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PUBLIC UTILITIES COMMISSION OF OHIO

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 Regulation.	)	*Case No. 93-487-TP-ALT*

OBJECTIONS TO THE STAFF REPORT OF INVESTIGATION AND SUMMARY OF MAJOR ISSUES

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APRIL 25, 1994

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Pursuant to Section 4909.19 of the Ohio Revised Code and Rule 4901-1-28 of the Ohio Administrative Code, the Office of the Consumers' Counsel (OCC) hereby makes its Objections to the Staff Report of Investigation, which was filed on March 25, 1994. OCC submits that these objections meet the specificity requirements of Rule 4901-1-28 of the Ohio Administrative Code and/or Alternative Regulation Rule IX.C. However, in the event that any objection is inadvertently unclear, a detailed, fully-developed explanation of OCC's position with respect to the Staff Report and the Application is found in OCC's direct testimony to be filed on May 5, 1994, which is fully incorporated herein.

OCC submits that failure to object to any aspect of the Staff Report should not preclude OCC or any other party from cross-examination or introduction of evidence or argument in regard to issues on which Staff's position changes between the issuance of the Staff Report and the closing of the record.

In accordance with the requirements set forth in Rule 4901-1-28 of the Ohio Administrative Code and/or Alternative Regulation Rule IX.C., OCC specifically objects to the findings, conclusions or recommendations contained in the Staff Report, or to the failure of the Staff Report to address certain matters, in the following particulars:

I. *GENERAL*

1. Staff erred in failing to relate its findings with regard to OBT's Plan to the criteria set forth in the Commission's Rules, for any of the issues addressed in the Staff Report, because the Rules require the Staff to consider these criteria in the Staff Report.
2. Staff erred in failing to address, and by failing to find inadequate, OBT's claimed bases for the need for alternative regulation.

II. *ALTERNATIVE REGULATION/PRICE CAP*

3. Staff erred in recommending that a price cap plan is a rational, appropriate alternative to rate-base, rate-of-return regulation in Ohio, because a price cap plan is not in the public interest. (Staff Report [SR] at 32.)
4. Staff erred in failing to recommend a residential rate freeze for the entire term of any approved alternative regulation plan for the Ohio Bell Telephone Company (Ohio Bell, OBT, or the Company).

5. Staff erred in failing to recommend that, if the Commission approves a price cap plan for Ohio Bell, that plan should include a consumer dividend of 0.5 percent to 1.0 percent, because a consumer dividend is needed to assure that customers share in the benefits of efficiencies derived from incentive regulation.

6. Staff erred in failing to recommend that, if the Commission approves a price cap plan for Ohio Bell, the Commission should establish an earnings-sharing mechanism which includes a neutral zone of 50 basis points on either side of the authorized rate of return, a trigger at the high end of the neutral zone which commences sharing 75% to customers and 25% to the Company, and a trigger farther above the authorized return which commences sharing 75% to the Company and 25% to customers. Such a mechanism is needed to assure that customers share in the benefits of efficiencies derived from incentive regulation.

7. Staff erred in failing to recommend that, if the Commission approves an alternative regulation plan for Ohio Bell, the plan should include an earnings sharing mechanism in which the value of the Company's infrastructure commitments are not included in rate base for the purpose of determining the Company's earned return.

8. Staff erred in failing to recommend adoption of an earnings cap which would require revenues above 135 percent of the authorized return to be subject to full refund and OBT to be subject to a Commission earnings investigation, because the Company should not be allowed to retain excess earnings beyond a certain limit.

9. Staff erred in failing to recommend that the Producer Price Index-Communication Equipment (PPI-CE) be used as the appropriate measure of inflation in any price cap plan, rather than the Gross Domestic Product Price Index (GDP-PI), because the PPI-CE more closely reflects the cost of providing telecommunications service. (SR at 37.)

10. Staff erred in failing to recommend that if any exogenous adjustments are allowed, a multi-year trend first needs to be clearly documented.

11. Staff erred in failing to recommend that, if a price cap plan which includes an adjustment factor for exogenous impacts is adopted, customers should have the right to initiate such adjustments. (SR at 42.)

