BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

RECEIVED
JUL 13 1994
DOCKETING DIVISION
PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of the **Ohio Bell Telephone Company** for Approval of an Alternative Form of Regulation.	:	Case No. 93-487-TP-ALT
In the Matter of the Complaint of the Office of the Consumers' Counsel,	:	
Complainant,	:	Case No. 93-576-TP-CSS
vs.	:	
The Ohio Bell Telephone Company,	:	
Respondent.	:	

Prepared Testimony
of
Joseph P. Buckley
Performance Analysis Division

Staff Exhibit 12

1. Q. Please state, for the record, your name, position, and business address.

A. My name is Joseph P. Buckley. I am employed as a Utility Rate Coordinator in the Performance Analysis Division of the Public Utilities Commission of Ohio (PUCO), 180 East Broad Street, Columbus, Ohio, 43215-3793.

2. Q. Please state, your educational and professional backgrounds.

A. I received a Bachelor of Science Degree in Economics from The Ohio State University in December 1986, and a Master's Degree in Business Administration from the University of Dayton in 1992. Also I attended, The Annual Regulatory Studies Program sponsored by The National Association of Regulatory Utility Commissioners (NARUC) held at Michigan State University and The Training for Utility Management Analysts also sponsored by NARUC. I have been employed by the PUCO since July 1987. While at the PUCO I have served as a Utility Rate Analyst, in the Finance and Economics section of Performance Analysis, and as a Utility Rate Coordinator in the Management and Operations Review (M&OR) section of Performance Analysis.

3. Q. What is your involvement in this proceeding?

A. I evaluated the directory agreement between Ameritech Ohio (OBT) and Ameritech Publishing Inc. (API). I will respond to Ameritech of Ohio (OBT)- B. OPERATING INCOME Objection 5 to the Staff Report of Investigation which addresses this topic.

4. Q. OBT B-5 stated that the Applicant objects to the Staff's inclusion of any API directory contribution in base period operating income. (Staff Report at 15). The Applicant stated that inclusion of any API contribution is inappropriate for ratemaking purposes.

OBT D-5b states that the Applicant objects to the inclusion of API directory contribution in the Applicant's income and equity balance.

How does the Staff respond to these objections?

A. In OBT's last rate case, Case No. 84-1435-TP-AIR and in GTE North Case No. 87-1307-TP-AIR, all Yellow Page revenues and expenses were included in the determination of test year operating income for the purpose of calculating the Applicant's revenue deficiency. The net Yellow Page revenues contributed to the jurisdictional revenue requirement and reduced the rates for other services below what they would have been absent the contribution from Yellow Pages.

5. Q. Does the Staff believe that Yellow Page revenues and expenses should be treated the same in this proceeding as they were in 84-1435-TP-AIR and 87-1307-TP-AIR? -

A. Yes, based on the historical treatment by the PUCO. Further the Staff is persuaded by the logic of the Modified Final Judgment, U.S. v AT&T (1982), 552 F. Supp. 131, 194, which states:

"In addition to these factors directly related to competition, there are other reasons why prohibition on publication of the Yellow Pages by the Operating Companies is not in the public interest. All those who have commented on or have studied the issue agree that the Yellow Pages provide a significant subsidy to local telephone rates. This subsidy would most likely continue if the Operating Companies were permitted to continue to publish the Yellow Pages.

The loss of this large subsidy would have important consequences for the rates for local telephone service. For example, the State of California claims that a two dollar increase would be necessary to offset the loss of revenues form directory advertising. Other states assert that increases of a similar magnitude would be required. Evidence submitted during the AT&T trial indicate that large rate increases of this type will reduce the number of households with telephone and increase the disparity, in terms of the availability of telephone service, between low income and well-off citizens. This result is clearly contrary to the goal of providing affordable telephone service for all Americans....."

"For these various interrelated reasons, the Court concludes that the prohibition, express or implied, on publication by the Operating Companies of the Yellow Pages directories is not in the public interest. It will therefore require that the proposed judgment be modified to specify that there will be no such prohibition."

Based on the above ruling the Staff believes that it would be inconsistent to treat the Yellow Page revenues and expenses in this proceeding differently than they were treated in 84-1435-TP-AIR or 87-1307-TP-AIR.

6. Q. What is the relationship between OBT and API?

A. API and OBT are both subsidiaries of Ameritech Corporation. In December 1983, OBT and API entered into an agreement in which API would pay OBT a fixed amount for the right to publish and sell advertising in the Yellow Page directories. The current agreement between OBT and API was signed in January 1991.

