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PRELIMINARY MATTERS

Public Counsel, is referred to in this brief as "Public Counsel." Appellant Florida Retail Union is referred to as "the Union." Public Counsel and Federation are referred to as "Appellant Union." Southern Bell Telephone and Telegraph Company is referred to as "Southern Bell." The Federal Service Commission is referred to as the "Commission." AT&T Company of the Southern States Inc is referred to as "AT&T."

Order No. 0162 is contained in the Record at page 2652. Order No. 20503 is dated August 28, 1989. References to the Record appear as "[R. at ___], except that references to the transcript of the hearing are signified as "[T. at ___]."

RESTATEMENT OF THE CASE AND FACTS

Appellants' Statement of the Case and Facts exaggerates the significance of stimulation and misperceives its role in the orders to be reviewed on this appeal. Contrary to the statements made in Appellants' briefs, the Commission did not find zero stimulation. It recognized that stimulation will occur but, on the basis of substantial competent evidence in the record, determined that the predicted levels of stimulation were unreliable. Accordingly, it exercised its discretion in fashioning a rate structure that would give the public the benefits of any stimulation that occurs without the necessity of predicting what the stimulation level will be.

One cannot appreciate how stimulation fits into the policy determinations made by the Commission without a broader understanding of the proceeding below and of the variety of interrelated factors the Commission considered in reaching its decision. When stimulation is considered in context, it becomes apparent that it was one of the many factors considered in the regulatory policy the Commission adopted. By isolating stimulation and ignoring the context, Appellants have created a distorted picture of what the Commission did. When the context is taken into account, it becomes obvious that Appellants' real complaint cannot be with the facts found by the Commission on the stimulation issue. It must be with the weight given to stimulation in the new regulatory policy the Commission adopted.

Because Appellants' Statement of the Case and Facts is inadequate, Southern Bell will restate the case and facts in order to place the stimulation issue in proper perspective.

The conventional approach to rate of return regulation was developed when telephone companies had a monopoly on most of the services they provided. It created a structure that is now incompatible with the demands of the deregulated environment in which telephone companies are pressed by competitors offering the same services or close substitutes for them. Southern Bell's petitions in this case asked the Commission to modify its traditional approach to the regulation of telephone rates in order to create incentives that would lead to a wider array of services at the lowest possible cost to ratepayers. In Order No. **20162**, the Commission squarely faced these fundamental issues of policy and approved a new approach which it adopted on an experimental basis.

The Commission's order begins with a description of both the method of rate regulation it has customarily followed and the modified approach suggested by Southern Bell:

Traditional utility regulation has historically taken the form of rate of return regulation (ROR) by independent regulatory authorities such as this Commission. Under this approach, privately-owned utilities such as Southern Bell are given the opportunity to collect rates which will cover operating costs and earn a reasonable rate of return on property devoted to providing the regulated service. In recent years in Florida, the Commission has calculated a rate of return as a mid-point and generally allowed a **100** basis point zone of reasonableness around that point. Southern Bell's current authorized zone is **14-16%**. The Southern Bell petitions are premised upon the idea that this traditional manner of

regulation needs to be altered in the light of technological developments and governmental actions, particularly the 1984 Bell System divestiture. In Southern Bell's view, alteration of the regulatory scheme would alleviate economic disincentives inherent in rate of return regulation.

Two major disincentives of ROR regulation discussed at the hearings were the incentive to overinvest and the lack of incentive to innovate, reduce cost and introduce new services. As to overinvestment, the theory is that, because the return is tied to rate base, there is an incentive to increase the rate base in order to increase earnings. In other words, regulated firms have reasons to "goldplate" their physical plants. The theory behind the reduced innovation is that no reason exists to reduce costs and improve productivity when these gains are returned to the utility's ratepayers.

To alleviate the perceived disincentives of ROR regulation, Southern Bell proposed a "rate of return sharing incentive plan." This plan assumed the existing 14-16% range for return on equity. Under the proposal, earnings above 15% would be split 50/50 between the company and its ratepayers. Southern Bell would retain 50% of the amount over 15% and the Commission could allocate the remaining 50% as it saw fit, including possible refunds and rate reductions. Although it was not clear from the petitions, Southern Bell did agree that its earnings after sharing would not exceed 16% under its plan.

[Order No. 20162. at 5-61.