12. Staff erred in failing to recommend that Ohio Bell experience a negative quality-of-service adjustment equal to twice the monthly service adjustment whenever it fails to meet a specific standard two or more times in any twelve month period, if a price cap plan is approved.

13. Staff erred in failing to recommend that, if the Commission approves an alternative regulation plan which provides pricing flexibility which is applicable to baskets of services, each basket should be limited to homogeneous groupings of services, rather than combining services from different cells, as recommended in NRRI Recommendation 2.12.

14. Staff erred in recommending that, prior to the Commission approving an alternative regulation 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 10 years, and to compare such rate effects with rate changes under rate base, rate-of-return regulation, in that Staff failed to recommend that such testimony should assume that the Company would use 100% of its ceiling price authority. (SR at 37.)

15. Staff erred in recommending approval of an alternative regulation plan for Ohio Bell with a term of greater than three years, because *no showing was made by Ohio* Bell (or required by Staff) that a longer term is in the public interest, as required by Rule XI.A. of the Rules for Alternative Regulation of Large Local Exchange Companies. (SR at 53.)

16. Staff erred in failing to recommend that Ohio Bell be required to construct accurate quality-of-service data for the period 1984-1990. (SR at 40.)

17. Staff erred in failing to recommend that Ohio Bell be required to exceed the Minimum Telephone Service Standards in exchange for approval of an alternative regulation plan.

18. Staff erred in failing to recommend that Ohio Bell be required to perform and file with the Commission annual embedded cost analyses for each major service category, because such analyses are necessary to prevent monopoly ratepayers from being required to subsidize competitive services.

19. Staff erred in failing to recommend that costs and revenues from competitive services be removed from the Company's revenue requirement, while other services should remain under rate-of-return regulation, because this is necessary to prevent monopoly ratepayers from being required to subsidize competitive services.

20. Staff erred in failing to recommend that, for the purpose of removing costs and revenues from competitive services from Ohio Bell's revenue requirement, competitive services be allocated 100 percent of their embedded costs and a share of joint and common costs, because such allocation is necessary to prevent monopoly ratepayers from being required to subsidize competitive services.

21. Staff erred in failing to recommend a cell classification structure which properly reflects growing competition for particular services by a relaxation of regulation based on market share and other factors because this would more significantly encourage competition than OBT's proposed classification and pricing methodology. (<u>See</u> testimony of Allen G. Buckalew in Case No. 93-487-TP-ALT.)

22. Staff erred in failing to recommend that, if a price cap plan is approved, Ohio Bell be required to forecast changes in demand for individual services, as recommended in NRRI Recommendation 2.6, and to make those forecasts available on a proprietary basis.

III. ***<u>RATES AND TARIFFS</u>***

23. Staff erred in failing to recommend an across the board distribution of the revenue decrease recommended on Staff Schedule A-1 to all services except private line services.

24. Staff erred in recommending an increase of $1.25 per month in the network access line rate paid by rotary-pulse customers. (SR at 67.)

25. Staff erred in failing to recommend that basic local exchange service for residential Touch-Tone customers be reduced by $1.80, because Touch-Tone is provided at virtually no cost. (SR at 66-67.)

26. Staff erred in finding the Company's proposal to deaverage the network access line rate element to be reasonable, because the proposal is contrary to the goal of universal service. (SR at 63.)

27. Staff erred in finding the Company's proposal to disaggregate residential exchange access service to be reasonable, because it will cause customer confusion and added billing expense, and because there is no current competition for that service. (SR at 65.)

28. Staff erred in finding that it would be proper for Ohio Bell to increase the cost of residential network access line rates in Access Areas C and D, based on Staff's finding that the residential network access line rate is below LRSIC in Access Areas C and D, because the boundaries of the Access Areas are arbitrary, and because LRSIC should not be used for pricing residential network access lines. (SR at 65.)

29. Staff erred in recommending a 1-PIC, as opposed to a modified 2-PIC, methodology in supporting intraLATA 1+ toll, because a modified 2-PIC method would further enhance customer choice. (SR at 78.)

30. Staff erred in failing to distinguish between "contribution" and "cross-subsidy" in, _inter alia_, its discussion of intraLATA 1+ toll. (SR at 78-79.)

