

IN THE SUPREME COURT OF FLORIDA

THE CITIZENS OF FLORIDA,)
Appellant,)
vs.)
KATIE NICHOLS, etc., et al.)
Appellees.)

Case No. 73,623

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On Appeal From The Florida Public

INITIAL BRIEF OF THE CITIZENS
On Behalf of the Citizens of the State of Florida

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INTRODUCTION

This is an appeal from orders no. 20503 and 20162 of the Florida Public Service Commission relating to the rates charged by Southern Bell Telephone and Telegraph Company. Order no. 20503 disposed of motions for reconsideration of order no. 20162.

The Public Counsel is charged by section 350.0611, Florida Statutes (1987) to provide legal representation for the people of the state in proceedings before the Florida Public Service Commission. Jurisdiction is conferred upon this Court by Article V, section 3(b)(2), Florida Constitution, and sections 350.128(1) and 364.381, Florida Statutes (1987).

Pursuant to Florida Rule of Appellate Procedure 9.220, this brief is accompanied by an appendix which includes a copy of the orders to be reviewed. References to the appendix are signified as (A ____). References to other portions of the record are signified as (R ____), except that references to the transcript of hearing conducted July 18-21, 1988, are signified as (T ____).

STATEMENT OF THE CASE AND FACTS

On January 13, 1988, Southern Bell Telephone and Telegraph Company simultaneously filed a "Petition for Rate Stabilization and Other Relief" (R 1) and a "Petition for Implementation Order and Other Relief" (A 56) with the Florida Public Service Commission. These petitions contained several proposals, two of which were (1) to reduce rates for various toll services over a three year period, and (2) to obtain permission to keep 50% of its earnings above a threshold return on equity of 15%. A later amendment to Southern Bell's petitions capped its requested return on equity at 16% (R 46).

A reduction in the corporate income tax rate and increased efficiencies associated with the provision of telecommunications services made these proposals possible (R 2). Additionally, given present economic conditions, Southern Bell believed it would be unable to retain the return on equity range of 14%-16% authorized in its last rate case (T 101). The Office of Public Counsel filed a petition on July 31, 1987, seeking to reduce Southern Bell's authorized midpoint return on equity from 15% to 12.25%. Commission order no. 19117 issued April 6, 1988, consolidated Public Counsel's petition with Southern Bell's two petitions on April 6, 1988 (R 638).

The relief requested in the petitions was based in part on the principle that a price reduction leads customers to purchase more of a service. The petitions refer to this principle by the term "stimulation." Page 2 of the petition for implementation

order, for example, states that stimulation mitigates the amount of revenue Southern Bell would otherwise lose from its proposed price reductions for intraLATA (short haul) toll rates:

"Southern Bell recommends that the Commission should reduce the Company's intraLATA message toll rates (MTS) by \$25 million in 1988, \$25 million in 1989, and \$30 million in 1990. The effects of stimulation would result in an annual net revenue reduction of approximately \$15 million in 1988, \$15 million in 1989 and \$18 million in 1990 to Southern Bell." (A 57).

Similarly, the petition states that stimulation mitigates the amount of revenue Southern Bell would otherwise lose from its proposed price reductions for the services Southern Bell provides interexchange carriers:

"Southern Bell further recommends that the Commission reduce its intrastate access charges by \$20 million in 1988, \$25 million in 1989 and \$30 million in 1990. These reductions, if passed directly on to our Southern Bell customers as an equivalent reduction in their intrastate, interLATA toll rates, would result after stimulation in an annual net revenue reduction of approximately \$15 million in 1988, \$18 million in 1989 and \$23 million in 1990 to Southern Bell." (A 60).

The Commission's order on prehearing procedure issued April 20, 1988, set the case for hearing (R 739).

Southern Bell filed testimony on May 2, 1988, supporting its petitions. Walter S. Reid, an operations manager in the company's comptroller's division, provided testimony about the amount the company expected to earn during 1988, 1989, and 1990.