In Order No. 20162, which addressed Southern Bell's proposal, the Commission recognized that:

The telecommunications industry has been and continues to be in a state of change. More and more aspects of the relevant markets are becoming competitive. A local exchange company, such as Southern Bell, must adapt to the new competitive world in which it finds itself. This Commission must also recognize these fundamental changes in the industry and

allow Southern Bell to transition itself for these changes. We thus believe that the incentive aspects of this plan will assist in this transition process. We hope it will result in a wider array of services at the lowest possible cost to ratepayers.

[Order No. 20162. at 6].

In its order, the Commission drew an analogy between the telephone company and a salesman working on commission. It observed that the salesman on commission would sell more goods than the salesman working for a flat salary. The salesman who has an incentive to sell more goods will do so. "A company's management and stockholders are no different. They make investment decisions based on the return they will receive. One can reasonably expect that given the opportunity to earn a higher return, even if it has to be shared, will encourage further investments and efficiencies as well as new services," [Order No. 20162. at 6].

Based on its finding that, in the new competitive environment, properly crafted incentives would encourage Southern Bell to provide better services at lower cost, the Commission altered its regulatory policy on a provisional, experimental basis. It approved Southern Bell's proposal in concept subject to procedures that would permit it to closely monitor the actual results of the plan and bring it to a halt if Southern Bell's actual earnings should be greater than it contemplated.

Although the Commission gave its general approval to the sharing concept Southern Bell proposed, its implementation departed substantially from Southern Bell's proposal. For example, the

Commission introduced the idea of an earnings threshold. It explained that "more efficient operations will result from setting the sharing threshold above the level at which rates are set. This will give the company a reason to reduce costs and introduce new services in order to reach the sharing threshold." [Order No. 20162. at 7]. Instead of the 15% return requested by Southern Bell, the Commission set the earnings level at 13.2%.¹ While Southern Bell had asked for the right to earn 15% before sharing would begin, the Commission required it to share its earnings with ratepayers after earning only 14%, and rather than the 50/50 earnings split that Southern Bell had suggested, the Commission approved a split that gave 60% of earnings over 14% to ratepayers. In explaining this difference it wrote:

The percentage amount that is split between the company and its ratepayers is necessarily a judgment call infused with policy considerations. Southern Bell proposed a 50/50 split, but conceded that the percentages were arbitrary. Other parties argued for an initial 80/20 split in the ratepayers' favor, to be phased to a 50/50 split as the percentage of overall earnings on equity increased. We find that the split should be 60/40 in the ratepayers' favor. We have deliberately tilted the balance in favor of ratepayers because of

¹ Public Counsel has asserted in his brief (p.8, n. 1) that in the proceeding below a staff witness recommended that Southern Bell be allowed a return on equity of only 12.5%. This misrepresents the staff's position on a point that is irrelevant to this appeal. The purpose of this footnote can only be to prejudice the Court. In fact, in the testimony to which Public Counsel refers, the staff member actually testified that Southern Bell's cost of equity was 13.2%. [T. at 16951. The 12.5% mentioned in Public Counsel's brief was a rate-setting point based on a new concept known as compounding. The Commission, after reviewing all the return on equity testimony (including testimony on compounding), ordered rates be set at 13.2%.

the balance in favor of ratepayers because of our inability to precisely identify earnings that result exclusively from productivity improvements generated by Southern Bell.

[Order No. 20162. at 7].

The last sentence is important because, as the Commission explained later, the difficulty of estimating the amount of stimulation was one of the reasons it could not identify earnings that would result exclusively from productivity improvements.

The Commission's order created a four-tier rate structure which began with a floor and ended with a ceiling on the earnings Southern Bell was entitled to achieve:

- 11.5% - Authorized Floor
- 13.2% - Rate Setting Point
- 14.0% - Sharing Begins
- 16.0% - Authorized ceiling after Sharing

[Order No. 20162. at 7].

All of these rates of return, except the 16% ceiling, were substantially lower than the rates Southern Bell had asked for.

Other changes made by the Commission from Southern Bell's proposal were equally significant. Southern Bell had proposed that it be allowed to share in all earnings over the sharing threshold. The Commission rejected this proposal. The Commission found it would be:

. . . fair to allow Southern Bell to share only increased earnings that result from the company's efforts. It is not equitable to allow Southern Bell to share earnings from exogenous factors such as tax or separations changes. Ideally, we would like to allow sharing of only those earnings attributable to productivity increases by the company. However, there is nothing in this record that provides a way to measure efficiency or to

establish an "industry norm" for labor, capital **and** total factor productivity. We do not believe that the productivity gains can be isolated at this time.