31. Staff erred in supporting the Company's application for entry into the interLATA toll market because the Commission has no jurisdiction over such entry, and such entry was not put at issue by the Company's application. (SR at 79.)

32. Staff erred in supporting the Company's application for entry into the interLATA toll market in that the list of issues it would require the Company to address prior to interLATA entry (loop unbundling, number portability and compensation) is incomplete; the Company should also address other issues, including but not limited to consumer protection and the effect on universal service. (SR at 79.)

33. Staff erred in recommending that the Company be allowed to offer Cell 3 services under contract, because this is contrary to Alternative Regulation Rule XIII. (SR at 80.)

34. Staff erred in failing to recommend that the Company actively market Call Trace and Line Blocking, so that these services reach maximum penetration.

35. Staff erred in failing to recommend that the Commission issue an order in this case making Ohio Bell's collection of revenues pursuant to its current rates subject to refund.

IV. *CONSUMER SERVICES*

36. Staff erred in failing to recommend that Ohio Bell's service representatives be prohibited from marketing optional services to residential customers who call for the purpose of making payment arrangements, or who have a payment arrearage at the time of the call.

37. Staff erred in failing to recommend, with regard to the Staff's recommendation that Ohio Bell closely monitor its service representatives to ensure full compliance with Section 4901:1-5-32(A) of the Minimum Telephone Service Standards, that Ohio Bell report periodically on the results of its monitoring. (SR at 93.)

38. Staff erred in failing to recommend that Ohio Bell be required to take corrective action with regard to customers who were given misleading or incomplete information concerning inside wire maintenance plans and privacy options.

39. Staff erred in failing to specifically recommend that the availability of the Annoyance Call Bureau should be one of the privacy options which customer service representatives are required to offer to customers. (SR at 94.)

40. Staff erred in failing to recommend Company action as a result of its Excel survey results, which show customer dissatisfaction is rising or remaining at a constant level. (SR at 90-91.)

41. Staff erred in failing to recommend Company action as a result of the rise in customer complaints about new service and repair service. (SR at 91-92.)

V. *SERVICE CELL CLASSIFICATIONS*

42. Staff erred in failing to recommend that Cell 3 services either have the same pricing constraints as Cell 1 services (in that they are monopoly services) or at

least the pricing constraints of Cell 2 services, in that the current pricing rules constrain Cell 3 monopoly services no more than Cell 4 demonstrably competitive services.

43. Staff erred in failing to recommend that Call Blocking (900 & 976) service be classified as a Cell 1 service, in that Call Blocking (900 & 976) service "meets the condition of public protection and privacy" to the same extent as Selective Call Screening. (SR at 55.)

44. Staff erred in failing to recommend that the Advanced Custom Calling Service Call Screening be classified as Cell 1, in that this service enhances privacy without revealing calling parties' numbers.

45. Staff erred in failing to recommend that Distinctive Ringing, Repeat Dialing, Call Forwarding, and Call Waiting be subject to constraints on maximum pricing, in that these services enhance the value of the network by increasing the number of completed calls and hence should be priced to maximize their penetration, rather than to maximize Ohio Bell's revenues.

46. Staff erred in failing to reject Ohio Bell's Cell 2 and Cell 4 classifications for residential services (other than Speed Dialing), because of Ohio Bell's failure to adequately demonstrate the existence of competition for those services. (See NRRI Report at 167-168.)

47. Staff erred in reclassifying certain private line services from Cell 4 to Cell 2 (SR at 57), and in failing to reclassify other private line services to

Cell 4 from Cell 2, inasmuch as private line services are as competitive as other nonresidential services which Staff has classified in Cell 4.

48. Staff erred in failing to recommend that no current Cell 1 service be allowed to be reclassified as a Cell 3 service, given the cell definitions recommended to be adopted for OBT.

49. Staff erred in failing to recommend adoption of NRRI Recommendation 8.4, in that such NRRI recommendation would create incentives that mimic more effectively the operation of a competitive market.