7. Q. When did the Staff begin its investigation of the directory agreement between OBT and API?

A. On November 13, 1991, the National Association of Regulatory Utility Commissioners passed a resolution recommending that states and the Federal Communications Commission (FCC), create joint audit teams to conduct audits of the Regional Bell Operating Companies (RBOCs). The audits were to address concerns over the relationships between the RBOCs and their affiliates.

In response to this recommendation, PUCO joined the FCC and Wisconsin Public Service Commission in an investigation of Ameritech Services Incorporated (ASI). It was determined at the time, that an investigation of API would be more appropriately conducted at the individual state level because of the individual contracts that API has with each of the five Ameritech RBOCs.

On October 28, 1992, the Staff of the PUCO issued an initial data request to OBT concerning API. The initial request asked the Applicant to provide preliminary data concerning the services provided by API to OBT and concerning basic financial information. Because of Staff work load restrictions, the API investigation was incorporated into the current alternative regulation investigation.

8. Q. What was the initial focus of the Staff's investigation of OBT's agreement with API?

A. The Staff wanted to review the financial analysis that supported the level of directory revenues received by OBT, and review the process that the Applicant went through when determining the reasonableness of the agreement.

9. Q. Did the Applicant provide the analysis or explain its process?

A. The Applicant and representatives of API stated during an interview on December 7, 1993,[1] that there was no financial analysis that supported the reasonableness of the compensation and that no one currently at the company could explain what process the Applicant went through to determine the reasonableness of the contract.

---

1 Attended by Joe Buckley and Ed Hess of the PUCO, Mike Shaedler and Audry Krekel of OBT and Andy Dutton, Mike Barry and Bill Champion of API.

In addition, the Applicant did not respond to Staff Data Request 20.6, which asked the Applicant to provide, "A detailed breakdown on how the $35.73 payment from API to Ohio Bell, per residential access line served, was calculated."

10\. Q. Did OBT provide any analysis of alternatives to having API supply its directories?

A. No, when the Staff asked for the studies that were conducted during the last OBT-API contract negotiation to assure OBT that the contract was fair and reasonable, OBT responded "That no specific studies were conducted."[2]

11\. Q. Was OBT aware that the reasonableness of the contract would be an issue the next time that its rates were assessed?

A. Yes. The Opinion and Order to Case Number 84-1435-TP-AIR (Ohio Bell Telephone), stated that "The Commission will, of course, continue to review the level of directory advertising revenues to determine their reasonableness, and will require Ohio Bell, as a part of its next rate case, to provide an analysis of alternatives to having API supply its directories." OBT should have documented its negotiation process supported with its financial analysis.

12\. Q. Was the Staff satisfied with OBT's responses to the October 28, 1992, Staff data request?

---

[2] Staff Data Request 40.2.

A. No, for example when the Staff requested:

> API-7 The rate of return earned on the sales to Ohio Bell Telephone Company for 1987, 1988, 1989, 1990, 1991, and the first 9 months of 1992.
>
> API-12 The total revenue received in 1987, 1988, 1989, 1990, 1991, and the first 9 months of 1992 from any source related to the provision of any service based in whole or in part on the relationship with Ohio Bell including revenues derived from the provision of directories containing any information provided by Ohio Bell.[3]
>
> API-13 The costs incurred by API in generating the revenues identified in response to Data Request API-12.
>
> API-14 The capital investments of API attributable to the revenues identified in response to Data Request API-12.
>
> API-15 The net earnings retained by API from the revenues identified in response to Data Request API-12.

The Company responded by saying, "Data does not exist in the requested form. Significant manual effort would be required to create it, and would

---

[3] This information was utilized by Applicant's witness Andrew W. Dutton (Ameritech Ohio Exhibit 33.0) on page 11 where Dutton stated "Yes, both API's Ohio revenue and API's total revenue followed these growth trends. Ohio's average annual published revenue growth, between 1985 and 1990, was 11%. Real growth in Ohio, or revenue adjusted for price increases, averaged 3.4% during this same time period...." This appears to contradict the response provided by OBT to the Staff.

be of questionable value since it would need to be developed on an allocation basis."

13. Q. What compensation does OBT receive from API?

A. The current contract between OBT and API for directory services states that the annual compensation OBT will receive from API will at least be equal to $35.73 per the lower of the average number of residential access lines served by OBT or per the average number of households in OBT's service area. The current agreement shall continue until December 31, 1995, and shall be extended from year to year thereafter unless either party notifies the other in writing that it does not wish to extend the agreement 12 months in advance of the termination date. For the test year in this case, the publishing fee paid by API to OBT was $85,598,000.