We will exclude the following earnings from the splitting process: all rate changes other than regroupings; changes resulting from significant governmental actions, such as tax changes, separations changes and depreciation changes, with a minimum impact of **\$3,000,000** on revenue requirements; refinancing of higher cost debt instruments and major technological changes. Southern Bell will not be permitted to enhance its profits through rate increases, no matter how slight the effect may be on earnings.

[Order No. 20162. at 7-81.

Because of the essentially experimental nature of its decision, the Commission provided that the plan would have a relatively short duration -- January 1, 1988, to December 31, 1990. It noted that at the end of that period it would "be better able to examine the merits of [the] incentives" it relied upon in formulating the policy embodied in its order. The Commission described its objective in providing this short term:

This plan shall be in effect from January 1, 1988 until December 31, 1990. This will give us over two years to examine how the company performs under the terms and conditions of the regulatory environment. This period of time should provide changes in the business cycle that will allow examination of the regulation in different kinds of economic times. All of the numbers upon which the plan is based are projected through the end of 1990. Projections any further out in time are likely to be very inaccurate. We therefore accept Southern Bell's proposal that this plan remain in effect through December 31, 1990.

[Order No. 20162. at 26].

To enable the Commission to closely monitor the actual effects of the plan, it required Southern Bell to make more detailed monthly and annual surveillance reports which must contain data that will enable the Commission to better police the effects of the plan in actual operation. And, to enable either the Commission or Southern Bell to bring the experiment to a halt if the assumptions on which it is based prove to be incorrect, the Commission included an escape clause:

In Southern Bell's Petition for Rate Stabilization Order and Other Relief, the following was listed as a "condition integral to this petition":

If during the term of this proposal, because of circumstances which are presently unforeseeable by the company or the Commission, for example, a precipitous increase or decrease in the Federal Corporate Income Tax rate, the financial position of the company or the interests of its ratepayers are placed in substantial jeopardy because of such unforeseen circumstances, the provisions of this proposal restricting rate proceedings shall be open for review by the Commission at the request of the company or the Commission.

This provision has been called an "escape clause" in the event large unforeseen changes take place during the term of this regulatory plan. While we endorse the language noted above, we wish to make absolutely clear that the possible discontinuation of this plan cuts both ways. In other words, significant unforeseen improvements in Southern Bell's earnings could result in action by this Commission in the same way that Southern Bell reserves the right to petition the Commission in cases of a major unforeseen decline which places the company in substantial jeopardy.

[Order No. 20162. at 8-91.

It can be seen from these provisions that, contrary to Appellants' briefs, which make it appear that the Commission accepted every figure Southern Bell submitted, the Commission departed from the proposal to Southern Bell's detriment on virtually all of the issues that will have an impact on the amount Southern Bell is authorized to earn.

Now that the overall policy embodied in the Commission's order has been described, it is appropriate to look at the stimulation issue and place it in perspective.

In economic theory, a fundamental law of demand is: "The higher the price, the lower the rate of consumption." Conversely, the rate of consumption of a good or service will increase if the price is reduced. The plan adopted by the Commission involves unprecedented reductions in rates. Because of the new competitive conditions in the market for telephone services and the fact that Southern Bell's past rate reductions occurred under different conditions, Southern Bell's previous experience did not provide a basis for accurately predicting what the demand for its services would be at the new lower rates. [T. at 940, 1003, 1013-14, 1943-44, 19451. While no one in the proceeding below disputed the fact that the reductions will produce some increase in the use of telephone services, there is no evidence in the record that the amount of increased use due solely to the lower rates is capable of either accurate prediction or even accurate determination after the fact. As almost any economics text reveals, the measurement of stimulation is possible in theory, but complicated in

practice. Stimulation definitely occurs, but it is not easy to quantify.² Factors that affect changes in the amount of any commodity demanded by consumers include, not only price reductions, but the number of consumers in the population, the extent of their knowledge of the reductions, the importance of the commodity in each consumer's total budget, the degree to which the commodity is advertised and promoted and the availability of substitute products in the market. The price elasticity of demand changes at each price level and from day to day depending on constantly shifting consumer preferences. Even without rate reductions, growth in telephone usage will occur as the population increases, as

² In R. Miller, Intermediate Microeconomics, p. 119 (1978), the author describes the difficulty of estimating elasticity:

We do not find out how consumers will react to something by asking them how they think they would react. We have to have some evidence of what they actually do in a real world situation. Consumers are very fickle individuals. It is generally safest to infer their preferences from their actual buying behavior.