VI. *<u>RATE OF RETURN</u>*

50. Staff erred in not providing a rationale for its selection of a return on equity range from the data presented.

51. Staff erred in failing to derive reasonable Ameritech-specific DCF results from the data in the Staff Report. Staff's rationale for rejecting the 10.20% "BxR" results (SR at 25) and 9.69% compound growth in earnings (<u>id</u>.) is inadequate. Further, Staff did not present reasons for not considering results such as those produced using the Zacks growth estimate (10.75%) or the IBES growth estimate (10.65%). (SR at 30).

52. Staff erred in including Cincinnati Bell Inc. (CBI) and ALLTEL in Staff's group of comparable telecommunications companies (SR at 31), inasmuch as CBI and ALLTEL are

significantly diversified away from providing local telephone service and use of CBI and ALLTEL data is therefore inappropriate for deriving a return on equity appropriate for local telephone service operations.

53. Staff erred in deemphasizing for use in the selection of a return on equity range the DPS, VLDG, and 1987 to 1992 historical Value Line dividend growth rate DCF calculations (SR at 26), because, inter alia, CAPM results using short-term interest rates suggest that these results are not unreasonably low.

54. Staff erred in rejecting the Ameritech-specific DCF as "low" (SR at 25), given the fact that an evaluation of risk criteria and betas shows that Ameritech-specific results should be below that of the comparable companies.

55. Staff erred in failing to adjust its recommended rate of return range to recognize the decrease in risk which would result from the adoption of an alternative regulation plan.

VII. *REVENUE REQUIREMENTS*

56. Staff erred in failing to remove from test year operating expenses amounts paid to Bell Communications Research (Bellcore) for:

   a) Research, development and planning activities for future services, because costs associated with future services should be recovered from future customers of those services;

b) Projects which are in actuality charitable contributions, because they provide no direct and primary benefit to ratepayers;

c) Projects involving lobbying activities, which provide no direct and primary benefit to ratepayers; and

d) Projects associated with National Security/Emergency Preparedness (NSEP), because these costs are recovered by Bellcore from government agencies.

57. Staff erred in its determination of rate base, in that it eliminated from rate base deductions, on Staff Report Schedule B-6.2, accumulated deferred income tax balances related to Vacation Pay and Lien Date Property Tax which represent non-investor supplied funds which are available for use by the Company.

58. Staff erred in its determination of rate base, in that it improperly included in rate base deductions, on Staff Report Schedule B-6, line 27, an amount for accumulated deferred income taxes related to SFAS 106, which should not be considered for rate base purposes because tax normalization for post retirement benefits under SFAS 106 for ratemaking has not been authorized for the Company by the Commission.

59. Staff erred in its determination of rate base by improperly including in plant in service $194,000 of Artworks in Account 2122.2, because such Artworks are not used and useful in providing utility service, have

no determinable life, are not subject to depreciation, and have the potential to appreciate in value.

60. Staff erred in its determination of adjusted operating expenses, in that it failed to remove those portions of incentive compensation programs expenses paid to employees as incentives to meet net income goals, which are primarily of benefit to shareholders rather than ratepayers.

61. Staff erred in its determination of adjusted operating expenses by improperly using the Company's 1993 estimated expense levels for medical and dental expenses, which were overstated. Staff should have used the Company's actual expenses for January to September, 1993.

62. Staff erred in its determination of adjusted operating expenses by not basing pension expense upon the most recent actuarial study for the Company's pension programs.

63. Staff erred in its determination of adjusted operating expenses by failing to eliminate test year expense accruals in Account 6121 for "changing buildings, motor vehicle, and other signage" for the transformation from the Ohio Bell logo to the new Ameritech logo, because this expense is not necessary for the provision of telephone service, is a non-recurring expense, and is an estimated accrual for an expected expense, and because the amount of the accrual is far greater than the Company's actual expense incurred for this purpose.

64. Staff erred in its determination of adjusted operating expenses by failing to reflect, in its calculation of federal income taxes, a three year amortization of the amount of the Company's unrestricted excess deferred income taxes resulting from the Tax Reform Act of 1986 (TRA86), and by failing to calculate the amortization at a 35% rate.

