



BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)
The Ohio Bell Telephone Company for)
approval of an alternative form of) Case No. 93-487-TP-ALT
regulation.)

SUPPLEMENTAL TESTIMONY OF PHILLIP A. ROMO
AMERITECH OHIO EXHIBIT 25S.0
SUBJECT: PRICE CAP PLAN

1. Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A: Phillip A. Romo, 45 Erieview Plaza, Room 1549,
Cleveland, Ohio 44114.

2. Q: ARE YOU THE SAME PHILLIP A. ROMO WHO FILED OHIO BELL
EXHIBITS 25.0 AND 25A.0?

A: Yes, I am.

3. Q: WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

A: The purpose of my supplemental testimony is to address
issues raised and recommendations made by the PUCO
Staff (the Staff) in its Report of Investigation in
Case No. 93-487-TP-ALT (Staff Report) and the National
Regulatory Research Institute (NRRI) Addendum to the
Staff Report regarding the price cap plan proposed by
Ameritech Ohio in Advantage Ohio. My supplemental
testimony also provides information regarding the
Advantage Ohio price cap plan requested of the Company
by the Staff in its Staff Report.

4. Q: HAVE YOU READ AND ARE YOU FAMILIAR WITH THE PUCO STAFF
REPORT OF INVESTIGATION IN PUCO CASE NO. 93-487-TP-ALT?

A: Yes.

5. Q: HAVE YOU READ AND ARE YOU FAMILIAR WITH THE NRRI
ADDENDUM TO THE STAFF REPORT OF INVESTIGATION?

A: Yes.

REACTION TO THE STAFF/NRRI REPORTS

6. Q: WHAT IS THE STAFF'S OVERALL, GENERAL CONCLUSION
REGARDING THE ADVANTAGE OHIO PRICE CAP PLAN?

A: The Staff accepts the NRRI conclusion that "a price cap proposal represents, in essence, a viable, appropriate adaptation of regulatory practice for Ohio at this time." The Staff states on p. 32 of its Report that "a price cap plan that includes adequate safeguards for ratepayers and others is a rational, appropriate alternative to rate-base, rate-of-return regulation in Ohio." Ameritech Ohio is pleased that the Staff has accepted the fundamental premise of price cap regulation but does not, however, agree with many of the Staff and NRRI recommendations regarding specific changes to the proposed price cap plan. These changes, if adopted by the Commission, affect the integrity of the price cap proposal to such a degree that the public interest would not be served. These changes should not, therefore, be adopted. The remainder of my testimony addresses these issues.

7. Q: FOR WHAT AREAS OF THE PRICE CAP PLAN DO THE STAFF AND
NRRI RECOMMEND CHANGES?

A: Both the Staff and NRRI make recommended changes to the inflation, service quality, productivity and exogenous components of the price cap adjustment formula. Both also make recommendations regarding the individual pricing limits proposed in the plan as well as the administration of the plan. This testimony responds to those recommendations from the perspective of the overall price cap plan. Specific responses to productivity issues can be found in the supplemental testimony of Dr. Christensen (Ameritech Ohio Exhibit 26S.0). Specific responses to service quality issues can be found in the supplemental testimony of Ms. West (Ameritech Ohio Exhibit 27S.0). Also, Mr. McKenzie responds to issues and recommendations regarding individual service pricing limits in his supplemental testimony (Ameritech Ohio Exhibit 24S.0)

8. Q: DO YOU AGREE WITH THE NRRI RECOMMENDATION ON P. 34 OF ITS REPORT THAT THE PRICE CAP PLAN SHOULD BE REDESIGNED SO THAT THE PRICE CAP IS APPLIED TO SMALLER AND, ALLEGEDLY, MORE HOMOGENOUS SERVICE GROUPS THAN THOSE PROPOSED IN THE PLAN?

A: No. NRRI is concerned that the plan needs to have

adequate safeguards for customers. I agree that the plan needs to have pricing safeguards for customers, especially those customers who purchase services which face a lesser degree of competition. Those are the services classified in Cell 1. The Advantage Ohio plan, however, already provides such safeguards by classifying these services as Cell 1 services and thus putting the most restrictive price limitations on them. The combination of the price cap plan described in my testimony and the price limits for Cell 1 services discussed in Mr. McKenzie's testimony provide adequate protection.

9. Q: DO YOU AGREE WITH THE STAFF'S RECOMMENDATION ON P. 37 OF THE STAFF REPORT THAT THE GROSS DOMESTIC PRODUCT PRICE INDEX (GDPPI) COMPONENT OF THE PRICE CAP FORMULA SHOULD HAVE AN ANNUAL LIMIT OF 7%?

