

IN THE SUPREME COURT OF FLORIDA

FILED
SID J. WHITE

MAY 11 1989

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

CLERK, SUPREME COURT
By _____
Deputy Clerk

Case No. 73,623

On Appeal From The Florida Public Service Commission

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

Jack Shreve
Public Counsel

Office of Public Counsel
c/o Florida House of
Representatives
The Capitol
Tallahassee, FL 32399-1300

(904) 488-9330

Attorney for the Citizens
of the State of Florida

TABLE OF CONTENTS

THE PROCEDURE USED BY THE COMMISSION TO SET RATES
REQUIRES A FINDING ABOUT STIMULATION 1

EVEN IF THE COMMISSION REJECTS SOUTHERN BELL'S EXPERT
TESTIMONY ABOUT STIMULATION, COMPETENT, SUBSTANTIAL
EVIDENCE IS STILL NEEDED TO SUPPORT THE COMMISSION'S
FINDINGS.. 10

NO PARTY DISPUTES THE POINT THAT ALL EVIDENCE SHOWS
STIMULATION. 12

CONCLUSION. 13

TABLE OF CITATIONS

Cases

Behm v. Division of Administration, State Department of Transportation, 292 So.2d 437 (Fla. 4th DCA 1974) 10

Behm v. Division of Administration, State Department of Transportation, 336 So.2d 579 (Fla. 1976) 10, 11

County of Sarasota v. Burdette, 479 So.2d 763, 765 (Fla. 2d DCA 1985) 11

Dade County v. Renedo, 147 So.2d 313 (Fla. 1962) 10

Slacter v. City of St. Petersburg, 449 So.2d 1006, 1007 (Fla. 2d DCA 1984) 11

Florida Statutes

Section 120.68(10), Florida Statutes (1987) 13

Section 364.055, Florida Statutes (1987) 3

THE PROCEDURE USED BY THE COMMISSION TO
SET RATES REQUIRES A FINDING ABOUT STIMULATION

Appellees Southern Bell and the Florida Public Service Commission defend the Commission's action by arguing that the Commission did not make a finding about stimulation'. Their argument, however, fails to recognize or discuss the crucial role played by the Commission's use of a target rate of return to set rates.

Appellees mask the procedure used by the Commission to set rates with their emphasis on a new procedure applied by the Commission to "share" earnings between the company and its customers. Southern Bell argues that this new procedure makes it 'relatively unimportant to predict the level of stimulation' (SouthernBell brief at 24). The Commission goes further, stating "under the shared earnings plan the Commission chose in this case, there is no necessity for accurately predicting stimulation . . ." (Commissionbrief at 7).

The shared earnings plan has nothing to do with the procedure used by the Commission to set Southern Bell's rates. The Commission targeted Southern Bell's rates to give it the opportunity to earn a 13.2% return on its equity investment during

¹ Southern Bell argues "...the Commission did not find zero stimulation. It found only that Southern Bell's predictions of the levels of stimulation were unreliable." (SouthernBell brief at 21). The Commission says it "made no finding regarding a specific level of stimulation." (Commissionbrief at 2).

1988, 1989 and 1990. The Commission's order states:

". . . we set the following returns on equity:
(ROE)

- 11.5% - Authorized Floor
- 13.2%** - Rate Setting Point
- 14.0% - Sharing Begins
- 16.0% - Authorized Ceiling after
Sharing'' (A 11).

The order goes on to say:

"We will set rates to produce a **13.2%** return on equity" (A 13).

The issue about stimulation focuses on whether the Commission correctly calculated the rate reductions necessary to target Southern Bell's earnings at a **13.2%** return on equity. The matter about shared earnings, on the other hand, deals with what happens if the utility should earn profits well above the targeted return on equity.

Under traditional rate of return regulation the utility is given the opportunity to collect rates which cover operating costs and allow it to earn a reasonable rate of return on its investment. In recent years the Commission has calculated a rate of return as a mid-point and has generally allowed a zone of reasonableness of plus or minus 100 basis points around that point (A 9). The utility keeps all earnings within this zone. If the utility's earnings fall outside the zone, action can be taken to change the

company's rates². This traditional method of setting rates targets rates for the midpoint of the allowed range.

If a utility's earnings approach the top of the allowed range, the utility argues that it has no further incentive to improve productivity or offer new services (A 10). This lack of incentive only occurs when the utility is earning at or near the top of its authorized earnings range (A 10)³.

