IN THE SUPREME COURT OF FLORIDA

THE CITIZENS OF FLORIDA, Appellant, v. KATIE NICHOLS, et al., Appellees.	)	CASE NO. 73,623

ANSWER BRIEF CF APPELLEE, FLORIDA PUBLIC SERVICE COMMISSION

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DESIGNATIONS AND ABBREVIATIONS

Appellee, Florida Public Service Commission, will be referred to in this brief as the "Commission".

Appellant, Office of Public Counsel, will be referred to in this brief as "Public Counsel".

References to the transcript are designated as "Tr. Vol. ___, p. ___". The transcript volumes cited in this brief are from the hearing held on July 18-21, 1988. The cited transcripts are located in R. Volumes XXV, XXVI, XXVII, and XXX.

References to the record are designated as "R. Vol. ___, p. ___".

STATEMENT OF THE CASE AND FACTS

Public Counsel's claim in its Statement of the Case and Facts that the Public Service Commission made a finding of zero stimulation is in error. The Commission made no finding regarding a specific level of stimulation.

Stimulation was not an issue in the case. Furthermore, Public Counsel did not submit a finding on stimulation as one of its proposed findings of fact.

SUMMARY OF THE ARGUMENT

The Commission's decision in this case should be affirmed. The Commission properly exercised its discretion to employ a ratemaking methodology which did not require the use of unreliable productions of stimulation.

Public Counsel has misconstrued the Commission's action in this case when it claims the Commission made a "finding of zero stimulation." The Commission made no finding regarding a specific level of stimulation. Therefore, Public Counsel's argument regarding competent substantial evidence is misdirected. That the Commission heard evidence regarding stimulation does not mean that the Commission was obligated to use stimulation in setting rates. It was the Commission's responsibility to weigh the stimulation evidence.

What the Commission did find was that predictions of stimulation were unreliable. The Commission, therefore, chose to use a shared earnings ratemaking plan which made the use of unreliable predictions of stimulation unnecessary.

POINT ON APPEAL

THE PUBLIC SERVICE COMMISSION PROPERLY EXERCISED ITS DISCRETION IN CHOOSING A SHARED EARNINGS RATEMAKING METHODOLOGY IN THIS CASE.

This case does not revolve around whether there was competent substantial evidence in the record regarding stimulation, but whether the ratemaking methodology the Commission chose in this case was a proper exercise of its discretion. Because of its misinterpretation of the Commission's action, Public Counsel has gone down the mistaken path of decrying the lack of competent substantial evidence for a finding that was never made. Public Counsel's legal argument regarding competent substantial evidence is, therefore, inapposite to this case.

In the case below, the Commission heard evidence regarding stimulation* (Tr. Vol. IV, pp. 514, 515, 523, 524, Tr. Vol. VI, pp. 831, 840, Tr. Vol. VII, pp. 978-982). Southern Bell had originally subscribed to a stimulation factor of .57, but changed

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*Stimulation, as Public Counsel says in its brief, is the economic theory that if the price of a product is lowered, people would tend to buy more of it. The theory as applied in this case means that because AT&T was ordered to lower its toll rates in response to Southern Bell's lowered access charge, customers would consequently make more toll calls, and the revenues resulting from this increased usage would decrease the amount of revenue reductions the Commission would be imposing on Southern Bell in this case. Thus, Public Counsel would have the Commission set even lower rates for Southern Bell to offset the increase in revenues Public Counsel expected to occur from this stimulation.

its position to .4 after a data request from the Commission staff directed the company to consider all of AT&T's Florida customers -- not just AT&T's Southern Bell customers -- in calculating how much stimulation would occur as a result of Southern Bell's lowered access charges (Tr. **Vol. VII**, p. **978).** The Commission accepted this evidence and indicated it would give it the weight it deserved (Tr. **Vol. VIII**, p. **1039).** The Commission also heard testimony from Southern Bell's witness, David B. Denton, that predictions of stimulation were becoming more difficult to make (Tr. **Vol. VII**, p. **1014)** and that such predictions were unreliable in that "any stimulation estimate is going to be wrong" (Tr. **Vol. XIII**, pp. **1943-1944).**