14. Q. How was the rate of $35.73, reached?

A. I do not know. The Applicant did not respond to Staff's Data Request 20.6, which requested, "A detailed breakdown of how the $35.73 payment from API to Ohio Bell, per residential access line served, was calculated."

15. Q. Does the Staff believe that the negotiated rate of $35.73 is adequate compensation?

A. Given that the Applicant could not support the rate, the Staff was left in a position to assess its reasonableness on its own. As a test for reasonableness, the Staff determined whether the customers of OBT were better off with or without the agreement. This test is similar to other tests that are applied to several other utilities regulated by this Commission, for less than arms length transactions.

16. Q. Will you explain how the Staff attempted to make this determination?

A. On less than arms length contracts, the most precise test is to run the revenue requirement calculation (Schedules A-1 through C-4.1) with and without the effects of the contract. The run with the lower revenue requirement is considered the least costly scenario. Other considerations such as reliability and quality are weighted to determine if there are offsetting advantages for a higher revenue requirement run. In this case, the Staff would have run a calculation with API payments to OBT and compared it to a run without the payment, but with Ohio specific directory advertising revenues, expenses, and investment.

The run with the contract which includes the API test year payment to OBT, was easily attained. Producing a run without the contract proved to be an impossible task. The Applicant was not able to provide Ohio specific directory advertising expenses and investment. API stated that it did not keep its financial information in this format. They further explained that it would be too burdensome to keep financial information on a state specific basis and that over the ten years of providing this service, they had not developed a system to provide for this format.

As a result, the Staff developed an alternative method of determining the reasonableness of the compensation OBT receives from API.

17. Q. What method did the Staff use to determine whether the OBT customer was better off with the current agreement with OBT and API?

A. The Staff used a trend analysis. The Staff wanted to determine if the amount that was being credited to OBT customers (API payments to OBT) had kept pace with the increases or decreases in Ohio contributed revenue to API.

Financial statements and return on equity calculations provided by OBT showed that API's earnings have been increasing, the revenues collected by OBT for API have increased, and the contribution from API to OBT has increased. However, the increase of the API payments to OBT has not increased at the same pace as the increases to API income and revenues. The Staff discovered that revenues collected for directory services by OBT for API had increased by 60% since 1985, while API's payment to OBT had increased only 24% since 1985, as shown in Exhibit JPB-I.

These trends are detailed on a graph attached to this testimony and marked as Exhibit JPB-II.

Therefore, the Staff's analysis makes the Applicant's directory advertising reasonableness of the contract questionable. The Staff is of the opinion that the increase in revenues collected by OBT for API should be passed back to the ratepayers.

18. Q. The Applicant has stated that the Yellow Page industry is highly competitive. Did the Staff consider this in its analysis?

A. The record indicated in Case No. 84-1435-TP-AIR, that OBT believed that it was subject to substantial competition in the directory advertising area. However, the Staff believes that API's earnings have not suffered adverse effects from this competition. This is illustrated by the Return on Average Equity (ROE), earned by API from its combined operations (When asked, OBT responded that they could not provide jurisdictional ROE), as shown in Exhibit JPB-III.

19. Q. How did the Staff calculate its adjustment?

A. The Staff's adjustment parallels its analysis. The Staff calculated the increase in directory advertising revenues collected by OBT for API and calculated the payment made to OBT from API. The Staff then calculated its access line increase based on the difference between the increase in collection by OBT and the increase in payment to OBT as summarized in Exhibit JPB-IV.

20. Q. What criteria did the Staff use when calculating the adjusted directory access line rate?

A. The Staff believes API should compensate OBT and consequently the ratepayer an amount equal to, at least, as much as OBT would have earned if it would have retained the directory operations.

21. Q. Does this conclude your testimony?

A. Yes, it does.

Percentage Increase In Revenues
Collected By OBT For API And Percentage
Increase Payment To OBT From API

Revenue Collected

($11,674,010+$8,592,886) ÷ 2 = $10,133,448*	- 1985 Revenues Collected
($16,119,467+$16,319,119) ÷ 2 = $16,219,293*	- 1993 Revenues Collected
$16,219,293-$10,133,448 = $6,085,845	- 1993 less 1985, Revenues Collected
$6,085,845/$10,133,448 = 60%	- Percentage Increase

Payment to OBT

($5,806,750 + $5,806,750) ÷ 2 = $5,806,750*	- 1985 Payment to OBT
($7,204,938 + $7,215,754) ÷ 2 = $7,210,346*	- 1993 Payment to OBT
$7,210,346 - $5,806,750 = $1,403,596	- 1993 less 1985, Payment to OBT
$1,403,596 ÷ $5,806,750 = 24%	- Percentage Increase

*In calculating the percentage increases, the Staff averaged the first 2 months of 1985 in an attempt to smooth out the large fluctuation that took place during the first 2 months of 1985. For consistency, the Staff continued using the 2 months averaging technique when calculating the percentages.