Responding to this criticism of traditional rate of return regulation, the Commission did two things in this case. First, it broadened the range of earnings allowed Southern Bell. It set four return on equity points: an authorized floor of 11.5%, a rate setting point of 13.2%, an earnings sharing threshold point of 14%, and an earnings ceiling point of 16% (A 11). Second, it implemented a new procedure called "sharing." To the extent Southern Bell is able to earn more than a 14% return on equity, Southern Bell keeps 40% of such earnings, and Southern Bell's customers receive the benefit of the remaining 60%. Southern Bell must return all after-sharing earnings exceeding a 16% return on equity.

² The utility, for example, could request an interim increase in rates pursuant to section 364.055, Florida Statutes (1987), to temporarily target their earnings at the bottom of the zone. The statute provides a similar procedure to the public counsel or other party to seek collection subject to refund of revenues above the top of the authorized range.

³ If the utility's earnings are at the bottom or middle of its authorized range, the utility's incentive to improve productivity is still high because it keeps 100% of additional profits.

The new approach taken by the Commission in this case is most remarkable for its similarity to the Commission's traditional approach. Like the traditional approach, rates are still targeted to allow the company to earn a specific return on equity: here, 13.2% (A 11, 13). Also, the company is still allowed a range of authorized earnings. Within the range of a 11.5% to 14.0% return on equity, the company has a very strong incentive to increase earnings and become more productive because it keeps 100% of all additional earnings. Between a 14.0% and 16.0% return on equity (after sharing), the company still has an incentive to increase productivity, albeit a smaller one because it retains only 40% of additional earnings.

Most importantly, under either the traditional approach taken by the Commission or the one taken in this case, rates are still targeted for a specific return on equity. Different incentives arise only if the company's earnings deviate from the targeted return on equity.

The rate setting process is straightforward. Once the Commission decided to target earnings at a 13.2% return on equity, it then predicted what Southern Bell would earn without any changes in rates. The Commission made these specific findings for 1988, 1989 and 1990 at pages 10 through 11 of order no. 20162 (A 14-15); these findings are not appealed. Next, the Commission calculated the extent to which these earnings would exceed a return on equity of 13.2%; these findings (A 16) are likewise not appealed. Finally, the Commission determined the price reductions necessary

to target Southern Bell's earnings at a return on equity of 13.2%; these findings are appealed.

The method chosen by the Commission to set rates required it to determine the effect of ordered price changes on Southern Bell's earnings. Without doing this, it would be impossible to target rates to a return on equity of 13.2%.

Consequently, the Commission made specific findings about the effect of toll price reductions on Southern Bell's earnings. Attachment 6 to order no. 20162 contains these findings (A 47). For example, the Commission found that its ordered intraLATA toll price reductions would reduce Southern Bell's earnings by \$73.4 million in 1989 and \$78.1 million in 1990.

This finding is wrong - - and contradicted by all evidence in the record - - because the calculations assume customers will make no additional purchases of toll services even with a price reduction of 27%. Had stimulation been taken into account, the negative impact on Southern Bell's earnings would have been mitigated considerably. The Commission could not avoid making a finding about stimulation once it decided to target rates to earn a 13.2% return on equity. Some customer reaction to the price reduction had to be determined in order to calculate the effect of toll price reductions on Southern Bell's earnings.

The Citizens agree with Southern Bell's admission that "the evidence that some stimulation will occur is undisputed" (Southern Bell brief at 17). However, Southern Bell is flatly wrong when it follows this admission by asserting "the Commission did not

conclude that there would be no stimulation.'" This specific conclusion is reflected in each of the findings showing the effect of toll price reductions on Southern Bell's earnings. See attachment 6 to order no. 20162 (A 47). The Commission used these findings to set rates.

Nor is Southern Bell correct when it asserts that "the level of stimulation was a relatively immaterial factor" (Southern Bell brief at 17). The Commission's refusal to follow the evidence about stimulation adversely affects Southern Bell's customers by at least \$31 million each year. The following discussion shows why.

The record contains two estimates of stimulation: the evidence submitted by Southern Bell in its direct case, and the evidence presented during cross examination by the staff of the Commission. Use of the lower estimate of stimulation would require the Commission to reduce rates by an additional \$42 million per year to target a 13.2% return on equity (R 2667-2671).