A: No. The Staff agrees with the Advantage Ohio proposal that the GDPPI is the appropriate measure of inflation for use in the price cap plan but recommends that an arbitrary upper limit be placed on the impact of inflation in the price cap adjustment formula. The Staff does not provide any support for this departure from the GDPPI and I know of no rationale. As discussed in my direct testimony on p. 9, the GDPPI was

selected because it is broad-based and relatively stable and, therefore, a good indicator of the externally-imposed inflationary pressures faced by Ameritech Ohio. Consumer related costs such as housing and food are included in the GDPPI but carry less weight than in the Consumer Price Index (CPI), for example. These qualities make it unlikely that the GDPPI will be disproportionately influenced by erratic price behavior in any particular sector of the economy. Movement in the GDPPI, either up or down, is thus the result of more fundamental movement in inflation to which companies like Ameritech Ohio are subject and it should, consequently, be fully reflected in the price cap adjustment formula. The Staff's proposal would skew the GDPPI on a one-sided basis. That kind of approach is neither logical nor fair.

10. Q: ON P. 29 OF THE NRRI REPORT, NRRI RECOMMENDS THAT THE FINAL PLAN SHOULD CONTAIN A SPECIFIC GDPPI REPORTING REQUIREMENT? WHAT IS AMERITECH OHIO'S OPINION REGARDING THIS RECOMMENDATION?

A: The Company agrees that a reporting requirement is appropriate. In fact, such a requirement is part of the filed Advantage Ohio proposal and is discussed in my direct testimony on p. 21 where it is stated that

"the Company will submit to the Commission the updated PCI with documentation supporting its development. This documentation will include the data supporting the GDPPI factor, the development of the service quality adjustment and the development of any exogenous impacts." NRRI's claim that the "Company proposal does not even call for checks in the arithmetic accuracy and reporting of the GDPPI" is, therefore, patently erroneous.

11. Q: DO YOU AGREE WITH THE NRRI CONCLUSION ON P. 103 OF ITS REPORT THAT "AN EXOGENOUS VARIABLE IN THE PRICE CAP EQUATION ACTS SOMEWHAT AS A DISINCENTIVE FOR A UTILITY TO OPERATE EFFICIENTLY BECAUSE IT SHIFTS RISK FROM SHAREHOLDER TO RATEPAYER"?

A: No. There is a basic assumption throughout NRRI's discussion of the exogenous factor that this component can only increase the price cap and protect Ameritech Ohio from increased costs. This assumption is simply not true. Under the proposed price cap plan, exogenous impacts can be either positive or negative - they can raise or lower the price cap. There is no predisposition to either possibility under the structure of the plan. For the period 1984-1993 Ameritech Ohio has identified two historical events as

falling within the criteria of the proposed exogenous parameters. The Uniform System of Accounts Rewrite (USOAR) in 1988 was a positive impact and an excise tax change in 1989 was a negative impact. Many of the exogenous events impacting the FCC price cap plan have been reductions to the federal price cap. Therefore, the proposed exogenous component of the price cap plan does not shift risk from the company to the customer. Rather, it reflects external, significant cost impacts in the price cap adjustment formula.

12. Q: DO YOU AGREE WITH NRRI'S RECOMMENDATION ON P. 109 OF ITS REPORT THAT ADJUSTMENTS FOR EXOGENOUS FACTORS SHOULD HAVE PRECISE GUIDELINES FOR THEIR INCLUSION IN THE PRICE CAP FORMULA?

A: Yes. In fact, the proposed exogenous component of the price cap formula has been narrowly defined in my testimony to include only significant externally imposed tax or accounting changes with just this in mind.

13. Q: ON P. 42 OF THE STAFF REPORT, THE STAFF RECOMMENDS A SET OF CRITERIA FOR THE PURPOSE OF DETERMINING WHETHER AN EVENT SHOULD QUALIFY FOR EXOGENOUS TREATMENT. WHAT IS YOUR OPINION REGARDING THESE RECOMMENDED GUIDELINES?