The company's forecast of earnings came from the company's budgeting process, a process which Mr. Reid described as "a sophisticated budget process which would be expected of a company that has to expend significant resources to meet strong customer demand in states such as Florida" (A 121; T 518). According to Mr. Reid, the two most accurate sources of information for determining the company's income during 1988, 1989, and 1990 are the company's budget and planning views (A 121-124; T 518-521).

The budgeting process starts with a detailed, ground-up forecast of customer demand and service requirements on a wire-center-by-wire-center basis. At later points in the process, the ground-up view is tested against the top-down view for reasonableness. If there is a difference between the levels produced by the ground-up view and top-down view, an analysis of the facts and circumstances underlying the two forecasts determines the most reasonable forecast (A 121-124; T 518-521).

The forecasted levels of revenue contained in the company's commitment budget are not only the best estimate of Southern Bell's revenues for the next year, according to Southern Bell's witness Reid, but they also represent management's objectives and resource commitments to meet these objectives (A 122-123; T 519-520).

Southern Bell's planning views are longer range and more flexible for changes in plans. The data, Mr. Reid explained, still represents the company's best estimate of revenue and expenses for the forecasted period (A 123; T 520).

Mr. Reid's prefiled testimony made a distinction between the "gross" revenue and "net" revenue impact of the proposed price reductions (A 125-127; T 522-524). The net impact accounted for stimulation and reflected the actual amount of revenue Southern Bell expected to receive after taking the price reductions into account (A 117-118, 125-127, 141-143; T 514-515, 522-524, 594-596). The net revenue figures are also the amounts used in Southern Bell's budgeting process (A 141; T 594). The "gross" revenue figure showed the effect on Southern Bell without accounting for the stimulation expected by Southern Bell (A 126-127; T 523-524). Southern Bell provided the "gross" revenue data only for information. The gross revenue data did not reflect Southern Bell's forecast of expected earnings (A 126-127; T 523-524).

David B. Denton, an operations manager in the company's rates division, also prefiled testimony on May 2, 1988, explaining that Southern Bell expected the price reductions for toll services to stimulate toll usage of the switched network (A 145; T 831). He said that the company's budgeting and planning process used a forecast of stimulation to project revenues (A 141-143; T 594-596).

Additionally, in prefiled rebuttal testimony, Mr. Denton stated that stimulation observed in the interexchange toll market resulted in large part from previous price reductions for interexchange access services provided by local exchange companies (A 148; T 840). The filing of all testimony concluded

on May 27, 1988, pursuant to the order on prehearing procedure issued April 20, 1988 (R 739).

None of the twenty two parties participating in the case took issue with the forecasts of toll stimulation submitted and used by Southern Bell. Accordingly, the list of issues contained in the prehearing order (R 1831-1879) did not recognize Southern Bell's estimate of toll stimulation as a disputed issue of material fact. The matter of toll stimulation was only implicitly taken into account in an issue asking for the forecasted net operating income of Southern Bell during 1988, 1989, and 1990 (issue 10 -- R 1853-1854). No party's position expressed any misgivings about Southern Bell's forecast of toll stimulation (R 1853-1854).

In spite of this, the staff of the Commission suggested a different estimate for stimulation at hearings held July 18-21, 1988. On June 26, 1988 -- well after the last date for filing testimony -- the staff sent a letter to Southern Bell (A 180; T 1032) asking it to use a different estimate of toll stimulation for access charges, but not for other toll services. The letter also asked Southern Bell to assume that interexchange carriers would flow the access service price reduction through to customers statewide, not just to customers residing in Southern Bell's territory (A 159-163, 177-188; T 929-933, 1029-1040). The parties received Southern Bell's response to the staff's letter while the hearings were in progress.