THE OHIO BELL TELEPHONE COMPANY
CASE NOS. 93-576-TP-CSS, & 93-487-TP-ALT

EXHIBIT JPB-II

DIRECTORY REVENUES

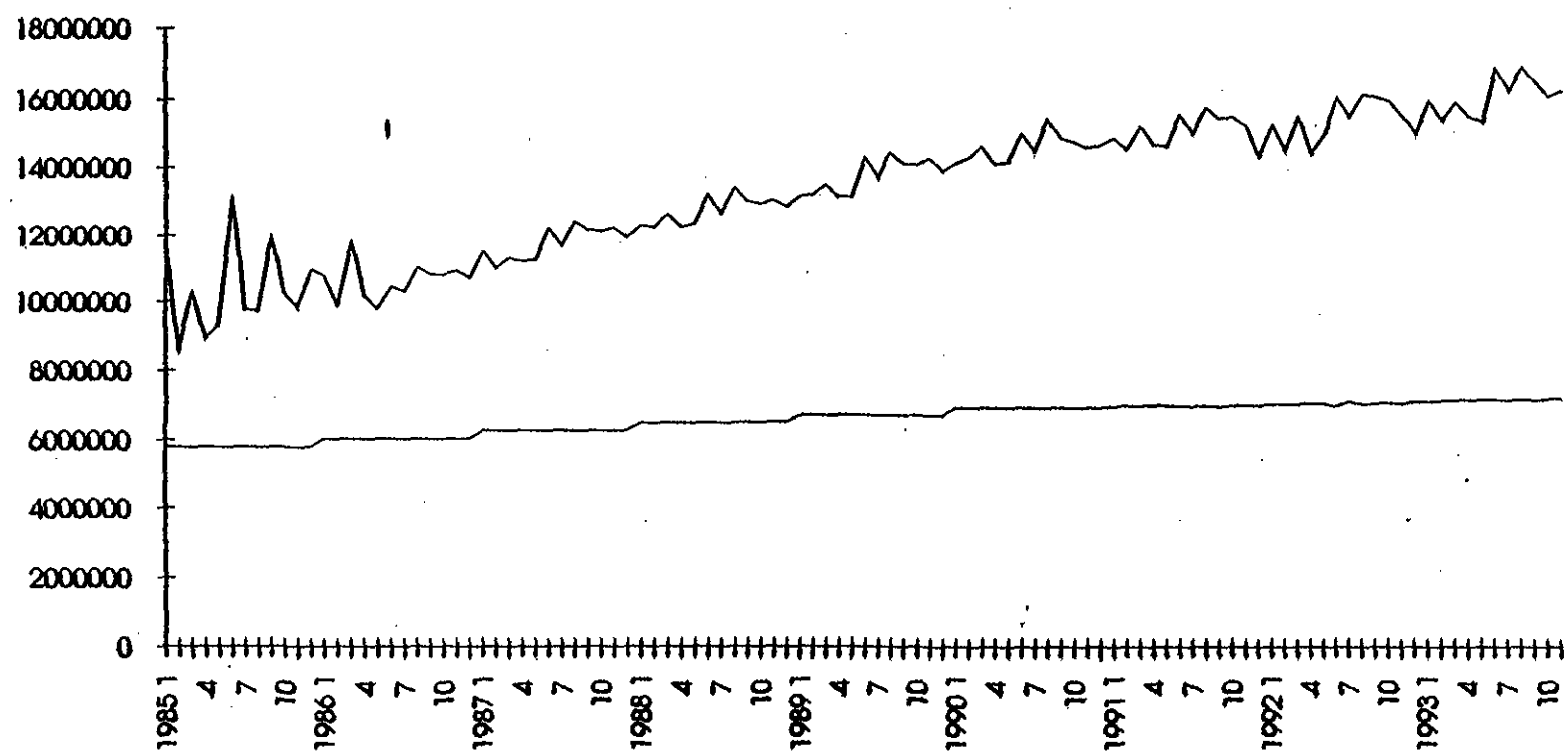

EXHIBIT JPB-III

API RETURN ON EQUITY

Year	Average Common Equity	Net Income	ROE
1991			
1990			
1989	CONFIDENTIAL MATERIAL FILED SEPARATELY		
1988			
1987			

(a) This number was not supported by the financial statements that the Applicant provided.

