has been Commission policy for as long as directories have been furnished to customers. Rate Increase Order, supra at 76-78.

The Legislature is presumed to be aware of the Commission's long-standing practice. This was especially true in light of its reenactment in 1980 of Chapter 364, Florida Statutes, during its sunset review of statutes governing the Commission's practices. State Ex Rel. Szabo Food Serv., Inc. of N.C. v. Dickinson, 286 So.2d 529, 531 (Fla. 1973).

This policy is implemented through the prescription of an accounting system for use by telephone companies. The Commission has adopted the Uniform System of Accounts (USOA) prescribed by the Federal Communications Commission. See Fla. Admin. Code Rule 25-4.17. The USOA deals with directory operations in Account 523-"Directory Advertising and Sales" and Account 649-"Directory Expenses," 47 Code of Federal Regulations §§31.523 and 31.649, respectively. General's

witness Johnson admitted that white page expenses, along with other directory expenses, are recorded in Account 649. (Tr. 35).

In the view of Commission Staff witness Livingston, the words: "the expense to a company to furnish directories" contained in section (3) of the statute, show that the Legislature intended white page expenses to be subtracted from directory revenues to arrive at gross profits. (Tr. 19). While this provision deals with the 40 percent expense cap that is applicable only to the 1982 gross profit computation, the fact remains that it is the only reference in the statute to the proper accounting for directory expenses.

Because the statute specifies a particular accounting methodology for one procedure, it is reasonably inferred that the same methodology is intended to apply throughout. Logic dictates this conclusion in the absence of directions elsewhere in the statute to follow an alternative methodology.

General initially asserts that: "Section 364.037 makes absolutely no mention of white page expenses anywhere in the statute." (App. Br. 11). But General then tries to read into the statute an exclusion of white page expenses through an interpretive shell game. By seeking to focus only on the subject matter of the legislation, directory advertising, General attempts to make the statute say that only those expenses associated with directory advertising should be included in the gross profit calculation.

The invalidity of General's argument is pointed out by its observation that: "Nowhere is permission given to include white page expenses in computing gross profit." Id. Indeed, given the Commission's consistent application of its long-standing policy on accounting for directory operations and the Legislature's awareness of it, the logical conclusion is that statutory language would have directed white page expenses to be excluded had the Legislature wished to reverse this practice.

The Commission submits that the treatment of white page expenses in the rule is a rational implementation of the statute, and as such it is reasonably related to the purposes of the statute.

C. The Commission adopted Rule 25-4.405 to prevent an undue subsidization of directory advertising operations.

In carrying out the directives of the statute, the Commission complied with the mandates of Chapter 364, Florida Statutes, to assure that rates are fair, just, reasonable and sufficient. The Commission carefully considered the manner in which any regulations adopted for implementing the statute would affect telephone rates. It sought to protect customers from inflated rates for monopoly services that would provide undue subsidies of a company's competitive directory advertising operations. The rule is, in fact, a reasonable

approach to the problem of insuring that the rates of monopoly service, i.e., local telephone service, are not inflated to subsidize the reduced rates of competitive services, e.g., directory advertising.

General's exertions in attempting to demonstrate the financial damage to its stockholders occasioned by the rule disserve this Court. A major thrust of the statute was to benefit telephone company stockholders by providing an incentive to increase sales of directory advertising. Prior to its enactment, stockholders received no direct benefit from directory advertising sales. One of the purposes of the legislation was to reward them directly from these activities for the first time. Even in the absence of a statute, this Court has upheld similar incentive programs as reasonable exercises of the Commission's general powers. See, e.g., Citizens of State v. Florida Public Service Commission, 464 So.2d 1194 (Fla. 1985). General cannot make a valid case that the Commission took away any advantage granted to its stockholders by the statute.

The testimony of General's witness Johnson was not accepted by the Commission. He complains of a "disadvantage" to General (Tr. 27) in the amount of $609,905. This is the difference in the 1982 gross profit figure established by the rule and the amount advocated by him. Under General's white page expense exclusion proposal, the portion for ratemaking would be higher by this $609,905 amount. Consequently, General's higher 1982

gross profit figure, after adjustment in a future test year, must result in a higher part of that year's gross profit going into ratemaking for the advantage of customers. By supporting a higher initial base line amount, General thus appears to argue in favor of a "disadvantage" to its stockholders. It is noteworthy that General did not later press this claim in its Comments (R-17) or its Brief.

The hypothetical comparison offered by General (App. Br. 7) is seriously misleading because it employs inconsistent methodology. The $500,000 white page expense cannot all go "below the line" to stockholders. General erred when it inaccurately supposed that the 1982 "Trended Gross Profit" figure of $4,500,000 could be identical in Case A and Case B. This is a practical impossibility. White page expense can either be included or excluded in calculating both 1982's gross profit and a subsequent test year's gross profit; it cannot be included in one calculation and excluded from the other.