Southern Bell's response to the letter (exhibit 14(b) -- A 224-225) employed a slightly lower price elasticity of demand for access prices than Southern Bell used in its budget and in its prefiled testimony. The term "price elasticity of demand" refers to the amount of stimulation resulting from a change in price. The company readily adopted this new estimate of stimulation. At the hearing, for example, Mr. Denton stated that he had determined "at least a couple days ago" that the new estimate suggested by the staff was more accurate than the estimate Southern Bell used in its budgeting process and in its prefiled testimony (A 158; T 982).

Southern Bell had used the following price elasticities of demand in its budgeting process: .57 for the access services provided to interexchange carriers, .40 for intraLATA message toll services, .094 for intraLATA WATS services, and .115 for intraLATA 800 service (A 169-173; T 978-982). In response to the staff's letter, Southern Bell changed the price elasticity of demand for the access services from .57 to .40, but left each of the other three price elasticities of demand unchanged (A 169-171; T 978-980).

The Citizens objected to the admission of exhibit 14(b) into evidence on the basis that no party had contested Southern Bell's estimate of stimulation either in prefiled testimony or in their prehearing statement. That objection was overruled (A 177-188; T 1029-1040).

During cross examination Mr. Denton testified that the price elasticities of demand used for the various toll services were estimates. With more competition now in the toll markets than there used to be, he claimed that it is more difficult to estimate the precise amount of stimulation (A 176, 202; T 1014, 1943). "You can be assured that any stimulation estimate is going to be wrong," he said (A 202-203; T 1943-1944). He also appeared to say that today's more competitive toll market would bring greater stimulation than realized in the past, although this portion of his testimony was ambiguous (A 208-217; T 1949-1958). He never suggested that reducing toll prices would not lead to stimulation.

The Commission's final order no. 20162 issued October 13, 1988, states that "we will set rates to produce a 13.2% return on equity" (A 13)¹/. In doing so, the Commission accepted the accuracy of every estimate of revenue made by Southern Bell for 1988, 1989, and 1990, except for Southern Bell's forecast of toll

¹/A staff witness recommended that Southern Bell be allowed a return on common equity of 12.5% for the purpose of determining revenue requirements (T 1695). Traditionally that is the earnings level used for rate setting purposes.

calling stimulation (A 42-43, 125). It completely accepted, for example, the accuracy of revenue forecasts for newly offered services expected to grow quickly (such as "ringmaster") and for firmly established services, such as operator and local exchange services (A 98-101). The Commission used zero stimulation for all toll services.

The Commission accepted the accuracy of every expense forecast, ranging from network operations and customer assistance expenses to marketing and general support expenses (A 30). The Commission did, however, "reserve" an additional amount of about \$165 million for future depreciation expense not reflected in Southern Bell's forecast of expenses. Rates were not reduced by this additional amount pending the filing and review of a depreciation study to be submitted by Southern Bell (A 28).

The Commission also accepted the accuracy of every projection of Southern Bell's asset accounts (A 14).

The order that accepted these revenue, expense, and asset projections of Southern Bell did not allow for the effects of stimulation incorporated in Southern Bell's petitions. The order only mentioned, without discussion, that the revenue projections for WATS and 800 services were "without stimulation" (A 18); it did not mention at all that the revenue projections for major services such as intraLATA MTS and interexchange carrier access charges excluded expected stimulation (A 16-20).

The Commission ordered revenue reductions of roughly \$73 million per year for intraLATA MTS toll calls and \$75 million per year for interexchange carrier access charges (A 47) -- when measured without accounting for the beneficial effect of stimulation. The corresponding price reduction for intraLATA MTS toll calls, for example, was about 27% (A 59).

The Citizens of Florida filed a motion for reconsideration of the Commission's order on October 28, 1988 (R 2665). The Citizens argued that the record would not support a finding of zero stimulation from the toll price reductions ordered by the Commission. The motion further stated that even if the Commission used the evidence least favorable to the customers of Southern Bell -- the evidence of price elasticities obtained by the staff in response to its letter -- additional rate reductions of about \$42 million per year would be required in order to set rates producing a projected return on equity of 13.2% (R 2667-2671). Even though Southern Bell had recognized stimulation all along, it sided with the Commission when it learned the Commission would not require it to recognize stimulation (R 2759-2764).