- A: Although the Staff recommendations are generally consistent with the Company's proposal, there are aspects of the recommendations with which Ameritech Ohio is concerned. The Staff recommends that an exogenous event is materially significant if its impact is at least 0.25 percent of intrastate revenues. This recommended threshold is lower than the 0.50 percent proposed by the Company. Also, the Staff recommends that exogenous events be limited to accounting changes, rules changes, or changes in law made by the state or federal regulatory Commissions or other governmental bodies. This definition is broader than the one proposed by the Company which would limit exogenous events to accounting or tax changes only. The Company is concerned that the Staff's recommendations are too broad and, as such, may add burdensome complexity and administrative requirements to the annual price cap update process.
14. Q: WHAT IS YOUR OPINION OF THE STAFF'S RECOMMENDATION ON P. 43 OF ITS REPORT THAT EXOGENOUS IMPACTS IN THE FORMULA BE LIMITED TO EVENTS WHICH ARE ONGOING FOR THE DURATION OF THE PLAN?
- A: I disagree with this recommended limitation. While most exogenous events will likely be of a long term

nature, there may be occasions when the event is more temporary. Since the reason for this component in the formula is to capture significant cost-impacting events beyond the Company's control, there is no reason to limit the potential events based on duration. A time limitation is purely arbitrary and erroneously assumes that the plan will somehow not work as proposed. The important criteria here are the external nature of the event and its importance as measured by the dollar impact, not the duration of the event. For instance, a tax change worth \$50 million, but in effect for a single year only, is no less significant in impact than one worth \$10 million per year over 5 yrs. In addition, from a practical standpoint, the Staff's recommendation will add administrative complexity to the process by requiring that judgements be made regarding an event's potential duration at a time when such information may be unknown.

15. Q: ON P. 99 OF ITS REPORT, NRRI REQUESTS THAT THE COMPANY DEFINE WHAT IT MEANS BY "APPLICABLE" REVENUES IN THE CONTEXT OF THE EXOGENOUS IMPACT CALCULATION. WHAT IS YOUR RESPONSE TO THIS REQUEST?

A: "Applicable" revenues will usually be total company revenues. This is because most exogenous events will

likely have expense impacts associated with the entire business. There is one exception, however. Where a tax or accounting change applies only to intrastate services, the applicable revenues would obviously be intrastate revenues.

16. Q: WITH RESPECT TO THE CALCULATION OF AN EXOGENOUS IMPACT, NRRI, ON P. 101-102 OF ITS REPORT, RECOMMENDS THAT A FULL YEAR'S WORTH OF DATA BE AVAILABLE BEFORE INCLUDING IT IN THE PRICE CAP ADJUSTMENT. DO YOU AGREE?

A: No. Given the timing of annual price cap updates, such a requirement could mean that an exogenous event could be in effect as long as two years before it is included in the price cap adjustment. It is not in the public interest to allow such extensive time to pass without reflecting its impact. As previously stated, NRRI loses sight of the fact that the exogenous impacts, as proposed by Ameritech Ohio, may increase or reduce the price cap adjustment formula.

Exogenous events which meet the Ameritech Ohio proposed criteria will be significant in impact and rare in occurrence. A full year of actual experience with such events will not be necessary to calculate their impact. Calculations can be based on a partial year of

information. If a revision needs to be made after more experience is gained with respect to the event, then it can be reflected in the next price cap update.

Indeed, to require a full year to pass essentially destroys the workability of the exogenous impact adjustment.

17. Q: WHAT IS YOUR OPINION REGARDING THE NRRI SUGGESTION ON P. 103 OF THEIR REPORT THAT A SERVICE-SPECIFIC TEST TO DETERMINE EXOGENOUS IMPACTS MAY BE APPROPRIATE?

A: A service-specific criteria test is not reasonable and simply not practical. Exogenous events very much tend to be total company impacting. Any attempt to allocate these impacts to specific services would be completely arbitrary and would increase the cost of administration with no corresponding public interest benefit.

18. Q: DO YOU AGREE WITH THE CONCLUSIONS REACHED BY NRRI REGARDING OHIO-SPECIFIC TAX CHANGES AS DISCUSSED BY NRRI IN ITS REPORT ON P. 115?

A: No. In a hypothetical situation regarding tax increases, NRRI assumes that the Ohio General Assembly passes a telecommunications tax increase that no other state does. NRRI concludes that this is captured in the GDPPI and that no exogenous treatment is needed in

the price cap formula for this event. NRRI's logic is faulty. While it is agreed that the Ohio tax increase would impact the GDPPI in some fashion, that impact would reflect the state of Ohio in proportion to the entire nation. A 5% tax increase in Ohio will not be reflected in the GDPPI at a 5% level. The impact will be much less, perhaps 1/50th of 5%. Therefore, if an exogenous adjustment for such an event is excluded, the true impact of the tax increase on the costs of Ameritech Ohio will be substantially underestimated in the formula. This would be true for both tax increases or decreases.