A correction is necessary for General's hypothetical comparison to be made consistent. In order for General's example to be properly presented, the 1982 white page expense must be excluded in arriving at 1982 "Trended Gross Profit". However, the 40 percent expense cap will most likely prevent this figure from being reduced dollar-for-dollar by the full amount of white page expenses. Reducing 1982 gross profit by a portion of 1982 white page expenses would lessen the difference between the "Incentive Amount" flowing to stockholders under Case A and Case B.

The Commission is most concerned about the fairness and consistency of the accounting methodology being applied. Neither General's stockholders nor its customers should receive a windfall through a misapplication of the accounting methodology. The statute has two discrete aims. First, telephone customers get an amount of future profits from directory advertising at the 1982 gross profit level plus the growth in Consumer Price Index and customer base. Secondly, the telephone company gets to retain future profits above that amount subject to a one-third cap. The intention of the Legislature was never to shift white page expenses out of the procedure for accomplishing these two aims.

Set out below is an accurate comparison of General's Case A and Case B analysis. It demonstrates the financial detriment suffered by customers under General's exclusion proposal. The comparison is constructed from estimates of 1984 directory revenues and expenses and assumptions concerning intervening Consumer Price Index changes and customer growth that were filed by General with the Commission. (R. Vol. II, Exhibit 6). See Appendix A. General's filing contains an error which leads to a flawed conclusion[1]; however, the revenue and

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[1] In calculating 1982 Expenses, Line No. 2(5), of $19,025,371, General neglected to account for the 40 percent expense cap; therefore, the accurate is $14,917,657. This correction produces a 1982 Adjusted Gross Profit, Line No. 6(5), of $26,184,120. See note 2, infra.

expense estimates and the Consumer Price Index and customer growth assumptions are reasonable.

The following table is provided to illustrate the relative magnitude of the portion of 1984 gross profit from directory advertising going into ratemaking and the part flowing to stockholders. The numbers are rounded to the nearest $100,000.

	CASE A	CASE B
Directory Revenues	$ 63,600,000	$ 63,600,000
Other Directory Expenses	(22,600,000)	(22,600,000)
White Page Expenses	(7,400,000)	---
Gross Profit	$ 33,600,000	$ 41,000,000
Adjusted 1982 Gross Profit	(26,200,000)[2]	(27,300,000)[3]
Incentive Amount	$ 7,400,000	$ 13,700,000

Case B, excluding white page expenses, results in a higher allocation of 1984 gross profit to stockholders. It should be noted that even more 1984 gross profit would have been included in the "Incentive Amount" but for the statute's cap of one-third of gross profits allowable to stockholders.

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[2] In accordance with Rule 25-4.405, General's Adjusted 1982 Gross Profit, $26,200,000, is found by multiplying its 1982 Gross Profit, $22,400,000, by 8.63% for customer growth and 7.72% for Consumer Price Index increase. The product exceeds two-thirds of the 1984 Gross Profit; therefore, the statutory minimum amount for ratemaking purposes is satisfied.

[3] Under General's exclusion proposal, the amount that would be General's Adjusted 1982 Gross Profit, $26,900,000, is computed by multiplying its 1982 Gross Profit, $23,000,000, by 8.63% for customer growth and 7.72% for Consumer Price Index increase. However, the figure thus produced is less than two-thirds of the 1984 Gross Profit. As a result, the statutory minimum amount, $27,300,000, is used instead for ratemaking.

Case A, including white page expenses, shows that a substantial portion of 1984 gross profit is reserved for stockholders, approximately 22 percent. This is a far cry from the "small amount" which General alleges they will receive under the rule. (App. Br. 5 & 6.)

The Commission properly rejected General's proposal in order to protect customers of monopoly services from subsidizing a competitive service, directory advertising. The Commission adopted the rule which is reasonably related to the purposes of the statute and is neither arbitrary nor capricious.

CONCLUSION

Rule 25-4.405, adopted by the Florida Public Service Commission for implementing section 364.037, Florida Statutes, to divide gross profits derived from directory advertising by telephone companies between ratepayers and stockholders, is reasonably related to the purposes of the statute and is neither arbitrary nor capricious. As such, the rule should be affirmed by this Court.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing Answer Brief of Appellee Florida Public Service Commission in Case No. 68,691 (Docket No. 840128-TL) has been furnished by United States Mail, this 11th day of August, 1986, to:

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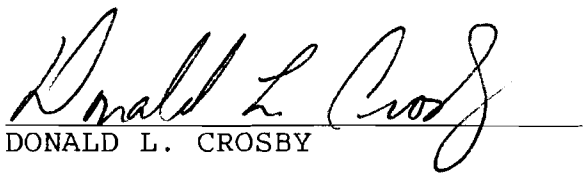

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