STAFF ADJUSTMENT

Increase in Collections by OBT for API

Calculation 1

(\$11,674,010 + \$8,592,886) ÷ 2 = \$10,133,448
(\$16,119,467 + \$16,319,119) ÷ 2 = 16,219,293
\$16,219,293 -\$10,133,448 = \$6,085,84
\$6,085,845 ÷ \$10,133,448 = 60%

Increase in Payment to OBT from API

Calculation 2

(\$5,806,750 + \$5,806,750) ÷ 2 = \$5,806,750
(\$7,204,938 + \$7,215,754) ÷ 2 = \$7,210,346
\$7,210,346 - \$5,806,750 = \$1,403,596
\$1,403,596 ÷ \$5,806,750 = 24%

Adjustment

60% - 24% = 36%	- Calculation 1-Calculation 2 = Calculation 3
36% * \$35.73 = \$12.86	- Calculation 3 * Current access rate = Staff adjustment
\$12.86 + \$35.73 = \$48.59	- Staff adjustment + Current access rate = Staff adjusted rate

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing **Prepared Testimony** submitted on behalf of the Public Utilities Commission of Ohio was served by regular, U.S. mail, postage prepaid or hand delivered to the parties of record on this 13th day of July, 1994.

STEVEN T. NOURSE
Assistant Attorney General

PARTIES OF RECORD:

Michael Mulcahy
Ameritech Ohio
45 Erieview Plaza, Room 1400
Cleveland, OH 44114

Barry Cohen
Associate Consumers' Counsel
Office of the Consumers' Counsel
77 South High Street, 15th Floor
Columbus, OH 43266-0550

Judith B. Sanders
Bell, Royer & Sanders Co., LPA
33 South Grant Avenue
Columbus, OH 43215-3927

Robin P. Charleston
AT&T Communications of Ohio, Inc.
227 West Monroe Street, 6th Floor
Chicago, IL 60606

Douglas W. Trabaris
MCI
205 N. Michigan Avenue, Suite 3200
Chicago, IL 60601

Mary Hull
Sprint Communications Co., L.P.
8140 Ward Parkway, 5E
Kansas City, MO 64114

William M. Ondrey Gruber
City of Cleveland
601 Lakeside Avenue, Room 106
Cleveland, OH 44114

Gregory Dunn
Crabbe, Brown, Jones, Potts & Schmidt
500 S. Front Street, Suite 1200
Columbus, OH 43215

Maureen Grady
Hahn Loeser & Parks
431 E. Broad Street, Suite 200
Columbus, OH 43215

Janine Migden
Hahn Loeser & Parks
431 E. Broad Street, Suite 1200
Columbus, OH 43215

William S. Newcomb, Jr.
Vorys, Sater, Seymour & Pease
52 East Gay Street
P. O. Box 1008
Columbus, OH 43216-1008

Bruce J. Weston
AARP
169 West Hubbard Avenue
Columbus, OH 43215-1439

Joseph Meissner
Legal Aid Society of Cleveland
1223 West Sixth Street
Cleveland, OH 44113

Karin Rilley
Education Section
Office of the Attorney General
30 East Broad Street, 15th Floor
Columbus, OH 43266-0410

Ellis Jacobs
Dayton Legal Aide
333 West 1st Street, Suite 500
Dayton, OH 45402

Samuel C. Randazzo
Emens, Kegler, Brown, Hill & Ritter
65 East State Street, Suite 1800
Columbus, OH 43215

Sally W. Bloomfield
Bricker & Eckler
100 South Third Street
Columbus, OH 43215

Dennis K. Muncy
Meyer, Copel, Hirschfield, Muncy,
Jahn & Aldeen
Athenaeum Building
306 W. Church Street, P.O. Box 6750
Champaign, IL 61826-6750

Cecil O. Simpson, Jr.
Office of The Judge Advocate General
Department of the Army
901 North Stuart Street
Arlington, VA 22203-1837

Daniel Malkoff
Dept. of Administrative Services
30 East Broad Street
Columbus, OH 43215

Sheldon Taft
Vorys, Sater, Seymour and Pease
52 East Gay Street
P. O. Box 1008
Columbus, OH 43216-1008

Clyde Kurlander
Teleport
Three First National Plaza
Chicago, IL 60602

Kerry Bruce
City of Toledo
Dept. of Public Utilities
One Government Center, Suite 1520
Toledo, OH 43604

William A. Adams
Arter & Hadden
10 West Broad Street
Columbus, OH 43215