65. Staff erred in its determination of adjusted operating expenses by failing to eliminate advertising expenses in Account 6613 for the "Your Link to a Better Life" and "Ameritech Brand Debut" campaigns, because they are non-recurring costs for institutional advertising used to enhance the Company's image and advertise a name change, and are not necessary for the provision of telephone service.

66. Staff erred in its determination of operating expenses by including $13,531,000 on Schedule B-3.3 for Amortization of Reserve Deficiency for Account 2211, Analog-ESS All Other Use, because any depreciation reserve deficiency amortization will lead to an overrecovery of the net plant balance remaining in this account at the time that the rates established in this case go into effect.

67. Staff erred in failing to exclude portions of USTA dues pertaining to Legislative Advocacy, Regulatory Advocacy, Public Relations, Dues, and Independent Meals & Entertainment, because these expenses are not necessary to the provision of telecommunication service and provide no direct and primary benefit to ratepayers.

68. Staff erred in failing to exclude portions of External Relations expenses in Account No. 6722 pertaining to Public Relations, Regulatory/Government Relations, and Ameritech Corporate, because these expenses are in the nature of lobbying and advertising, are not necessary to the provision of telecommunication services, and provide no direct and primary benefit to ratepayers.

69. Staff erred in failing to use the straight line method consistently over the lease term in computing the amortization expenses for capital leases.

70. Staff erred in failing to properly compute the amortization expense for Capital Lease 46143 30174C to reflect the 12/93 ending date of the lease term.

71. Staff erred by failing to properly compute the amortization expense for leasehold improvements because the amortization for leases which begin or end during the test year should be recognized only during the months in which those leases were in effect, and not for the entire twelve months.

72. Staff erred by failing to exclude the corporate advertising expenses under Account No. 6722.52, which are institutional and promotional in nature and do not provide any direct and primary benefit to ratepayers.

73. Staff erred by failing to exclude Product Advertising expenses which are institutional or promotional in nature, because these expenses confer no direct and primary benefit to ratepayers.

74. Staff erred by failing to exclude expenses relating to the Community Issues and Priority Survey because this type of study aims to improve the community and public relations image of the Company and is goodwill and image building in nature.

VIII. *COMMITMENTS*

75. Staff erred in failing to find that the commitments in OBT's plan are inadequate to justify granting alternative regulation to OBT.

76. Staff erred in evaluating Ohio Bell's proposal to invest in upgrading its telecommunications network over the next five years as a commitment separate from its infrastructure modernization commitments, because the proposed modernization is a direct result of the proposed telecommunications investment.

77. Staff erred in failing to recommend that Ohio Bell make some progress towards its ISDN deployment schedule in the year 1997. (SR at 101.)

78. Staff erred in considering as a commitment OBT's proposal to continue to offer residential flat rate service as an option during the term of the alternative regulation plan, because the proposal does not meet the Commission's definition of a commitment and OBT would be unable to justify the elimination of flat rate service under traditional regulation.

79. Staff erred in finding that Ohio Bell's $382.2 million to $476.2 million in expenditures specifically identified for its infrastructure modernization commitment is sufficient to justify granting alternative regulation to Ohio Bell. (SR at 104.)

80. Staff erred in failing to recommend that if Ohio Bell is granted the pricing flexibility of a price cap plan, Ohio Bell should be required to identify a minimum of $1.6 billion dollars of identifiable infrastructure investment above and beyond what is necessary for the maintenance of Ohio Bell's common carrier obligations, including the Minimum Telephone Service Standards. (SR at 103-104.)

81. Staff erred in failing to adopt NRRI Recommendation 9.1, that the public should be informed that the Company's proposed $1.6 billion infrastructure commitment is for the most part business as usual, or the continued normal evolution of the network. Such information would assist the public in making informed comments on Ohio Bell's proposal.

82. Staff erred in failing to adopt NRRI Recommendation 9.4, that Ohio Bell be required to explain its lack of progress on infrastructure modernization compared to other states that are ahead of Ohio and still subject to rate of return regulation. (SR at 104.)

83. Staff erred in failing to adopt NRRI Recommendation 7.5, that Ohio Bell be required to clarify in writing in this proceeding exactly what it means by a residential price cap and/or freeze, and instead assuming that Ohio Bell's intent is to cap all rates except carrier services at baseline levels during various terms of the plan.

