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PERFORMANCE ANALYSIS DIVISION  
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

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  
Richard C. Cahaan  
Performance Analysis Division

Staff Exhibit 19

Date Submitted: August 3, 1994

1 1. Q. Would you please state your name, address, position, and background  
2 for the record.

3  
4 A. My name is Richard C. Cahaan. I am employed by the Public Utilities  
5 Commission of Ohio, 180 E. Broad Street, Columbus, Ohio 42315, and I  
6 am the Economics Officer in the Performance Analysis Division of the  
7 Utilities Department. I have been employed by the PUCO since 1983  
8 and have testified in numerous rate cases and other proceedings before  
9 the Commission.

10  
11 I have received a B.A. degree from Hamilton College and an M.A.  
12 degree in Economics from the University of Hawaii, and I have com-  
13 pleted all course work and passed the written and oral general and field  
14 examinations at the Ph.D. level at Cornell University. I have been a  
15 faculty member, either full time or part time, at the State University of  
16 New York - Cortland, Eisenhower College, Ithaca College, Cornell Uni-  
17 versity, The Ohio State University, and Capital University.

18  
19 2. Q. What is the purpose of your testimony?

20  
21 A. I was responsible for the preparation of the section of the Staff Report  
22 entitled "Financial Analysis of the Applicant's Plan" (pages 123 to 129  
23 of the Staff Report). I am responding to the objections which have  
24 been made regarding this material, which, to my knowledge, were only  
25 made by the Applicant. These are found in Section D of the Appli-  
26 cant's objections.

27

1 3. Q. In Section D, objection 1 states: "Applicant objects to the Staff's conclu-  
2 sion that the information Applicant has provided is insufficient to  
3 understand Applicant's rationale. (Staff Report at 123). The informa-  
4 tion provided is both extensive and sufficient." How do you respond?  
5

6 A. I accept the Applicant's objection, within the context of the cited Staff  
7 report pages. Certain information on revenues, which seemed to be  
8 missing at the time I wrote that section of the Staff Report, had, in fact,  
9 been provided.  
10

11 4. Q. In its second objection, the Applicant "objects to the Staff's overall  
12 approach to its analysis of the Applicant's plan. (Staff Report at 123  
13 -129). The Staff's approach is not forward-looking and fails to recognize  
14 important public interest benefits of the plan." How do you respond?  
15

16 A. I find the objection to be confusing. To begin with, the referenced pages  
17 do not constitute the Staff's "overall approach" to the Applicant's Plan,  
18 which is the topic of the entire Staff Report, not just the referenced  
19 pages. Next, the referenced pages are based on a financial analysis  
20 which is obviously forward-looking, at least over the 1994-1998 time  
21 frame.  
22

23 Lastly, consideration of the public interest benefits of the plan was not  
24 attempted in the analysis contained in the referenced pages, nor was it  
25 relevant to the purpose of that section of the Staff Report. The refer-  
26 enced pages consisted of a chapter entitled "Financial Analysis of the  
27 Applicant's Plan." Perhaps, because this chapter was placed at the end

1 of the Staff's discussion of the Plan, the Applicant considered it to be an  
2 overall conclusion and summary of the Staff's position. It was not.  
3 The chapter's perspective was limited to an examination of the Appli-  
4 cant's financial condition and financial performance, as delineated in  
5 the chapter's introductory paragraph. These limited aims were also  
6 expressed in the last section of the chapter, which limits the conclu-  
7 sions to being "from a financial perspective." The chapter, and the  
8 analysis upon which it is based, takes no position with respect to the  
9 requirement that the Plan be in the public interest.  
10

11 5. Q. In its third objection, the Applicant "objects to the Staff's suggestion  
12 that ratepayers would not be well served by the plan as currently struc-  
13 tured." Such a suggestion would seem to go beyond the limited per-  
14 spective you have outlined above. How do you respond?  
15

16 A. The Applicant's objection mischaracterizes the Staff Report's discus-  
17 sion and takes it out of context. The exact language on page 124 is:  
18 "However, the projected fall in net plant value, with its implications  
19 for a declining rate base, certainly raises the possibility that ratepayers  
20 are not well served by the Plan as currently structured." A declining  
21 rate base, by itself, would lead to lower rates under traditional regula-  
22 tion, while the price cap plan does not propose such a reduction. Of  
23 course, whether traditional regulation would, in fact, produce lower  
24 rates would depend upon other variables, besides the rate base.  
25 Nonetheless, the declining rate base raises the possibility that rates  
26 would be lower under traditional regulation, and the wording of the  
27 Staff Report properly expresses this situation.