19. Q: NRRI ALSO RECOMMENDS A 90-DAY COMMISSION REVIEW OF PROPOSED EXOGENOUS IMPACTS. DO YOU AGREE WITH THE NRRI'S CONCLUSIONS IN THIS REGARD AS CONTAINED AT PAGE 99 OF THE NRRI REPORT?

A: No. A 90-day review for exogenous impacts is unnecessary. Based on the criteria for these events described in my direct testimony, they will be significant events which occur infrequently. In fact, as previously discussed, only two events in the last ten years would have qualified for exogenous treatment under the price cap plan. Due to this infrequency and the significance of the events, the Staff will be aware

of their occurrence, their approximate magnitude and likelihood of being part of the adjustment process prior to the Commission review.

20. Q: DO YOU AGREE WITH THE STAFF'S RECOMMENDATION ON P. 47 OF THE STAFF REPORT THAT "BANKING" OF UNUSED INCREASES OR DECREASES SHOULD NOT BE PERMITTED IN THE PRICE CAP PLAN?

A: I disagree with the Staff's recommendation on this matter. The Staff's concern is that banking capability "could subject the Applicant's customers to substantial abrupt rate increases". A closer look at the Company's proposal reveals that this concern about the plan is unfounded.

While the proposed plan would permit unused upward price flexibility to be used at a future time, this flexibility applies to the overall customer service group only and not to the individual service price limits of the plan. In particular, this means that the upper limit for Cell 1 service price increases, 5% plus the adjustment to the price cap in that year, is completely independent of the amount of unused upward price flexibility retained from previous years. The Cell 1 upper limit is unaffected by banking. The

proposed upper limits on Cell 2 prices are likewise unaffected by the existence of banking in the proposal.

An example is helpful in demonstrating how this is proposed to work. Assume that the overall price cap adjustment for the residence customer service group in year A is 2.0% and in year B is 1.0%. Consistent with the Advantage Ohio proposal, the limit on individual Cell 1 price increases would then be 7.0% in year A and 6.0% in year B. Suppose that in year A, the Company elects to increase Cell 1 prices less than the 7.0% limit or perhaps even decrease them. Does the fact that the Company did not increase Cell 1 prices to their limit in year A increase the year B limit of 6.0%? No. The limit for Cell 1 price increases in year B is still 6.0%. In a broader example, suppose that in year A the Company increases overall residence price levels by something less than the overall price cap limit of 2.0%. Does this increase the Cell 1 price limit in year B? No. The Cell 1 pricing limit in year B is still 6.0%. The price limits for individual Cell 1 services are unaffected by the existence of the proposed banking capability. While banking affects the ability of the company to change prices within the limits, it does not impact the limits themselves. In

short, the public is clearly protected.

NRRI makes several unfounded statements regarding banking on p. 41-42 of its Report. NRRI argues that banking encourages anti-competitive behavior by allowing the company to temporarily underprice services, drive out its foes, and then raise prices substantially based on the banked ability to do so. This argument ignores the fact, discussed previously, that the upper and lower price limits for individual services under the proposal are unaffected by the existence of banking capability. The Company will not be able to "underprice" its services. The plan requires that price reductions conform to the lower boundaries discussed in Mr. McKenzie's direct testimony. Banking does not change individual service upper price limits.

NRRI also argues that price cap plans in general around the country do not have carry-forward provisions and cites the FCC AT&T and LEC price cap plans among them. NRRI is wrong to include them in this group. The FCC interstate price cap plans for AT&T and the LECs does have a banking provision which is similar to the one proposed as part of the Advantage Ohio price cap plan.

NRRI is also concerned that banking will somehow diminish the company's incentive to become more efficient. This is simply not true. The basic premise of price regulation - that the company has the incentive to become more efficient because it can be rewarded for those efforts - is totally unaffected by the existence or non-existence of banking in the price cap formula.

21. Q: DO YOU AGREE WITH THE STAFF'S RECOMMENDATION ON P. 50-51 OF ITS REPORT REGARDING THE PROCESS FOR ANNUAL COMMISSION REVIEW OF THE PRICE CAP (PCI) ADJUSTMENT?

A: No. The Staff's recommended 90-day Commission review period for the annual PCI adjustment is cumbersome and unwarranted. The PCI adjustment is simple and straightforward as proposed. Furthermore, the Commission will have continuous oversight of Ameritech Ohio's prices. In the event the Commission has the desire to investigate some aspect of the Company's pricing practices, including the calculation and implementation of the PCI, it can do so at any time after implementation.