Under the regulatory scheme adopted by the Commission in this case, the Commission's refusal to recognize any stimulation causes rates to be targeted to a return on equity of at least 14.5% instead of 13.2% (R 2667-2671)⁴. With the shared earnings approach used in this case, Southern Bell - - not its customers - - keeps

⁴ A one percentage point difference in return on equity is equivalent to a change in revenue of about \$32 million per year (T 657), so a difference of \$42 million per year is equivalent to a change of about 1.3% (i.e. 14.5% minus 13.2%) in return on equity.

all earnings between a return on equity of 13.2% and 14.0%. Southern Bell also keeps 40% of earnings between 14.0% and 14.5%. As a result, Southern Bell keeps \$31 million out of \$42 million which would otherwise benefit customers if rates reflected even the least favorable evidence in the record about stimulation⁵. The Commission's refusal to follow this is hardly a "relatively immaterial factor," as expressed by Southern Bell. Southern Bell's customers are still harmed by at least \$31 million every year by the Commission's refusal to recognize any stimulation - - even with the regulatory scheme used by the Commission in this case.

Thus, the sharing plan relied upon so heavily by Southern Bell has nothing to do with the issue of whether rates correctly targeted an earnings level of a 13.2% return on equity. The issue about stimulation deals with this point. The shared earnings plan only mitigates the harm to Southern Bell's customers from \$42 million per year to \$31 million per year.

Interestingly, the Commission's order on reconsideration states that acceptance of stimulation would provide customers all of the predicted benefits before they take place (A 2). Just the opposite is true. The Commission's refusal to recognize any stimulation provides Southern Bell benefits unsupported by the record.

Southern Bell's attempt to position the issue before the Court as one of reconciling "competing purposes" of chapters 364 and 120,

⁵ $(14.0 - 13.2)(\$32 \text{ million}) + (.4)(14.5 - 14.0)(\$32 \text{ million}) = \$31 \text{ million}.$

Florida Statutes (Southern Bell brief at 19) simply deflects the Court's attention from what the Commission actually did. The Commission made a decision to target rates at a return on equity of 13.2%. The Citizens do not contest that decision in this appeal. The Citizens do contest specific, numerical calculations - - findings of fact - - necessary to carry out that decision. In order to carry out its policy, the Commission had to calculate the impact of toll price reductions on Southern Bell's earnings. All evidence showed that a price reduction in toll services would lead to increased purchases of toll services. Yet the Commission's calculations showing the impact of toll price reductions on Southern Bell's revenues are grounded on a finding that no additional purchases will be made.

While it is true that the record contains two estimates of stimulation for toll access services (but not other toll services), it does not follow that the existence of different estimates in the record allows the Commission to disregard all estimates and use zero in their place⁶. What if toll rates had been reduced a hundred fold, and the estimates of stimulation ranged from a tripling to a quadrupling of toll purchases by customers? Would

⁶ Southern Bell's restatement of the case and facts takes liberties with the record when describing the difficulty of quantifying stimulation. Much of Southern Bell's description at pages 9 through 11 of its brief is not contained in the record. For example, its description of factors affecting stimulation is not contained in the record. Southern Bell brief at 10. Nor was Southern Bell's lengthy quote from R. Miller, Intermediate Microeconomics, ever presented to the Commission. At best, such matters should be presented as argument, not fact.

the Commission be entitled to find no stimulation because it couldn't determine which estimate was best? That is what Southern Bell implicitly argues when it frames the issue as one of whether the estimates were "reliable" and whether the Commission was therefore entitled to reject them all (SouthernBell brief at 21)⁷.

Indeed, if the Commission may use zero as an estimate of stimulation when it finds the record evidence unreliable, couldn't it also use any other figure? Why not ten instead of zero? There is nothing unique about using zero when zero is not an estimate of stimulation found in the record. There is a big difference between (1) finding that stimulation cannot be projected without error, and (2) using an estimate of zero stimulation unsupported by the record. This is particularly true when, as Southern Bell admits, ". . . there was no disagreement in the record about whether stimulation would occur. Everyone agreed there would be some" (SouthernBell brief at 13).

⁷ Any projection is going to be "unreliable" simply because it is a projection. The Commission accepted Southern Bell's budget to project the level of each and every expense and asset of Southern Bell for 1988, 1989 and 1990, and, except for stimulation, accepted Southern Bell's budget to project the level of each and every revenue during 1988, 1989 and 1990. Southern Bell's budget uses an estimate for stimulation (A 141-143; T 594-596).