* * *

. we know that relative price is not the only thing that determines the demand curve for a commodity. . . . there [are] other determinants of changes in demand. These [are] changes in such things as real income, tastes and preferences, the prices of related goods, expectations of future price changes, and population. Thus we know that if we were to attribute changes in quantity demanded solely to changes in the relative price of that particular good, we would probably be introducing a serious error into our estimates of price elasticity of demand.

consumers become more affluent, and as new telephone services are created and promoted.

When price reductions do occur and usage increases, it may be difficult to determine, even after the fact, how much of the increase was due solely to the price change and how much was due to other factors. [T. at 10141. If the amount of growth due to price changes alone cannot be accurately determined from hindsight, it is even more difficult to predict it in advance with any degree of accuracy, especially when market conditions under which the changes are made differ from those in the past.

Southern Bell acknowledged in its Petition for Implementation that its gross revenues would be stimulated by the rate reductions. It tried to estimate the stimulation that would be produced by the reductions in its forecast of revenues for the years covered by the **experiment**.³ Its estimates, which were made by David Denton, are the only evidence of stimulation in the **record**.⁴

³ Public Counsel's brief [p. 5] correctly points out that Walter Reid, an operations manager in Southern Bell's Comptroller's division, distinguished between "**gross**" revenue and "**net**" revenue, the latter taking stimulation into account. It incorrectly states that the gross revenue figure was provided "**only for information**." Reid recommended that gross figures be used to test the reasonableness of the rate reductions. [T. 524]. While he gave estimates for both gross and net revenues, he was careful to point out that the net figures would be correct only if the predicted levels of stimulation should occur. [T. 523-24, 545].

⁴ Although Public Counsel's brief attributes opinion evidence on stimulation levels to Walter Reid, it is clear from Reid's testimony that all the estimates of stimulation were made by Denton and passed on to Reid who included them in his testimony on revenues. [T. at 514-15].

a

David Denton, a Southern Bell economist, was the only witness to discuss stimulation in any detail. During **AT&T's** cross examination, Denton was asked about whether previous access charge reductions had stimulated the revenues of **AT&T** and other interexchange carriers. Denton pointed out that stimulation came not only from price reductions but also from "more intense advertising and **promotion.**" [T. at 923-24]. He explained that the access charge reductions Southern Bell proposed would stimulate Southern Bell's revenues only to the extent interexchange carriers such as **AT&T** pass the reductions on to consumers by reducing their own rates. [T. at 945]. But, if they did pass on the reductions, the interexchange carrier rate might be lower than Southern Bell's competing rates, and Southern Bell could lose revenue. [T. at 940].

a

It was disclosed during Denton's cross examination that the Commission staff had questioned Southern Bell's initial estimate of stimulation as too high and that Southern Bell had responded with a lower estimate which Denton had included in the calculations contained in Exhibit 14(b). [T. at 979, 1032]. Denton revealed that the initial figure had been the one Southern Bell had used in trying to estimate the effect of a previous access charge reduction, but there was no reason to believe another reduction would produce the same stimulation as the first. He mentioned reasons why interstate and intrastate consumers might react differently to price changes. These included "the extent of competition, the intensity of competition, the amount of promotion, advertising, the variety of rate plans that are offered in the

interstate versus intrastate," [T. at 981]. He admitted, however, that Southern Bell had not been able to determine how much of its past growth had been attributable to rate reductions and that it had become more difficult to predict levels of stimulation than in the past when Southern Bell was the only provider of telephone service. [T. at 982, 1013-14]. In his testimony on the effect of price reduction in the plans made available to residential users, Denton noted that "with the exception of the one that was the flat rate option, we really have no experience with these kind of plans." [T. at 10031.

During Denton's testimony one of the members of the Commission recalled a previous Commission proceeding in which the stimulative effect of rate reductions had been overestimated, the facts had not matched up, and "consequently, the revenues were not generated that were anticipated." [T. at 19431. Denton responded:

You can be assured that any stimulation estimate is going to be wrong.

[T. at 1943-44] (emphasis added).

Denton went on to explain that the Southern Bell model had assumed that stimulation would occur instantaneously, an assumption that was not realistic since it takes time for the word to get out on lower prices and there is a time lag before the reduction is effective. [T. at 1944-45].