The Staff's recommendation for a 90-day review period also includes an opportunity for interested parties to file objections as part of the annual review process. This suggestions carries with it a real concern that the efficiencies sought in the regulatory process as part of this plan could be severely compromised. The basis of the price cap plan is to establish, in the current public proceeding, a straightforward, predictable, mechanism for setting price limits. Establishment of a formal intervention as part of the annual review will only encourage parties to slow down and complicate the process by rehashing issues, by then decided by the Commission, regarding the price cap approach. Customers will continue to have the complaint process at their disposal under Advantage Ohio. There is no need to add a formal intervention process to the annual review.

22. Q: WHAT IS YOUR OPINION WITH RESPECT TO THE STAFF'S RECOMMENDATIONS ON P. 50-51 OF THE STAFF REPORT REGARDING THE GROUP PRICE INDEX (GPI) REVIEW PROCESS?

A: The Staff recommends an extension from the proposed 30-day review to a 60-day review period for the updated quantities used for the GPI calculation. This extension is not necessary. The update to the

quantities is simply an extraction of actual billed service quantities for a representative historical period. With the exception of adding new services and possible service restructure, the quantities will be associated with the same service, measured in the same way, from one year to the next. Also, while the update to the quantities is an annual event, the Staff will become familiar with the quantities during the year as GPI updates are submitted to the Staff in conjunction with proposed price increases.

The Staff also suggests on p. 51 of the Report that quantities should be updated to reflect calendar year 1993 for application in the first year of Advantage Ohio. I agree that the quantities to be used for the first year of the plan should be actual quantities which are representative of 1993. I made a similar proposal on p. 29 of my direct testimony.

23. Q: DO YOU AGREE WITH THE NRRI RECOMMENDATION ON P. 28 OF THEIR REPORT THAT AMERITECH OHIO SHOULD BE REQUIRED TO FORECAST INDIVIDUAL SERVICE DEMAND AND SUBMIT THEM TO THE COMMISSION?

A: No. The Staff, on p. 52 of its Report, disagrees with NRRI's recommendation, as well. It is my opinion that

application of historical quantities in the calculation of the GPI is the appropriate methodology. The quantities, along with respective service prices, are to be used as weights in the GPI calculation as described in my direct testimony on p. 15. These weights should represent what customers in the customer service group are actually purchasing rather than some projection of what they will purchase. Forecasting will add unnecessary complexity and uncertainty to the proposed process.

24. Q: AS REQUESTED BY NRRI ON P. 31 OF THEIR REPORT, PLEASE CLARIFY AMERITECH OHIO'S POLICY REGARDING THE TIMING OF PRICE DECREASES FOR CELL 1 SERVICES.

A: As described in my direct testimony on p. 30, price decreases for Cell 1 services may be made at any time. This is in contrast to the proposed restriction that price increases for Cell 1 services may be made only once per year. The proposal is that there be no explicit limit placed on the number of price decreases for any Cell 1 service in a year. Of course, price decreases will conform to the lower price limits described in Mr. McKenzie's direct testimony, and there will also be practical limits on the ability to decrease prices. The marketplace will dictate the need

to reduce prices. Also, there will be administrative constraints with respect to notice periods for Cell 1 price changes and the requirements for updated tariff submission to the Staff which are described in Mr. McKenzie's direct testimony.

25. Q: ON P. 31 OF ITS REPORT, NRRI REQUESTS THAT AMERITECH OHIO PROVIDE INFORMATION REGARDING ITS USE OF QUANTITY UNITS WHICH ARE DIFFERENT THAN TARIFF SERVICE UNITS. WHAT IS YOUR RESPONSE TO THIS REQUEST?

A: Ameritech Ohio's proposal is to use quantities for the weights in the GPI calculation which exactly match the unit structure upon which we price and bill those services. Where a flat monthly rate is charged for a service, the applicable units will be the flat monthly unit upon which the price is charged. These are the same types of units that are found in Mr. McKenzie's Ex. 3.0/4.0. NRRI's recommendation that competitors and others should have the opportunity and need to comment on this unit structure is unfounded. The units must be consistent with the way the service is actually priced. That is our proposal.

26. Q: NRRI STATES ON P. 48 OF ITS REPORT THAT THE COMMISSION SHOULD ASSUME THAT AMERITECH OHIO WILL PRICE ITS SERVICES AT THE PRICE CEILINGS. DO YOU AGREE WITH NRRI?