Commission order no. 20503 issued December 22, 1988 (A 1) disposed of the motion for reconsideration without citing any evidentiary support for the Commission's finding of zero stimulation:

"Public Counsel argues that the reduction in access charges, message toll service (MTS) and WATS/800 service will result in stimulation,

or increased use of the services due to the lower prices. Public Counsel further posits that the increased usage makes the revenue reduction estimates stated in Order No. 20162 lower than they actually will be due to the absence of stimulation factored into those estimates. There was some evidence that some stimulation could occur were the various rates to be lowered. 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. Our past experience with including stimulation in access charge reductions indicates that even Southern Bell cannot determine with any reliability the degree of stimulation that will occur. See Order No. 19677, Section IV, Paragraph C. pp. 20, 21. 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. The myriad of factors that can affect the stimulation such as overall economics conditions and rate of growth add to the uncertainty surrounding the stimulation. In the present case, if stimulation occurs and as a result, Southern Bell's earnings rise above 14% return on equity, customers will receive 60% of the benefit between 14%-16% and all benefits over 16%. Acceptance of Public Counsel's argument would factor in the stimulation and provide customers with all of the predicted benefits before they take place. The approach used in Order No. 20162 is more appropriate on these facts and the Motion for Reconsideration on this point is hereby denied." (A 2).

The Citizens of Florida filed a notice of administrative appeal on January 20, 1989.

SUMMARY OF THE ARGUMENT

All evidence of record showed that a price reduction for toll services would lead to increased purchases of toll services. The Commission did not, and could not, point to evidence in the record to support its finding of zero stimulation. Instead, it referred to an order in another docket and referred to factors such as overall economic conditions which it presumed to know independent of record support.

No competent, substantial evidence in the record supports the Commission's decision. The Court will not uphold an order of the Commission where the justification is found outside of the record. General Development Utilities, Inc., v. Hawkins, 357 So.2d 408 (Fla. 1978). Likewise, reference to general economic conditions does not constitute competent, substantial evidence. Broward County Traffic Association v. Mayo, 340 So.2d 1152 (Fla. 1977). The portions of the Commission's orders dealing with stimulation, projections of revenues, and rates should be quashed and remanded to the Commission for further proceedings.

ARGUMENT

NO COMPETENT, SUBSTANTIAL EVIDENCE SUPPORTS
THE COMMISSION'S FINDING OF ZERO STIMULATION

The Citizens do not ask the Court to reweigh conflicting evidence presented to the Florida Public Service Commission and then reach a different conclusion. Here all evidence showed that a price reduction for toll services would lead to increased purchases of toll services. Southern Bell itself provided this evidence, as did the Commission staff. In the face of price reductions of up to 27% for toll services, there is no competent, substantial evidence in the record to support the Commission's finding of zero stimulation.

The Commission's initial order contained no discussion about stimulation. It even failed to mention that the Commission disregarded stimulation when projecting revenues for major services such as intraLATA MTS and access charges (A 16-20). In its reconsideration order, the Commission still does not point to evidence in the record to support its order; instead, it refers to an order in another docket and "a myriad of factors... such as overall economic conditions..." (A 2). Decisions of the Florida Supreme Court find this sort of rationale inadequate.

The case of General Development Utilities, Inc., v. Hawkins, 357 So.2d 408 (Fla. 1978) is on point. The petitioners asked the Commission to approve rates based on a hypothetical capital structure. Instead of using its actual capital structure of

92.19% equity and 7.81% debt, the company proposed using a capital structure of 50% equity and 50% debt. The record contained the company's actual capital structure and its proposed capital structure, but the Commission chose instead to reach outside of the record and use a capital structure equal to the average capital structure of water companies generally.