When the testimony ended, there was no disagreement in the record about whether stimulation would occur. Everyone agreed there would be some. But evidence on the level of stimulation was

unclear. The record contained "estimates" by Southern Bell of the amount by which its revenues would be stimulated, but, as Public Counsel's brief [p. 9] points out, they were nothing more than estimates. The record also contained testimony that these estimates had no reliable foundation and that in the new competitive environment in which Southern Bell was operating, Denton had little confidence in his ability to make predictions of stimulation levels. Southern Bell's previous experience with rate reductions was limited, and it could not tell from that experience what part of its growth had been attributable to price reductions and what part had come from other factors. If the Commission had determined as a matter of policy that the amount of stimulation was a material factor, it could have accepted Southern Bell's estimates. On the other hand, the record certainly contained evidence from which the Commission could reasonably have determined that the level of stimulation could not be reliably predicted.

When the Commission entered Order No. 20162 it did not specifically mention the stimulation issue because it obviously considered prediction of stimulation to be immaterial in light of the policy embodied in the order, especially the 60/40 split which the Commission said it chose because of its "inability to precisely identify earnings that result exclusively from productivity improvements generated by Southern Bell." [Order No. 20162. at 7].

Public Counsel, noting the absence of any discussion of stimulation, requested a rehearing and made the same arguments as Appellants are making on this appeal. On December 22, 1988, in

Order No. 20503, the Commission unanimously rejected Public Counsel's contentions, explaining its position in the following language:

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 economic 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 about 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.

[Order No. 20503. at 2] (emphasis added).

a In the following sections of this brief, we will demonstrate that these findings were supported by competent substantial evidence and were within the Commission's discretion.

SUMMARY OF ARGUMENT

Appellants have set up a straw man that they can easily knock down with a simplistic argument. The straw man is Appellants' assertion that the Commission, ignoring undisputed evidence that lower rates will stimulate increased use of telephone service, found that "zero stimulation" would occur. Having distorted the Commission's orders into a finding of "zero stimulation," Appellants argue that there was no evidence to support it.

If, as Appellants say, the Commission's orders had really been based on a finding of zero stimulation, Appellants' legal argument would be powerful indeed. As Appellants demonstrate, the evidence that some stimulation will occur was undisputed. But, Appellants' major premise that the orders were based on a finding of zero stimulation is simply untrue. The Commission did not conclude that there would be no stimulation. It knew that usage would be stimulated, but it was "unpersuaded that the stimulation levels indicated will occur with any degree of reliability." [Order No. 20503. at 2] (emphasis added). The record clearly supports this finding. The only witness who testified on the stimulation issue made it clear that the estimates were unreliable.

Most importantly, under the regulatory policy adopted by the Commission and embodied in its orders, the level of stimulation was a relatively immaterial factor. Instead of trying to make a finding on the amount of stimulation, a finding which the only witness on the issue had said would inevitably be wrong, the

Commission created a rate structure that made accurate prediction of the level of stimulation unimportant. This was a policy choice that was well within its discretion.

ARGUMENT

Introduction

This case, like McDonald v. Department of Banking & Finance, 346 So.2d 569, 574 (Fla. 1st DCA 1977), requires the Court "to reconcile the competing purposes of two statutes." Chapter 364, Florida Statutes (1987), confers on the Commission broad powers to approve the rates charged by telephone companies, and Chapter 120, Florida Statutes (1987), places constraints on the manner in which the Commission may go about performing that task.

In Order No. 20162, the Commission described its obligations under Chapter 364 in the following words:

Section 364.03, Florida Statutes, requires that telephone company rates be "fair, just, reasonable and sufficient." The end result of reasonable rates also appears in Section 364.035 (1) and 364.14, Florida Statutes. Florida Statutes do not dictate a means to achieve this end result. Section 364.035 provides that a telephone company must not be denied a "reasonable return" upon its rate base and Section 364.14 provides that the Commission shall allow a "fair and reasonable" return on its prudent investment used and useful in the public service. Section 364.055, F.S., also requires the Commission to set upper and lower limits upon the return on equity.

[Order No. 20162. at 28].

This Court has pointed out that "rate regulation is essentially one of legislative control. The fixing of rates is not a judicial function; hence our right to review the conclusion of the legislature or of an administrative body acting upon authority delegated by the legislature is limited." United Telephone v.

Mayo, 345 So.2d 648, 654 (Fla. 1977). Moreover, the Commission has considerable discretion in the ratemaking process. City of Miami v. Public Service Commission, 208 So.2d 249, 253 (Fla. 1968).