1 6. Q. In its fourth objection, the Applicant objects to the Staff's conclusion  
2 that the \$1.6 billion commitment "in financial terms . . . is not large,"  
3 as stated on page 125 of the Staff Report. How do you respond?  
4

5 A. The conclusion was based upon the evidence presented on the previ-  
6 ous page of the Staff Report. I believe that the evidence fully supports  
7 the conclusion.  
8

9 7. Q. The Applicant supports its objection by pointing out, "By any reason-  
10 able measure, Applicant's \$1.6 billion commitment is commensurate  
11 with other elements of the plan and satisfies the public interest test."  
12 Have you considered or utilized this perspective in your analysis?  
13

14 A. Hardly. I have no idea what the Applicant means by "any reasonable  
15 measure." I have cited size, asset base, and cash flow as reasonable  
16 measures, but I have no idea what the Applicant considers to be rea-  
17 sonable. Also, I have no idea as to how I would determine whether the  
18 investment is commensurate with other elements of the plan, nor, if  
19 such a determination were possible, the usefulness or meaning of such  
20 a determination -- would it mean that the investment is large or the  
21 plan is small? As to whether the investment satisfies the public inter-  
22 est test, the Applicant is free to make the assertion; as I have explained,  
23 this subject was not germane to the financial analysis.  
24

25 8. Q. In objections 5a and 5c, the Applicant objects to the treatment of the  
26 SFAS 106 TBO amortization. How do you respond?  
27

1 A. The determination that the SFAS 106 expenses and balances should be  
2 eliminated from the regulated total company accounts was made by the  
3 Accounting Officer, Mr. Hess, and will be addressed by his testimony.  
4 My role was simply to incorporate this determination in the financial  
5 model -- in short, to do the arithmetic. I notice that Mr. Kukla's testi-  
6 mony (Ameritech Ohio Exhibit 31AS.0, page 40) expresses some dis-  
7 agreement with this calculation, although, after reading the testimony  
8 several times, I still do not understand exactly what he sees as the prob-  
9 lem. I would point out that I followed the methodology used by the  
10 Applicant in working paper WPH-3.7, *i.e.*, I set up my spreadsheet in  
11 exactly the same fashion, and followed the same procedure to reverse  
12 the addition to common equity which had been made by the Applicant.  
13 In that exhibit, Mr. Kukla had started with the 12/31/93 Stockholders  
14 equity per corporate view, added in a SFAS 106 adjustment, and sub-  
15 tracted out an API adjustment. In effect, the Staff sees these adjust-  
16 ments as not warranted, and, with a minor discrepancy for nonregu-  
17 lated activities, did nothing more than reverse the process.

18  
19 9. Q. Did you make the determination of the inclusion of the API directory  
20 contribution, or did you, as you put it, just do the arithmetic?

21  
22 A. The latter.

23  
24 10. Q. In objection 5d, the Applicant objects to an adjustment of the efficiency  
25 factor. How do you respond?  
26

1 A. I disagree with Mr. Kukla's evaluation (Ameritech Ohio Ex. 31AS.0,  
2 page 41.) It is true that the numbers used for the efficiency offset in the  
3 expense forecast are derived from a different source than those con-  
4 tained in productivity component of the price cap formula. It is also  
5 true that the numbers are not the same. However, all this is irrelevant.  
6 Conceptually, the same factors which drive the efficiency offset would  
7 also drive the productivity component, although the relationship may  
8 not be on a one-to-one basis.

9  
10 To illustrate this point, consider the following hypothetical situation.  
11 Suppose that new, known technological advances in hardware and  
12 software clearly indicated that the growth rate of labor productivity,  
13 service units per unit of labor, would leap to 20% per year, without any  
14 special effort other than normal levels of investment. Should not this  
15 change also be reflected in the productivity component of the price cap  
16 formula, since both the efficiency offset and the productivity compon-  
17 ent are meant to reflect the trend line of unit costs?