The Court found "insurmountable difficulties" with the Commission's choice of capital structure. General Development Utilities at 409. It said that the Commission plainly violated the notions of agency due process embodied in the administrative procedure act. For example, the Commission's use of evidence found outside of the record breached (1) section 120.59(2), Florida Statutes (1975), which directs an explanation of findings of fact by facts of record, (2) section 120.57(1)(b)7, which states that findings of fact are to be based exclusively on the evidence of record and on matters officially recognized^{2/}, and (3) section 120.61, which contemplates notice of matters to be officially recognized and the opportunity to contest them.

^{2/}Section 120.57(1)(b)7, Florida Statutes (1975) is now section 120.57(1)(b)8, Florida Statutes (1987).

The Commission's decision here contains the same deficiencies found in General Development Utilities, Inc. The Commission ignored the evidence provided by Southern Bell that price reductions for toll services would lead to greater purchases of toll services. Instead, the Commission looked to matters outside of the record: an order in another docket^{3/}. No party had notice that the Commission might ignore stimulation. Indeed, there was no contest at all among the parties about the amount of stimulation until the staff introduced a different estimate at the hearing. No party ever proposed that the Commission find zero stimulation. The Commission's actions here violate the notions of agency due process embodied in the administrative procedures act, just as they did in General Development Utilities, Inc.

^{3/}The Commission cites its order no. 19677 in docket no. 860984-TP to support its finding about stimulation. Other orders of the Commission, however, reach a different conclusion. In its order no. 17053 issued January 23, 1987, the Commission stated "It is a basic tenet of economics that, when the price of a good or service declines, consumers will purchase greater quantities of such good or service. This phenomenon is known as stimulation. Because we have proposed a substantial reduction in MTS and WATS in conjunction with the proposed decrease in access rates, we believe there will be a significant increase in toll volume due to stimulation... we find it appropriate to require ATT-C to recognize and account for stimulation." In re: Intrastate telephone access charges for toll use of local exchange services, 87 F.P.S.C. 1:79,82 (1987). Even the order cited by the Commission merely states that Southern Bell has not been able to determine the exact stimulative effect of an access charge reduction. In re: Investigation into NTS Cost Recovery - Phase II, 88 F.P.S.C. 7:144,164 (1988). The Federal Communications Commission, incidentally, routinely accounts for stimulation when reducing interstate toll rates.

The Commission also looked to a myriad of other factors, such as overall economic conditions and uncertainty surrounding stimulation, to reject stimulation while accepting all other Southern Bell forecasts of revenues, expenses, and asset values. This, too, does not support the Commission's finding. In Broward County Traffic Association v. Mayo, 340 So.2d 1152 (Fla. 1977) the Commission granted a motor carrier unrequested relief from inflationary factors occurring after the filing of a rate application. The Commission found inflationary forces to be "clearly evident," but the Court reversed, finding no substantial, competent evidence to support the Commission's decision. The Court found no basis on which the Commission could claim expertise regarding inflationary factors in the economy generally or in the trucking industry in particular. See also Florida Cities Water Company v. Florida Public Service Commission, 384 So.2d 1280 (Fla. 1980).

In a few cases some evidence was presented to the Commission to support a finding, but the Court reversed because the evidence was insufficient to constitute competent, substantial evidence. In City of Plant City v. Mayo, 337 So.2d 966 (Fla. 1976) the Commission required Tampa Electric Company to pass through municipal franchise fees to residents in affected municipalities instead of treating such fees as general expenses. The Commission based its decision on two grounds: technical advances in billing and the inequity of imposing system-wide payments on customers outside municipal limits. Only two utility company witnesses in the rate proceeding commented on the subject of

franchise fees. Their testimony went in general terms to the source, legal basis, nature, and prior treatment of franchise fees in utility regulation.