In the case below, the Commission never indicated that a calculation of stimulation was essential to establishing a rate structure for Southern Bell. Apparently, during the hearing Public Counsel was assuming that the Commission would factor in stimulation when it set rates (Tr. Vol. **VIII**, p. **1031).** Public Counsel should have been disabused of that notion when its vigorous objection to Exhibit **14-B** (Tr. **Vol. VIII**, p. **1030)** was overruled (Tr. **Vol. VIII**, p. **1040).** At that point, Public Counsel was put on notice that its foregone conclusion, i.e., there would be stimulation at a **.57** level, was now in dispute. Yet, after the hearing, Public Counsel failed to include a finding on stimulation in its thirty-four proposed findings of fact (R. **Vol. XIII**, p.

2388). There was no reason for the Commission to make a finding regarding a specific level of stimulation.

It is a mischaracterization of the Commission's action, to describe it as making a "finding of zero stimulation." Rather than depend on unreliable predictions regarding stimulation, the Commission chose to devise a rate structure that obviated the need for an accurate prediction of stimulation. As the Commission stated in its Order on Reconsideration (No. 20503):

> The existence of this evidence does not automatically mandate Commission acceptance of the evidence as the Public Counsel suggests. It is this Commission's prerogative to weigh the evidence that is presented. We remain unpersuaded that the stimulation levels indicated will occur with any degree of reliability. . . . The access charge reduction and attendant MTS and WATS/800 reductions are a part of the total picture in this docket. We were aware of the stimulation argument in adopting the overall plan. We deliberately tilted the plan in favor of ratepayers to account for the prospective nature of the reductions in such ways as the 60/40 split in the ratepayers' favor. This would tend to offset any stimulation revenues that may or may not come to pass.

R. Vol. XV, p. 2787.

Public Counsel is arguing that, because the Commission heard evidence regarding stimulation, it was required to use stimulation in setting rates. This argument is contrary to case law. This Court long ago recognized that the Legislature reposed in the Commission the authority to use its expertise in designing a rate structure. Florida Retail Federation, Inc. v. Mayo, 331 So.2d

308, 312 (Fla. 1976). The reasoning this Court employed in Occidental Chemical Company v. Mayo, 351 So.2d 336 (Fla. 1977), illustrates the point. In Occidental, the Commission had heard evidence on Florida Power Corporation's cost of service, but did not rely on that evidence in setting rates. On appeal, Occidental argued that the Commission's decision was not supported by competent substantial evidence. The Commission argued that "cost of service need not be the sole or dominant factor in structuring rates anyhow." Id. at 340, Noting that no statute mandated a pure cost of service rate structure, the Court stated:

> It is immaterial whether we agree with Occidental as to the weight to be given a particular 'cost of service' formula. The Commission sets rates; not this Court.

Occidental at 340.

It is the Commission's responsibility to weigh the testimony of expert witnesses. United Telephone Co. v. Mayo, 345 So.2d 648, 654 (Fla. 1977). The Commission's decision not to rely on the stimulation evidence in its ratemaking methodology, should not be second-guessed by this Court based on its reweighing of that evidence. Jacksonville Suburban Utilities Corporation v. Hawkins, 380 So.2d 425, 426 (Fla. 1980).

The Commission's order comes before this Court clothed with the presumption of validity, which can only be overcome "where the Commission's error either appears plainly on the face of the order or is shown by clear and satisfactory evidence." Citizens v.

Public Service Commission, 425 So.2d 534, 538 (Fla. 1982). There is nothing in the record -- and Public Counsel has pointed to nothing in the statutes or Commission rules or policy -- that requires the Commission to use a stimulation factor in setting rates. Public Counsel has failed to show that the Commission erred in this case.