Appellants do not challenge the Commission's power under Chapter 364 to determine as a matter of rate-making policy how much weight, if any, should be given to stimulation. As a general proposition, that decision is well within the discretion delegated to the Commission by the legislature.

The issues raised by this appeal are created solely by the requirements of Chapter 120. Section 120.68 sets forth the standards the Court must follow in reviewing the Commission's decision. Although subsection 120.68(7) requires the court to deal separately with disputed issues of agency procedure, interpretations of law, determinations of fact or policy within the agency's exercise of delegated discretion, this case raises only two issues. One is an issue of fact-finding and the other an issue of policy. The two issues are:

1. Whether competent, substantial evidence supported the Commission's determination that the evidence on the levels of stimulation was unreliable; and
2. Whether the Commission properly exercised its discretion in fashioning a regulatory structure under which it was unnecessary to predict the level of stimulation.

I. THE COMMISSION'S DETERMINATION THAT THE PREDICTIONS OF STIMULATION LEVELS WERE UNRELIABLE WAS SUPPORTED BY COMPETENT SUBSTANTIAL EVIDENCE.

Section 120.68(10) defines the function performed by a court in reviewing agency findings of fact:

(10) If the agency's action depends on any fact in a proceeding meeting the requirements of s. 120.57, the court shall not substitute its judgment for that of the agency as to the weight of the evidence on any disputed finding of fact. The court shall, however, set aside agency action or remand the case to the agency if it finds that the agency's action depends on any finding of fact that is not supported by competent substantial evidence in the record.

Appellants argue that the Commission improperly found that the rate reductions would produce zero stimulation in Southern Bell's revenues. As we have pointed out, however, the Commission did not find zero stimulation. It found only that Southern Bell's predictions of the levels of stimulation were unreliable. This means that if Appellants' contention is to have any meaning, it must be recast. The issue must be whether there was substantial competent evidence in the record to support the Commission's determination that Southern Bell's estimates of the amount of stimulation were unreliable.

Even If The Evidence On Stimulation Levels Had Not Contained Internal Conflicts, The Commission Would Have Been Entitled To Disregard It.

Appellants are correct in saying that Commission expertise is not a substitute for evidence in the record. The cases they have cited correctly hold that to support an affirmative finding there

must be evidence in the record. In other words, if the Commission had found that a particular level of stimulation would occur, its finding might have been subject to challenge unless the record contained evidence to support it. However, that is not what happened here. Here, the Commission did not find a particular level of stimulation. It held merely that the evidence that had been offered on the level of stimulation was unreliable. Thus, the cases Appellants have cited are not in point. Another group of cases must be considered. They hold that a trier of fact may disbelieve unrebutted opinion evidence.

In Behm v. Division of Administration, State Department of Transportation, 292 So.2d 437 (Fla. 4th DCA 1974), a condemning authority offered no evidence to rebut expert testimony offered by a property owner in an eminent domain case. The jury refused to believe the unrebutted testimony and the property owner appealed. After citing a host of cases, the court held that in arriving at its findings a trier of fact may reject opinion evidence even if it **is** unrebutted. Id. at 440-41; **see** Cronin v. State, 470 So.2d 802 (Fla. 4th DCA 1985).

Behm and the cases it cites did not involve triers of fact having specialized expertise. Here the Commission does have that expertise. When the legislature has delegated fact finding authority to a regulatory agency with specialized expertise, there is even more reason to permit the agency to disbelieve evidence it finds unreliable.

The Evidence On Predicted Levels Contained Internal Conflicts.

In this case, of course, the evidence was not conflicting in the usual sense in which one witness says one thing and another witness says the opposite. Here only one witness testified on the stimulation issue. He defended Southern Bell's estimates of stimulation, but when asked on cross examination about the methods used in arriving at the estimates and the difficulties of estimating stimulation levels, he agreed "that any stimulation estimate is going to be wrong." [T. at 1943-44] (emphasis added). With this evidence in the record, the Commission was entitled to use its prior experience to decide what evidence to accept on stimulation levels. Its finding was clearly supported by competent substantial evidence and may not be disturbed.

If the Court agrees that the Commission's finding was supported by competent substantial evidence, that should be the end of the matter. But that would not be the case if the Court should decide that the Commission's finding was unsupported. If the Court should find that the Commission had no justification for disbelieving the stimulation estimates, Section 120.68(10) requires it to take another step and consider whether Commission's orders "depended" on its rejection of the stimulation evidence. The issues underlying this question are intimately related to the policy determinations made by the Commission in its orders and will be discussed in the next section.