18  
19 However, the Applicant's objection 5d is confused about the matter, as  
20 related to the actual financial analysis performed. Page 129 of the Staff  
21 Report discusses why the same considerations would justify a change  
22 in both components. However, contrary to the assertion of the Appli-  
23 cant's objection, Staff Report states that the efficiency factor was not, in  
24 fact, adjusted.  
25

1 11. Q. The Applicant's sixth objection disputes the conclusion that the Staff's  
2 adjustments are feasible from a financial perspective and asserts that  
3 the adjustments are not feasible. How do you respond?  
4

5 A. Financial feasibility, from the Staff perspective, contains two main  
6 areas: the ability to carry out the \$1.6 billion commitment program, and  
7 acceptable financial ratios with respect to earnings and interest cover-  
8 ages.  
9

10 The Applicant's ability to fund the commitments program is not  
11 impaired under any scenario run. Even with the most severe price cap  
12 adjustments modeled, the Applicant can finance the commitments  
13 program from internal funds. From this perspective, the Staff's  
14 adjustments are clearly feasible.  
15

16 Regarding earnings and interest coverages, the scenarios show accept-  
17 able results when averaged over the five year period. As the Staff  
18 Report notes, however, the distribution of the earnings creates a prob-  
19 lem, despite the average, with high earnings in the early years and low  
20 earnings in the later years. Does this mean the adjustments are not  
21 feasible? If I were offered a three-year contract as a consultant, to be  
22 paid at five times my current salary in the first year, twice my current  
23 salary in the second year, but only one-fourth my salary in the third  
24 year, would I be wise to decline on the basis that I would have difficulty  
25 getting by in the last year, on that year's salary alone?  
26



1           However, I recognize that the time distribution is not optimal and cre-  
2           ates problems. For this reason, the Staff Report was carefully worded to  
3           indicate that the adjustments which were modeled were not to be  
4           applied mechanically, but were ingredients which could be utilized to  
5           fashion a solution.

6  
7   12.   Q.   In its seventh objection, the Applicant has objected to your "conclusion  
8           that the Staff's recommendations would produce a more balanced plan  
9           than that proposed by the Applicant. (Staff Report at 129)," and asserts  
10          that "Applicant's plan is balanced; the Staff's recommendations would  
11          upset the careful balance of elements presented in the plan." How do  
12          you respond?

13  
14       A.   The Applicant's objection demonstrates a most interestingly egregious  
15          reading of the referenced page of the Staff Report. Nowhere was a con-  
16          clusion reached about the Staff's recommendations, because the Staff's  
17          recommendations, as a whole, were not modeled and analyzed. The  
18          Staff Report rather clearly, I believe, describes the analytical steps taken.  
19          The purpose was to utilize the Applicant's information and the Staff's  
20          adjustments, to obtain what the Staff believes is a truer picture of the  
21          applicant's financial condition under its proposed plan, and then to see  
22          how much room there was for changes in one "ingredient" -- the price  
23          cap formula. Many aspects of the plan were necessarily left out, either  
24          because of increasing complication or because of their speculative  
25          nature. For instance, the impacts of unbundling and 1+ presubscrip-  
26          tion (the subjects of the Applicant's eighth objection) were not mod-

1           eled or analyzed. To quantify these other "ingredients" would have  
2           required considerable research and heroic assumptions.

3  
4           Thus, the analysis does not purport to represent the Staff's recom-  
5           mendation, and the Applicant's objection mischaracterizes the conclu-  
6           sion of the analysis. As to the question of balance, the analysis merely  
7           shows that a more balanced plan could be achieved, without addressing  
8           the specifics. "Balance," in this usage, was referring to the balance of  
9           interests between Ameritech Ohio and its ratepaying customers. If  
10          Ameritech is asserting that its plan, as presented, is balanced, then I  
11          have no idea as to what kind of balance is meant.

12  
13       13.    Q.    Does this conclude your testimony?

14  
15          A.    Yes, it does.

## CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing Prepared Testimony of Richard C. Cahaan, 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 3rd day of August, 1994.



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