The Court indicated that nothing would prevent the Commission from implementing a policy of charging municipal franchise fees only to residents of the affected municipalities as long as there was sufficient evidence in the record. The general testimony of the two utility company witnesses, however, was insufficient to provide the competent, substantial evidence needed to back up the Commission's decision. The Court found the Commission's decision wholly lacking sufficient evidentiary support.

Similarly, in Florida Bridge Company v. Bevis, 363 So.2d 799 (Fla. 1978), the amount of evidence presented at a hearing was insufficient support for the Commission's decision. The evidence showed that the company president was in his office 142 days out of approximately 250 working days during the test year. On that basis the Commission disallowed 108/250ths of the president's compensation. The Court found the Commission's decision arbitrary and a substantial departure from the essential requirements of law. The record contained no evidence that the company president rendered services for any business other than Florida Bridge while not present in the company's home office, nor was there evidence to suggest that the president's duties were confined to those which he could do while sitting at his desk in the home office. The Court found the Commission's use of ratio lacking in logic, precedent, or policy. See also Florida

Power Corporation v. Public Service Commission, 424 So.2d 745 (Fla. 1982); Florida Power Corporation v. Public Service Commission, 456 So.2d 451 (Fla. 1984); Duval Utility Company v. Florida Public Service Commission, 380 So.2d 1028 (Fla. 1980); Citizens v. Hawkins, 356 So.2d 254 (Fla. 1978).

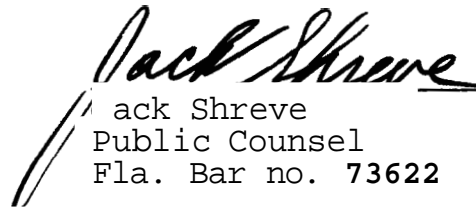
Here the Court need not go as far as it did in City of Plant City and Florida Bridge Company. All evidence supports recognition of stimulation; the only question is how much stimulation should be recognized. Southern Bell's prefiled testimony and prehearing position shows the larger amount of stimulation. Southern Bell's response to the staff's letter shows a slightly lower amount of stimulation for interexchange access services, but the same amount for other toll services. The Citizens do not contest the Commission's authority to choose an amount of stimulation falling within this range. The Commission, however, went completely outside of the range supported by the record.

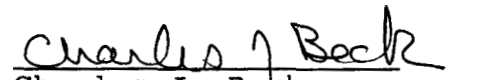
The Court has upheld many decisions of the Commission because support existed in the evidence presented at hearing. Often the support comes from the direct testimony of a witness favoring a particular position. Southern Bell Telephone and Telegraph Company v. Florida Public Service Commission, 443 So.2d 92,95 (Fla. 1983); Citizens of the State of Florida v. Public Service Commission, 435 So.2d 784,788 (Fla. 1983); Citizens of the State of Florida v. Public Service Commission, 425 So.2d 534,538 (Fla. 1982); Utilities, Inc., of Florida v. Florida Public Service

Commission, 420 So.2d 331 (Fla. 1982); ~~Rolling Oaks Utilities, Inc., v. Public Service Commission~~, 418 So.2d 356 (Fla. 1982); United Telephone Company of Florida v. Mayo, 345 So.2d 648,654 (Fla. 1977). At other times the Commission is upheld because supporting evidence is elicited through cross examination. South Florida Natural Gas Company v. Public Service Commission, 534 So.2d 695 (Fla. 1988); ~~Gulf Power Company v. Florida Public Service Commission~~, 453 So.2d 799,802 (Fla. 1984). Nonetheless, there must be supporting evidence. No such evidence in the record supports the Commission's decision here.

CONCLUSION

No competent, substantial evidence supports the Commission's finding of zero stimulation. Accordingly, the portions of Commission orders no. 20162 and 20503 dealing with stimulation, projections of revenues, and rates should be quashed and remanded to the Commission for further proceedings.


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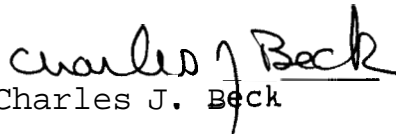
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