A: No. While the Commission should evaluate the plan with respect to the price limits of the plan it should not assume that the Company will always price at the upper limits of the plan. The market will dictate price levels which may or may not reside at the price cap. Also, there are practical limits to the ability of the Company to make full use of the upper price limits of the plan for a succession of years. This particularly applies to the Cell 1 upper price limit of 5% plus the price cap adjustment. Given the relative weight of Cell 1 services in both the residence and non-residence customer service groups, upper limit increases to Cell 1 services require substantial annual reductions to the remaining Cell 2-4 services. After a period of about five years beyond the committed price freeze period, cumulative required price reductions for the services in these Cells would need to reach an estimated 50% in order for the maximum residence Cell 1 price increases to take place over this period. The Staff recognized this characteristic of the price cap plan in their Table A example on p. 49 of the Staff Report. While

the Staff presents a modified version of the Advantage Ohio price cap proposal, the comparison of the price limits with and without an overall price cap in the examples illustrates the practical upper limits over time for Cell 1 prices.

27. Q: ON P. 144 OF THEIR REPORT NRRI STATES THAT THE ADVANTAGE OHIO COMMITMENT TO FREEZE RESIDENTIAL PRICES IS "VAGUE" AND THAT AMERITECH OHIO SHOULD CLARIFY ITS INTENTIONS. WHAT IS YOUR RESPONSE?

A: The proposed commitment regarding pricing in the first three years of the Advantage Ohio plan is not vague and does not leave room for the Company to increase prices where it states that it won't, as NRRI implies. The commitment is stated simply and in a straightforward fashion in the direct testimonies of Brown, McKenzie and myself. My testimony further describes in detail the mechanics of the price commitments with regard to their treatment within the price cap framework.

INFORMATION REQUESTED IN THE STAFF REPORT

28. Q: WHAT INFORMATION DOES THE STAFF RECOMMEND THE COMPANY PROVIDE?

A: On p. 37 of its Report of Investigation, the Staff

recommends that "prior to the Commission approving the Applicant's Plan, OBT file supplemental testimony to demonstrate how basic rates would have been affected had its price cap framework been in effect over the past ten years, and to compare such rate effects with rate changes under rate base, rate-of-return regulation."

29. Q: ARE YOU ABLE TO DEMONSTRATE HOW BASIC RATES WOULD HAVE BEEN AFFECTED UNDER THE PRICE CAP FRAMEWORK?

A: My response to the Staff's request is limited to providing a historical simulation of the limits of the price cap framework and a comparison of those limits to actual basic service price levels over the historical period. As I described in my direct testimony and Mr. McKenzie described in his, the price regulation proposed in the Advantage Ohio plan places limits on individual service prices and overall limits on customer service group prices as well. The plan is not designed to automatically adjust prices and does not attempt to project future price levels. Price changes will be made within the price limits of the plan based on the pricing principles described by Mr. McKenzie in his testimony.

30. Q: PLEASE DESCRIBE HOW THE HISTORICAL ANALYSIS OF THE
PRICE CAP FRAMEWORK WAS CONDUCTED.

A: A historical simulation of the price cap framework was completed and provided in response to NRRI Data Request Number Six-Eight, which was submitted by Ameritech Ohio to NRRI in September 1993, and which is included as part of Appendix B in the NRRI Addendum to the Staff Report of Investigation. This analysis assumes that the price cap framework became effective at the beginning of 1984. The first price cap adjustment would have occurred in 1985 with annual adjustments through the simulation period ending in 1993. The annual formula adjustments were simulated by calculating the annual historical adjustment to each of the individual formula components, which I describe in my direct testimony, where the data exists to do it.

31. Q: WERE YOU ABLE TO SIMULATE HISTORICAL ADJUSTMENTS TO
EACH OF THE PRICE CAP FORMULA COMPONENTS?

A: No. Due to historical data limitations, adjustments to the service quality component of the formula were not included in the analysis. Adjustments were made to the other formula components and included in the study. As detailed in the response to NRRI Data Request Number Six-Eight and included in the NRRI Addendum Appendix B,

historical values for the inflation component were obtained from GDPPI values for this period as published by the U.S. Department of Commerce, Bureau of Labor Statistics. The productivity offset was set at the proposed level of 1.9%, which we continue to believe is the appropriate number to use for purposes of this proceeding. Historical exogenous impacts, developed in response to the Data Request, were used in this analysis.

32. Q: WHAT ARE THE RESULTS OF THIS PART OF THE ANALYSIS?

A: The results of this analysis, shown on Attachment 25S.1, estimate that the Price Cap Index (PCI) would have had an average annual adjustment of about +1.7% per year over the period 1984 through 1993.

