

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF THE RATES OF)
GTE SOUTH, INCORPORATED) CASE NO. 10117

ORDER MODIFYING SEPTEMBER 1, 1988 ORDER AND
ADDRESSING PETITIONS FOR REHEARING

On January 19, 1988, GTE South Incorporated ("GTE South") filed a notice of proposed adjustments in its rates and charges. On September 1, 1988, the Commission entered an Order granting GTE South an increase in intrastate revenues of \$7,947,185.

On September 21, 1988, GTE South as well as the Attorney General of the Commonwealth of Kentucky, by and through his Utility and Rate Intervention Division and the Lexington-Fayette Urban County Government ("AG-LFUCG") filed petitions for rehearing on certain issues.

GTE South asked for rehearing on eight issues. The AG-LFUCG petitioned for rehearing on two issues. On October 3, 1988, GTE South and the AG-LFUCG filed responses to the petitions. The Commission will address the validity of rehearing on each of these issues.

GTE South has requested rehearing on the Commission's determination of the effect of Central Office Equipment ("COE") Categories 3 and 4 allocations on 1987 levels of intrastate investment and expenses. The Commission, after consideration of the issues and being advised, is of the opinion and finds that

rehearing on the impact of COE Categories 3 and 4 allocations should be granted.

GTE South requested rehearing on the issue of intrastate access revenues. Specifically, GTE South alleges that the Commission ignored the impact of its January 1988 access tariff filing in reflecting in this general rate case the denial of the increase proposed in Case No. 10171, The Tariff Application of GTE South Incorporated (Access Services). The Commission, after consideration of the issues and being advised, is of the opinion and finds that rehearing on the issue of the appropriate intrastate access revenues should be granted.

GTE South requested rehearing on whether the Commission incorrectly determined that the going level of COE maintenance expenses were nonrecurring, when the increases were actually a result of transfers among accounts. The Commission, after consideration of the issues and being advised, is of the opinion and finds that rehearing on the going level of COE maintenance expense should be granted.

GTE South requested rehearing on the issue of the appropriate level of directory advertising revenues and the retention ratio. As presented, there are two issues involved. The first issue is whether the Commission has the authority to impute revenues to a local exchange company which were derived from transactions with affiliated companies. As this is a question of law, not fact, the Commission, being advised, is of the opinion and finds that it should entertain all arguments on this issue by counsel for GTE South and the AG-LFUGC. Second, concerning the appropriateness of

imputing a retention ratio, the Commission, being advised, is of the opinion and finds that rehearing should be granted.

GTE South requests rehearing on whether the General Office normalized expenses were correctly calculated. These expenses were correctly calculated, and GTE South's adjustment was included. However, the Commission herein finds that its September 1, 1988 Order should be modified at page 44 to delete the phrase "rejects GTE South's adjustments and . . ." Thus, the corrected sentence now reads:

"Thus, after much consideration, the Commission accepts the AG-LFUCG's adjustment of \$1,690,065."

In its petition for rehearing, GTE South requested that the Commission reconsider its calculation on the cost of capital. GTE South contends that by ignoring the \$75 million in equity that was issued to reduce short-term debt, the Commission has not recognized GTE South's cost of capital under its current capital structure. In addition, GTE South contends that the Commission's decision to disallow the pro formed capital structure was inconsistent with previous positions taken by the Commission. The AG-LFUCG responded by noting that the Commission has traditionally used end-of-period capital structure as noted in final Orders in Case No. 10117, Case No. 9678, Adjustment of Rates of General Telephone Company of the South, and Case No. 8045, Adjustment of Rates of General Telephone Company of Kentucky. Further, the AG-LFUCG agreed with the Commission that GTE South's actual end-of-test period capital structure was much more representative than

its proposed capital structure. Therefore, the AG-LFUCG recommended that GTE South's petition be denied in this area. The Commission having reviewed the record is of the opinion and finds that GTE South should be granted rehearing on this issue.

Another issue raised by GTE South was on the allowed return on equity ("ROE"). GTE South contends that a 12.75 percent ROE is not fair, just, or reasonable as compared with investments of similar risks and is not adequate to maintain GTE South's financial integrity and attract capital at a reasonable cost. GTE South also stated that since the Commission found that Dr. Weaver's "b x r method" can understate the growth component of the discounted cash flow ("DCF") model, then his DCF analysis is not credible. However, as noted in the September 1, 1988 Order, the Commission took into consideration that the "b x r method" can understate growth and, thus, understate the ROE.

GTE South also contends that the "Commission has missed the point made by all three witnesses (Austin, Furst, and Weaver) in their use of flotation costs."¹ GTE South contends that all three witnesses used flotation costs for determining ROE for comparable companies and, therefore, they should be applied to GTE South as well. However, the Commission is of the opinion that it is GTE South that "has missed the point" of the findings in the Order. The Commission stated that an allowance for flotation cost should

¹ GTE South Petition for Rehearing, page 27.

be rejected because GTE South "has been unable to identify these costs . . . (and) . . . if these costs have been incurred, GTE South has neither demonstrated nor convinced the Commission that these costs have not been recovered as expense items."² Further, the Commission believes that GTE South has given a misleading impression of Dr. Weaver's testimony on flotation costs. Dr. Weaver testified that he does not recommend nor does he believe that GTE South has incurred any flotation costs.³

In its response to GTE South's petition, the AG-LPUCG stated that the authorized rate of return is adequate beyond cavil.⁴

Therefore, the Commission is of the opinion that GTE South has not presented any new arguments or evidence on the issues of return on equity and flotation costs that the Commission has not already thoroughly considered in this case. The Commission firmly believes that an ROE of 12.75 percent is sufficient to maintain GTE South's financial integrity and is within the range of other investments of comparable risks. After review of the record the Commission finds that GTE South has not presented any additional evidence and, therefore, rehearing on the issues of ROE and flotation costs should be denied.

² Order, September 1, 1988, page 83.

³ Transcript of Evidence, Volume VI, page 215-216.

⁴ AG-LPUCG Response to GTE South's Petition for Rehearing, page 4.

GTE South requested modification of ordering paragraph 7 of the September 1, 1988 Order. The Commission agrees with GTE South and finds that the ordering paragraph 7 of its September 1, 1988 Order should be modified to read as follows:

"Within 30 days of the end of the 2-month period during which the additional amounts are billed, GTE South shall file with the Commission a schedule showing the total additional amount billed to its customers."

The AG-LFUCG requested rehearing on its proposed adjustment to increase toll revenues. GTE South objected to the Commission rehearing this issue. The Commission is of the opinion and finds that the issue of the revenues should be reheard and that evidence concerning toll expenses and investment should also be reviewed.

The AG-LFUCG proposed that rehearing should be granted to recognize reduced depreciation and its impact on revenue requirements. The Commission agrees and finds that a rehearing should be granted.

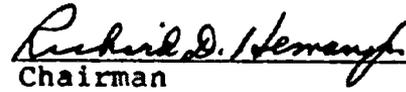
ORDERS

IT IS THEREFORE ORDERED that:

1. Each of the above findings be and they hereby are ordered.
2. Testimony on the issues granted rehearing herein shall be filed by the parties not later than October 28, 1988.
3. Subsequent to the filing of testimony a procedural schedule will be established for the conclusion of these issues.

Done at Frankfort, Kentucky, this 11th day of October, 1988.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director