II. THE COMMISSION PROPERLY EXERCISED ITS DISCRETION IN FASHIONING A REGULATORY STRUCTURE UNDER WHICH IT WAS RELATIVELY UNIMPORTANT TO PREDICT THE LEVEL OF STIMULATION.

Section 120.68 also defines the role to be performed by a court in reviewing an agency's exercise of discretion or policy:

(12) The court shall remand the case to the agency if it finds the agency's exercise of discretion to be:

(a) Outside the range of discretion delegated to the agency by law;

(b) Inconsistent with an agency rule;

(c) Inconsistent with an officially stated agency policy or a prior agency practice, if deviation therefrom is not explained by the agency; or

(d) Otherwise in violation of a constitutional or statutory provision; but the court shall not substitute its judgment for that of the agency on an issue of discretion.

As Order No. 20503 made clear, the Commission did not take any specific estimate of stimulation into account when it issued Order No. 20162. Instead, the Commission elected to change the rate structure. Deciding whether to consider the specific estimates of stimulation in the new rate structure was clearly a policy determination which the Commission was empowered to make. As we have demonstrated, the legislature has given the Commission broad authority to determine the means to be used in regulating telephone rates. The primary substantive constraint on Commission power is that the rates fixed must be fair and reasonable. Appellants do not claim that the rates fixed by the Commission are substantively unfair. In view of the Commission's very broad

discretion, Appellants cannot complain (and have not complained) that the Commission violated any substantive provision of the Constitution or Chapter 364 in adopting the new sharing structure. Thus, their complaint can only be that the Commission improperly exercised its discretion; i.e., that it violated some procedural constraint in Chapter 120.

Turning to the procedural issue, it should be noted that the Appellants do not contend that the Commission's decision is inconsistent with any Commission rule or officially stated Commission policy. They do not argue specifically that the Commission's failure to calculate stimulation is inconsistent with prior agency policy or that it created new policy, but, for the sake of completeness, we should perhaps assume that this is their contention and refute it now.

In declining to estimate a specific level of stimulation and use it to increase Southern Bell's gross revenue figure, the Commission was acting consistently with Commission policy expressed in its previous decisions.

The Commission recognized the unreliability of predictions of stimulation in Docket No. 860984-TP, In re: Investigation into NTS Cost Recovery - Phase 11, Order No. 19677, which it cited in Order No. 20162. In that proceeding the Commission discussed stimulation associated with access charge reductions and stated:

However, it appears there may be a potential technical and financial problem with determinins, whether there is any stimulation and further, the specific stimulation level.

. . . Our experience with past access reduction supports this. Even though CCL rates were

reduced by 41.9% in 1987, neither Gulf nor Centel could identify any stimulation. Further, Southern Bell stated that "With our switched access demand models, we have not been able to determine the exact stimulative effect of the access charge reductions in 1987."

Order No. 19677 at p. 21 (emphasis added).

While the Commission directed local exchange carriers such as Southern Bell to consider stimulation in connection with future access reductions and provide an estimate of the stimulation level, the Commission also recognized "the difficulty involved in determining the precise amount of stimulation and acknowledge[d] that in some cases no stimulation **results.**" *Id.* at p. 21.

Repression is the converse of stimulation. It occurs when prices are raised. Assuming all other factors such as consumer income and preferences remain the same, when the price of any product increases, the amount demanded is reduced. In previous cases involving rate increases, Southern Bell has asked the Commission to take repression into account. The Commission has always refused to do so, regarding predicted levels of repression as speculative and therefore not specifically allowable. In Docket No. 760842-TP, In re: Petition of Southern Bell Telephone and Telegraph Company for Authority to Increase its Rates and Charges, Order No. 7926, Southern Bell, using a stimulation/repression model, asserted that proposed rate increases would have a depressing effect on revenues and that the Commission should give **it** a repression allowance. The Commission refused to do so, saying:

While the model appears to be statistically sound, its aggregate nature precludes its applicability to the design of rates for message toll service. For that reason, together with the Company's failure to consider the impact on revenue of other pertinent factors, the Commission concludes that the request for inclusion of a repression allowance should be denied. See also, Docket No. 840187(2)-TL, In re: Petition of General Telephone Company of Florida for an increase in its rates and charges, Order No. 13837.

Order No. 7926 at p. 37.