33. Q: DO THESE RESULTS TAKE INTO ACCOUNT THE ADVANTAGE OHIO PRICE COMMITMENTS FOR THE FIRST THREE YEARS OF THE PLAN?

A: No. An adjustment must be made to the PCI estimates to develop the "effective" price cap changes which reflect these commitments. As described in my direct testimony, no prices can increase in the first year of the plan and no basic local exchange access and local usage service prices may increase for the first three

years of the plan. These services are excluded from the price cap plan until the end of this commitment period. In order to include the impact of this price commitment on the estimated price flexibility for the entire residence customer service group, an adjustment is made to account for the fact that a substantial portion of the services have no upward price flexibility over the commitment period. This adjusted result is included on Attachment 25S.1 as the "Composite Percent Change Limits". The "effective" price cap changes shown for the first three years more accurately reflect the actual upward flexibility which would have existed for the entire residence customer service group.

34. Q: WAS A SEPARATE ANALYSIS PERFORMED FOR THE HISTORICAL SIMULATION OF RESIDENCE SINGLE LINE FLAT RATE (1FR) USAGE SERVICE PRICE LIMITS?

A: Yes. The simulated upper limit for the residence 1FR usage price was calculated based on historical changes in the price ceiling adjustment formula for this service that is described in Mr. McKenzie's direct testimony. The simulation also reflects the commitment that this price will not be increased in the first three years of Advantage Ohio. The results of this

simulation reflect an average historical change in the price ceiling of about 2.11% per year and are included in the results shown on Attachment 25S.2.

35. Q: DOES YOUR ANALYSIS PROVIDE HISTORICAL SIMULATIONS OF THE PRICE LIMITS FOR BASIC SERVICES?

A: Yes.

36. Q: IS IT REASONABLE TO ASSUME THAT THE UPPER LIMIT FOR BASIC SERVICE PRICES WOULD HAVE INCREASED 5% PLUS THE PRICE CAP ADJUSTMENT FOR EACH YEAR OVER THIS PERIOD?

A: No. Basic exchange access and local usage services are classified as Cell 1 services in the plan. Although the proposed annual upper limit for individual Cell 1 service prices is 5% plus the adjustment to the price cap in each of those years, it cannot be assumed that this level would have actually been sustainable over that period. The price cap plan requires that the weighted average of all prices within the customer service group remain within the price cap at all times. As a result, if a group of prices are increased by a greater percentage than the PCI increases, another service or group of service prices must increase less than the PCI change or perhaps even be decreased to stay within the constraint. For the residence customer

service group, given the proportional weight of Cell 1 services in the service group, annual basic local exchange price increases at the Cell 1 upper limit would have required cumulative price decreases of 69% across the entire group of Cell 2-4 services over this period of time. For the non-residence customer service group, cumulative decreases of 96% would have been required. It is not reasonable to assume that this would or even could have happened given the limitations of the price floors which the plan proposes.

37. Q: WHAT IS AN APPROPRIATE ASSUMPTION, THEN, REGARDING THE SIMULATED HISTORICAL UPPER PRICE LIMITS FOR BASIC SERVICES?

A: A specific assumption in this regard is speculative. Several reasonable possibilities can be examined, however. If the practical upper limit for these prices had increased at the same percentage as the effective PCI discussed previously, the average simulated annual change is estimated at 1.7% for residence basic services and 1.4% for non-residence. If the practical upper limit for these prices had increased at the same rate as the effective PCI with an additional 2.5% per year increase (or one-half of the full 5% flexibility), then the average increase in the upper limit for basic

service prices would have been about 2.8% per year for the residence customer group and about 3.2% for non-residence. Use of this upward price flexibility would have required the equivalent of a 22% cumulative price decrease across the board for all services in Cells 2-4 in the residence customer service group. For the non-residence customer service group the required cumulative decrease in Cell 2-4 would have been about 41%. These separate assumptions can provide a practical range for the simulated historical results.

38. Q: WHAT ARE THE BASIC PRICE UPPER LIMITS THAT THESE ASSUMPTIONS WOULD YIELD?

A: Basic exchange access and local usage service price levels which were in effect at the end of 1983 are the upper price limit for those services through 1986 in the analysis. This is consistent with the Advantage Ohio pricing commitments. For a residence access line with Touchtone, including the 1FR usage package, the price in 1983 was \$14.45. The upper price limit for this service, assuming the average 1.7% average annual increase in that limit, would have increased to \$16.99 in 1993 with an average price of \$15.15 over the period. This upper price limit is lower than the \$17.05 actual price which is charged for the service

today and below the actual average price charged over this period of \$16.98. Under the assumption of an average upper price limit increase of 2.8% per year, the upper limit would have been \$18.48 in 1993 with an average of \$15.72 over the period. These results are summarized on Attachment 25S.2.