84. Staff erred in failing to recommend that Ohio Bell commit to a specified number of full-time educational and technical staff for a specified number of years as the dedicated support team which Ohio Bell will provide to work with the educational community in developing and implementing distance learning applications.

85. Staff erred by failing to recommend that Ohio Bell provide CPE (such as codecs, modems, laser equipment etc.) in schools, as a part of its commitment to distance learning. Such a commitment would enhance the use, and therefore the value, of Ohio Bell's commitment to fiber deployment and distance learning.

86. Staff erred by recommending that Ohio Bell file its proposed discounted educational tariff in this proceeding merely "prior to" the Commission approving its Plan. (SR at 108.) Staff should have required the filing of such

tariff at a specified, earlier date, so that interested parties would have the opportunity to evaluate the proposed discounted tariff.

87. Staff erred by failing to recommend that OBT perform and file demand forecasts and cost studies for various distance learning services to schools. Absent such cost studies, the only information available is Ohio Bell's cost estimate, and an assessment of the true value of this commitment is problematic.

88. Staff erred by failing to recommend that Ohio Bell educate public serving institutions not only as to the potential availability of fiber based services, but also as to services resulting from technologies other than fiber, and the possible applications of these services. (SR at 111.)

89. Staff erred by failing to recommend that Ohio Bell establish a goal to increase the level of participation in its Basic Telephone Service Assistance Program (TSA and SCA) by at least a specified minimum percentage as a part of its universal service commitment. (SR at 117.)

90. Staff erred by failing to recommend that OBT offer Per Line Number Privacy to all customers at no charge, because ratepayers should not be charged to preserve privacy they enjoyed until now as a matter of course.

91. Staff erred by failing to recommend that Call Trace be available on a nonsubscription basis for a charge of no more than $1.00 per activation, because only a nominal

charge will permit victims of harrassment to avail themselves of this service effectively without excessive charges, and yet prohibit casual use.

92. Staff erred by failing to recommend that OBT provide a call back prevention function to prevent unwanted call returns through Automatic Callback.

93. The Staff erred in failing to recommend that Ohio Bell be subject to penalties if it fails to fulfill its commitments.

94. The Staff erred by failing to recommend any process to enforce Ohio Bell's performance of its commitments.

Respectfully submitted,

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STATEMENT OF MAJOR ISSUES

1. Whether alternative regulation for Ohio Bell Telephone Company is in the public interest.
2. Whether approval of a price cap plan for Ohio Bell Telephone Company is in the public interest.
3. Whether approval of Ohio Bell's Advantage Ohio Plan is in the public interest.
4. Whether Ohio Bell's current rates are just and reasonable.
5. If an alternative regulation plan is approved for Ohio Bell, what the length of that plan should be.
6. If a price cap plan is approved for Ohio Bell, what the features of that price cap plan should be.
7. Whether the Commission should require cost studies and market share analysis for competitive services, for the purpose of removing costs and revenues related to those services from Ohio Bell's revenue requirements.
8. Whether rates for Ohio Bell's rotary-pulse customers should be increased.
9. Whether the commitments set forth in Ohio Bell's plan are sufficient to justify adoption of alternative regulation for Ohio Bell.

10. Whether the Commission should require Ohio Bell to undertake additional commitments if it adopts an alternative regulation plan.

11. Determination of the proper rate of return for the Ohio Bell Telephone Company.

12. Whether revenues from Ohio Bell's monopoly services subsidize its more competitive services.

13. Whether the Company's LRSIC methodology is a proper standard for pricing.

14. Whether the Company's costs are properly allocated between the intrastate and interstate jurisdictions.

15. How any revenue decrease should be allocated among the services offered by Ohio Bell.

16. Whether Ohio Bell's collection of revenues pursuant to its current rates should be made subject to refund.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of these Objections of the Office of the Consumers' Counsel to the Staff Report of Investigation and Summary of Major Issues have been served by first class mail, postage prepaid, or hand delivered to the following parties of record this 25th day of April, 1994.

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