EVEN IF THE COMMISSION REJECTS SOUTHERN BELL'S
EXPERT TESTIMONY ABOUT STIMULATION, COMPETENT, SUBSTANTIAL
EVIDENCE IS STILL NEEDED TO SUPPORT THE COMMISSION'S FINDINGS

Southern Bell cites the decision of the Fourth District Court of Appeal in Behm v. Division of Administration, State Department of Transportation, 292 So.2d 437 (Fla. 4th DCA 1974) for the proposition that a trier of fact may disbelieve unrebutted opinion evidence⁸. Southern Bell not only fails to acknowledge this Court's opinion in the same case (Behm v. Division of Administration, State Department of Transportation, 336 So.2d 579 (Fla. 1976)), but it also fails to recognize that the trier of fact must still base its findings on other evidence in the record if it disbelieves the expert's testimony. Citing the opinion of Mr. Justice Drew in Dade County v. Renedo, 147 So.2d 313 (Fla. 1962), this Court stated about the trier of fact:

"As in all other cases where the evidence is conflicting, it is within their province to resolve such conflicts but the results reached in such process must be within the evidence and supported by it." Behm at 582.

The Court goes on to say:

"The jury in a condemnation proceeding may not make an independent determination of the value of the property. But in evaluating,

⁸ Southern Bell brief at 22.

interpreting, and weighing the credibility of the testimony of an expert witness they may apply to the expert testimony their knowledge and experience, view of the property, as well as other evidence in the case to determine its reasonableness. The opinion of an expert is worth no more than the reasons on which it is based, and if properly susceptible to differing interpretations the jury is at liberty to make such interpretations." Behm at 582.

The Court suggests that the jury in Behm was free to reject an assumption by the expert about the remaining useful life of a condemned building. The expert assumed a remaining useful life for the building of twenty five years, but that assumption overlooked other testimony adduced during the trial. Behm at 581. See also County of Sarasota v. Burdette, 479 So.2d 763, 765 (Fla. 2d DCA 1985) (Although a jury may properly award damages in an amount less than that suggested by expert testimony, it must still be guided by the greater weight of the evidence, and it is not free to totally ignore the only evidence presented to it), and Slacter v. City of St. Petersburg, 449 So.2d 1006, 1007 (Fla. 2d DCA 1984). Here no evidence supports the Commission's use of zero stimulation to set Southern Bell's rates.

NO PARTY DISPUTES THE POINT THAT ALL EVIDENCE
SHOWS STIMULATION

The Citizens' initial brief showed that no party disputes the point that all evidence shows stimulation. The question about the correct estimate for stimulation first arose at the hearing - - after the filing of testimony was closed. Citizens' initial brief at 5-6. Nonetheless, the Commission makes a point that the Citizens did not submit a finding on stimulation as one of its proposed findings of fact⁹ ¹⁰.

The initial petition filed by Southern Bell contained an estimate of stimulation, and this estimate was later backed up with prefiled testimony showing that a toll price reduction would lead to increased purchases of long distance services by customers. The Citizens relied on Southern Bell's estimate of stimulation and did not contest or submit prefiled testimony rebutting this portion of Southern Bell's case. Likewise, except for the staff's other estimate, no other party contested this aspect of Southern Bell's case.

The staff of the Commission provided a different estimate for the first time at the hearing, but even here the staff only contested the magnitude of just one estimate of stimulation

⁹ Florida Public Service Commission brief at 1.

¹⁰

The Citizens argued the issue about stimulation in both a brief filed at the Commission and in a motion for reconsideration filed at the Commission.

provided by Southern Bell. No one disputed the point that customers would purchase more toll services at lower toll prices.

Southern Bell is now in the incongruous position before this Court arguing that the Commission properly rejected Southern Bell's own evidence about stimulation. The Citizens did not submit testimony to the Commission about stimulation because it was not a contested issue. There was no point contesting evidence when we agreed with Southern Bell's estimate of stimulation. There was nothing to contest. Southern Bell should be estopped from now arguing against its own representations which the Citizens relied on at the Florida Public Service Commission. **As** Southern Bell states in its brief, "When the testimony ended, there was no disagreement in the record about whether stimulation would occur. Everyone agreed there would be some" (Southern Bell brief at 13).

CONCLUSION

The Citizens concur with Southern Bell that section 120.68(10), Florida Statutes (1987) defines the standard applied by the Court when reviewing agency findings of fact". If an agency's action depends on any fact not supported by competent, substantial evidence, the court should set the agency action aside or remand the case to the agency.