I have also performed an analysis of the upper limit for non-residence basic exchange access and local usage services. For a single business access line with Touchtone, including 90 local messages per month, the price in 1983 was \$25.60. The upper price limit for this service, assuming the average 1.4% average annual increase in that limit, would have increased to \$29.09 in 1993 with an average price of \$26.91 over the period. This upper price limit is lower than the \$30.76 actual price which is charged for the service today and below the actual average price charged over this period of \$30.47. Under the assumption of an average upper price limit increase of 3.2% per year, the upper limit would have been \$34.48 in 1993 with an average of \$28.94 over the period. These results are summarized on Attachment 25S.2.

39. Q: ARE THERE ANY OTHER CONCLUSIONS REACHED AS A RESULT OF
YOUR HISTORICAL ANALYSIS?

A: Yes. An exercise such as this in "backcasting" price
cap impacts has very suspect value in the evaluation of
the future implementation of the Advantage Ohio plan.
The results of a historical comparison of the price cap
framework to actual price levels are sensitive to the
historical time period which is selected. This is due
to the timing of past price changes.

40. Q: DOES THIS CONCLUDE YOUR TESTIMONY?

A: Yes, it does.

The Ohio Bell Telephone Company Data Request Number Six-Eight

1) PCI Calculation without a Service Quality Adjustment, with Exogenous Impacts

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
GDPI (base 1987 = 100)	88.1	91.1	94.3	97.0	100.0	103.9	108.6	113.5	118.1	121.6	

PCI ADJUSTMENT FORMULA:

GDPI PERCENT CHANGE	3.41%	3.51%	2.86%	3.09%	3.90%	4.52%	4.51%	4.05%	2.96%		
PLUS PRODUCTIVITY OFFSET	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%	-1.90%
PLUS SERVICE QUALITY ADJ.	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
PLUS EXOGENOUS IMPACTS	0%	0%	0%	0%	0%	2.18%	-0.45%	-0.15%	0%	0%	0%
PCI PERCENT ADJUSTMENT	1.51%	1.61%	0.96%	3.37%	1.55%	2.47%	2.61%	2.15%	1.06%		

PCI WITHOUT SERVICE QUALITY ADJ.

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
	100.00	101.51	103.14	104.14	107.65	109.32	112.02	114.95	117.42	118.67	

PERCENT CHANGE LIMITS:

- PCI	0.00%	1.51%	1.61%	0.96%	3.37%	1.55%	2.47%	2.61%	2.15%	1.06%	
- CAPPED SERVICES (1984-86)	0.00%	0.00%	0.00%	0.00%	0.96%	3.37%	1.55%	2.47%	2.61%	2.15%	1.06%
COMPOSITE PERCENT CHANGE LIMITS (Note 1)	0.00%	0.60%	0.65%	0.96%	3.37%	1.55%	2.47%	2.61%	2.15%	1.06%	

Note 1 - Composite Percent Change Limit is a weighted average of PCI and Capped Service Change Limits reflecting the Advantage Ohio commitment that there will be no rate increases for any service in the residence or non-residence Customer Service Groups in the first twelve months of the plan and for an additional twenty-four months there will be no increases in the rates for residence and non-residence Customer Service Group exchange access and local usage. Over 60 % of Ohio Bell's revenues are from services which are capped in the first three years. Therefore, the weight for capped services in the Composite PCI Percent Change is 60.0 %

ROMO SUPPLEMENTAL TESTIMONY
ATTACHMENT 25S.2

	1983	1993	Average Price	Annual Average Percent Change
Residence Access Line with Touchtone and 1FR Usage				
Actual Price Levels	\$14.45	\$17.05	\$16.98	
Simulated Price Cap Upper Limits				
@PCI	\$14.45	\$16.99	\$15.15	1.7%
@PCI+2.5%	\$14.45	\$18.48	\$15.72	2.8%
Non-Residence Single business access line with 90 local calls				
Actual Price Levels	\$25.60	\$30.76	\$30.47	
Simulated Price Cap Upper Limits				
@PCI	\$25.60	\$29.09	\$26.91	1.4%
@PCI+2.5%	\$25.60	\$34.48	\$28.94	3.2%