The Commission rejected the repression arguments Southern Bell advanced in Docket No. 820294-TP, Order No. 12221 (Southern Bell's 1982 rate case). On page 41 of its order in that case, the Commission refused to accept repression estimates concluding that:

Our revenue adjustments do not reflect the Company's repression data offered in this case because we do not believe the repression estimates offered are based on sound analytical models.

Contrary to his position here, Public Counsel has consistently opposed Southern Bell's requests for repression allowances. For example, in Docket No. 820294-TP (the 1982 rate case), Public Counsel's opposed such an allowance for the same reason the Commission gave for refusing to believe the stimulation evidence in this case. In opposing a repression allowance, he filed a brief arguing that:

Unless the repression/stimulation effects are determined in a reasonable manner, such effects should not be considered in revenue calculations and ratesetting.

Public Counsel's Brief, p. 122, May 23, 1983.

Even if the Commission's refusal to accept the predicted levels of stimulation had been a departure from previous Commission policy, nothing in Chapter 120 prevents an agency from changing its policy or creating a new one. The only procedural constraint on the ability of an agency to change a policy or create a new policy is that it may not adopt incipient policy without explaining its factual basis and reasoning. Southern Bell Telephone and Telegraph Company v. Florida Public Service Commission, 443 So.2d 92, 96 (Fla. 1983); McDonald, 346 So.2d at 582; see Gulf Coast Electric Cooperative v. Florida Public Service Commission, 462 So.2d 1092, 1094 (Fla. 1985). And, obviously, the agency's explanation must be sufficient to make it clear that the incipient policy was not arbitrary or, stated another way, that it had a rational basis. Southern Bell Telephone and Telegraph Company v. Florida Public Service Commission, 443 So.2d 92, 96-97 (Fla. 1983).

In this case, the Commission fully explained its decision not to take any specific estimates of stimulation into account in fixing Southern Bell's rates. In Order No. 20162, the Commission took great pains to elucidate its reasons for adopting the new sharing structure embodied in the order, a rate structure that is **not** challenged on this appeal. It expressed general confidence that the new structure would give Southern Bell an incentive to invest more efficiently, to create innovative new products, and to provide better services at lower cost. Because of its concern about stimulation levels and its ability to distinguish

between earnings due to the new incentives and those due to exogenous factors, the Commission provided that the experiment would remain in effect only until December 31, 1990, required Southern Bell to file more detailed monthly and annual surveillance reports, and included an escape clause that would enable it or Southern Bell to pull the plug if the earnings anticipated in the calculations failed to materialize or exceeded the parties' estimates.

In responding to Public Counsel's concerns that it had not taken stimulation into account, the Commission gave a cogent explanation, pointing out that it had

. . . . 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 economic 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 anticipated benefits before they take place.

[Order No. 20503. at 2].

It is manifest from the Commission's orders that it considered the experiment embodied in Order No. 20162 to be vitally important to the people of Florida. If successful, it would result in new

products, better service and lower rates. But the experiment could only be successful if it could be left in place and monitored closely over its full term. The Commission expressed serious doubts about the accuracy of the stimulation predictions. If the predictions should turn out to be wrong, the experiment might be aborted by either party. As it stands, Order No. 20162 reduces Southern Bell's earnings by an aggregate of \$672 million. Southern Bell opposed such a large reduction on the ground that the returns permitted would be lower than those required to enable it to raise needed capital. If the Commission had accepted the estimates of stimulation and reduced Southern Bell's rates still further and if the stimulation levels failed to materialize, the return Southern Bell would actually realize might be unreasonably low. By rejecting the specific predictions of stimulation and changing the sharing ratio from 50/50 to 60/40, the Commission rendered determination of the stimulation level unnecessary, and at the same time, reduced the risk that this important experiment might have to be aborted. The decision it made was within its discretion, supported by evidence, reasonable and adequately explained. The Appellants have offered no reasons that could justify reversal.

CONCLUSION

Southern Bell respectfully submits that the Commission properly found that the evidence of predicted levels of stimulation was unreliable and that it properly exercised its delegated discretion in creating a rate structure under which the level of

discretion in creating a rate structure under which the level of stimulation need not be predicted because ratepayers will share in the benefits of any stimulation that occurs under a formula deliberately tilted in their favor. Since the Commission's order was well within its discretion, it must be affirmed.

Respectfully submitted

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a correct copy of the foregoing has been furnished by United States Mail to the following parties on this 17th day of April, 1989.

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