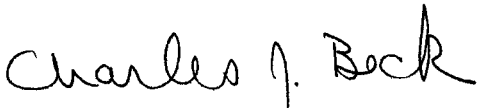
Southern Bell and the Commission argue that the Commission's

¹¹ Southern Bell brief at 21.

order does not depend on a finding about stimulation, but the Commission's decision to target Southern Bell's rates at a return on equity of 13.2% cannot be carried out without making such a finding. The Commission did make such a finding: it used an estimate of zero for stimulation to calculate the impact of toll price reductions on Southern Bell's earnings during 1988, 1989 and 1990. The Commission then used these findings to set Southern Bell's rates. This contradicts all evidence in the record about stimulation and affects the rates ordered by the Commission by at least \$42 million per year. The Court should remand the case to the Commission for action consistent with the evidence in the record.



Jack Shreve
Public Counsel
Fla. Bar no. 73622



Charles J. Beck
Assistant Public Counsel
Fla. Bar no. 217281

Office of Public Counsel
c/o Florida House of
Representatives
The Capitol
Tallahassee, Fl. 32399-1300

(904) 488-9330

Attorneys for the Citizens
of the State of Florida

CERTIFICATE OF SERVICE
Case No. 73,623

I HEREBY CERTIFY that a correct copy of the foregoing has been furnished by U.S. Mail or hand-delivery to the following parties on this 12th day of May, 1989.

William H. Adams, III
David Otero
Mahoney, Adams, Milam,
Surface & Grimsley
P.O. Box 4099
Jacksonville, FL 32202

Susan Clark
Rob Vandiver
Tracy Hatch
William Bakstran
Legal Department
Fla. Public Service Commission
101 E. Gaines Street
Tallahassee, FL 32301

Joseph Gillan
Gillan Associates
P.O. Box 541038
Orlando, FL 32854-1038

Rebecca Weeks
Tariff Regulatory Law
United States Air Force
HQ AFCC/JAY - Bldg. T-40
Scott AFB, IL 62225

Michael W. Tye
AT&T Communications
Suite 505
315 S. Calhoun Street
Tallahassee, FL 32301

Joseph A. McGlothlin
Lawson, McWhirter, Grandoff
& Reeves, P.A.
522 E. Park Ave., Suite 200
Tallahassee, FL 32301

Kenric E. Port
MCI Telecommunications Corp.
400 Perimeter Center Terrace
N.E., Suite 400
Atlanta, GA 30346

Richard D. Melson
Hopping, Boyd, Green
& Sams
Post Office Box 6526
Tallahassee, FL 32314

Mr. Dellon E. Coker
Chief, Regulatory Law Office
Mr. Cecil O. Simpson, Jr.
General Attorney
U.S. Army Legal Services Agency
JALS-RL 3527
5611 Columbia Pike
Falls Church, VA 22041-5013

Patrick K. Wiggins
John C. Davis
Ranson & Wiggins
Post Office Drawer 1657
Tallahassee, FL 32302

Douglas S. Metcalf
Communications Consultants, Inc.
1600 East Amelia Street
Orlando, FL 32803

Daniel R. Loftus
Boult, Cummings, Connors
& Berry
222 Third Avenue North
P.O. Box 198062
Nashville, TN 37219

Mark Neptune
Teltec Saving Communications Co.
1020 N.W. 163rd Drive
Miami, FL 33169

Thomas R. Parker
Associate General Counsel
GTE Florida Incorporated
P.O. Box 110 MC 7
Tampa, FL 33601

Joaquin R. Carbonell, III
Southern Bell Telephone &
Telegraph Company
150 W. Flagler St., Suite 1910
Miami, FL 33130

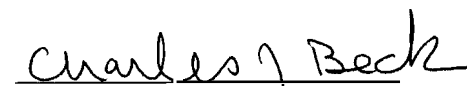
Bruce Renard
Floyd Self
Messer, Vickers, Caparello,
French & Madsen
P.O. Box 1876
Tallahassee, FL 32302

William Hyde
Roberts, Baggett, LaFace &
Richard
101 East College Avenue
P.O. Drawer 1838
Tallahassee, FL 32302

Norman Horton
Mason, Erwin, Horton, P.A.
1020 E. Lafayette St.
Suite 202
Tallahassee, FL 32301

Rita A. Barmann
General Regulatory Attorney
US Sprint Communications Co.
1850 M Street NW
Suite 1110
Washington, DC 20036

R. Douglas Lackey
Robert Fitzgerald
Southern Bell Telephone &
Telegraph Company
4300 Southern Bell Center
Atlanta, GA 30375


Charles J. Beck