Sharing of earnings is an innovative approach to setting rates for telephone companies, which have traditionally been rate base regulated. Under the shared earnings plan the Commission chose in this case, there is no necessity for accurately predicting stimulation because whatever level of stimulation is obtained, the customers will benefit from a sharing ratio deliberately tilted (R. Vol. XV, p. 2787) in their favor. By using the shared earnings methodology, the Commission gave Southern Bell an incentive (R. Vol. XIV, p. 2610) to be more productive in that it would be able to keep forty percent of its earnings that exceeded a fourteen percent return on equity. The other sixty percent would be returned to its customers. Under traditional rate base regulation, the company would not be allowed to exceed its 13.2% return on equity by more than 100 basis points (R. Vol. XIV, p. 2610). Thus, it would have had no incentive to be more productive once its earnings approached 14.2%.

In making its decision, the Commission evaluated the theory that traditional rate of return regulation has two important drawbacks: 1) since return is tied to rate base, companies have an incentive to increase rate base, i.e., to "gold plate" their

physical plant; and 2) there is a disincentive for companies to innovate, because gains arising from reduced costs and improved productivity are returned to the ratepayers (R. Vol. XIV, p. 2607). The Commission concluded that these disincentives are most likely to occur when a company is at or near the top of its authorized range. In allowing Southern Bell to share in the benefits of improved productivity, it was the Commission's intent that the result would be "a wider array of services at the lowest possible cost to rate payers" (R. Vol. XIV, p. 2607).

The plan for sharing earnings between the company and the ratepayers was, the Commission found, consistent with sections **364.03, 364.035(1),** and **364.14,** Florida Statutes, which require fair, just, reasonable, and sufficient rates (R. Vol. XIV, p. 2629). This Court affirmed a similar shared earnings plan in the electric industry. Citizens v. Public Service Commission, **464** So.2d **1194** (Fla. 1985). In that case a Commission order requiring an 80/20 split between ratepayers and shareholders resulting from economy energy sales was contested by Public Counsel as unnecessary. The Court affirmed the order, which provided utilities with an incentive to maximize economy energy sales and thereby provided a net benefit to ratepayers.

In the present case, not only would Southern Bell's customers receive sixty percent of the earnings over fourteen percent return on equity, they would also gain the full benefit of any savings resulting from factors not attributable to Southern Bell's own efforts, such as governmental action affecting taxes or

depreciation, reduced cost of debt, major technological changes, and all rate changes other than regroupings (R. Vol. XIV, pp. 2608, 2609). Moreover, 100% of earnings over sixteen percent return on equity (after sharing) would belong to the ratepayers (R. Vol. XV, p. 2787). The more stimulation the company experiences, the more its customers will benefit. Public Counsel would have the Commission speculate ahead of time as to how much stimulation there will be and set even lower rates based on such speculation, regardless of whether the expected stimulation ever comes to pass. As the Commission stated in its order on reconsideration:

> Acceptance of Public Counsel's argument would factor in the stimulation and provide customers with all of the predicted benefits before they take place.

R. Vol. XV, p. 2787.

The record is clear that there is considerable uncertainty with regard to predicting stimulation. The Commission found that stimulation could not be predicted with sufficient reliability. The shared earnings plan it devised solved the problem of making a virtually impossible prediction by making such a prediction unnecessary. This was a proper exercise of the Commission's discretion in choosing an appropriate ratemaking methodology in this case.

CONCLUSION

The shared earnings rate structure the Commission employed in this case obviated the need to use unreliable predictions of stimulation and was a reasonable exercise of the Commission's expertise in choosing an appropriate ratemaking methodology, which is within the Commission's lawful discretion. Because stimulation was not an issue and because a finding regarding stimulation was not essential to establishing fair, reasonable, just, and sufficient rates, the Commission did not commit error by not using a calculation of stimulation when it set rates in this case.

Therefore, this Court should affirm the Commission's order.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Answer Brief of Appellee has been furnished by U.S. Mail this 17th day of April, 1989 to the following:

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