IN THE SUPREME COURT OF FLORIDA

GTE FLORIDA INCORPORATED, Appellant, vs. J. TERRY DEASON, ETC., ET AL., Appellee.	)	CASE NO. 82,003

ANSWER BRIEF OF APPELLEE
FLORIDA PUBLIC SERVICE COMMISSION

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SYMBOLS AND DESIGNATIONS OF THE PARTIES

Appellee, The Public Service Commission, is referred to as the "Commission". Appellant, GTE Florida Incorporated is referred to as "GTEFL" or "the Company". The Office of Public Counsel is referred as "Public Counsel". The staff of the Florida Public Service Commission is referred as "staff".

The transcript of the Commission's hearing in these dockets is referenced as "T. ___"; the transcript of the December 16, 1992 agenda conference "AT. __"; and the transcript of the May 4, 1993 agenda conference on reconsideration "ATR. ___". Exhibits are referred to as "Ex. __". References to GTEFL's initial brief are listed as "Brief at __".

STATEMENT OF THE CASE AND FACTS

The Commission generally accepts the statement of the case and facts as presented by GTEFL in its initial brief. However, the Commission notes that the Company has not resisted the temptation to interject argument and insinuation into its Statement of the Case and Statement of the Facts. For example, the Statement of the Case at page 5 refers to the "Commission's unsupported opinion of 1994 financial conditions" and the fact that the agenda conference on reconsideration "took less than an hour". Obviously, the Commission has a different view of the validity of its opinion on 1994 financial conditions. It is also unaware of any requirement that it spend more than an hour in making a decision on a motion for reconsideration. The Commission is confident that the Court will be able to evaluate the subjective element contained in such pronouncements and others interspersed in GTEFL's Statements of the Facts and the Case.

SUMMARY OF ARGUMENT

It is the Commission's decision embodied in its order that is the subject of judicial review, not the Commission's "decision-making process" which GTEFL has interjected into its argument.

The record shows that the Commission's adjustment to affiliate expenses paid to GTE Data Services, Inc. (GTEDS) was supported by competent substantial evidence. That evidence was supplied by Public Counsel's witness DeWard and GTEFL's own witnesses. The Commission's decisions in GTEFL's 1981 rate case and in United Telephone Company of Florida's (United) rate case support its order. GTEFL was on notice of the Commission's policy on affiliate transactions. The United decision makes precisely the same kind of adjustment as was made for GTEFL in the order on appeal.

It was a matter of the Commission's discretion to determine that it should grant an incentive to maintain beneficial affiliate relationships by allowing a higher return for GTE Supply, Inc. (GTES) than for GTEDS. The Commission's approach to affiliate transactions is consistent with its past practices and the decisions of other states. The Florida Commission and others have recognized that pricing of affiliate transactions must take into account the reality that the affiliate's prices are effectively controlled by the operating companies.

The Commission's decision to disallow GTEDS' expenses down to cost plus a reasonable rate of return has not created a new policy. The Commission's policy applying special scrutiny to affiliate transactions is long-standing. It was the facts of this case which

did not support allowance of the full profit level obtained by GTEDS, where GTEFL and other operating companies provided 90 percent of its business.

The Commission has not imposed an impossible burden of proof on GTEFL. GTEFL's affiliate expenses were in fact allowed, including a reasonable rate of return, even though the Commission found that some adjustment was necessary for GTEDS and GTES.

The Commission's adjustment for GTES' expenses was likewise supported by the record evidence, Commission precedent and its policy on affiliate transactions. The Commission acted within its discretion when it determined that the Company deserved an incentive to maintain and develop its affiliate relationships. This Court has upheld the Commission's discretion to reward favorable corporate policies in analogous situations by allowing a utility an increased return on equity.

The Commission's deferral of $10,000,000 in FAS 106 costs is reasonable based on the evidence presented in this case. In consideration of the data presented by GTEFL's own witnesses, the Commission could reasonably conclude that the Company will earn up to an additional $23,000,000 in 1994 which will offset the deferred FAS 106 costs. GTEFL was put on notice by Issue 25-I in the Commission's prehearing order that the effect of 1994 earnings on FAS 106 costs would be considered. In any case, the entire amount was at issue, and the Commission's deferral of $10,000,000 of FAS 106 costs was a reasonable exercise of its ratemaking discretion. The Commission's decision to defer these costs was consistent with

the test-year concept and the Commission's discretion in recognizing what will and will not be included in test-year expenses.

The Commission's removal of GTEFL's investment in its subsidiary GTE Communication Corporation (GTECC) 100 percent from equity was consistent with past Commission decisions. The parent-debt adjustment rule does not mandate that the Commission consider the effects of non-utility investment on cost of capital in the same manner as it allocates tax expense. The removal of the GTECC investment 100 percent from equity was designed to compensate for the additional capital costs associated with the Company's investments in riskier enterprises. The GTECC investment was consistent with the Commission's adjustment in the United rate case in purpose and effect.

GTEFL has not met its burden to overcome the presumption of correctness which attaches to the Commission's orders. The Commission's decision should be affirmed on all issues.

ARGUMENT

In its summary of argument, GTEFL invokes the Court's motion ruling in Citizens of the State of Florida v. Beard, 613 So.2d 403, (Fla. 1993), to invite the Court to join in its assault on the Commission's "decision-making process". GTEFL mistakenly postulates that this is "one of the first instances where the Court has been asked to consider the Commission's oral decision-making process as a part of the appellate record". (Brief at 7).[1] The Company then proceeds to pepper its brief with references to what this or that Commissioner or staff member said at agenda conference. GTEFL goes so far as to even implicitly chide the Commission for spending "less than 90 minutes" in deciding the Company's case at the agenda conference. (Brief at 4).

The Court should decline GTEFL's invitation to weigh the Commission's decision based on may have been said in the course of its deliberations. The Court should, as it always has, weigh the Commission's decision based on the contents of its written orders and the evidentiary record developed in the proceeding. If the Court should accept GTEFL's invitation to analyze the mental impressions of the Commissioners and staff, then it must logically

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[1] Before the Court's holding in Citizens of the State of Florida v. Beard, 613 So.2d 403 (Fla. 1992), appellants asked for and sometimes received permission to include staff recommendations and agenda transcripts in the record. See, e.g. Case No. 75,597, Citizens of Florida v. Wilson, 568 So.2d 1275 (Fla. 1990); Case No. 77,153, Gulf Power Company v. Wilson, 597 So.2d 270 (Fla. 1992); and Case No. 79,338, Florida Power and Light Company v. Beard, currently pending before the Court. Even in the Occidental case, the Court had before it staff recommendations and agenda transcripts which reflected the alleged violations of procedure.

also consider how the Commissioners may have weighed the credibility of the witnesses in the five days of evidentiary hearings; what relevant information they may have gleaned through the scores of questions they asked the witnesses in the case and the effect on their decision; what they surmised from the evidence contained in the 13,000 plus pages record on appeal; how their decision may have been influenced by discussions with their aides and many other subjective factors which could possibly have some bearing on the ultimate decision made. That path leads to chaos.

The Commission's order must stand or fall based on its content and the record evidence that supports it. Indulging the attempts of an appellant such as GTEFL to discredit the Commission and its staff by selective references to agenda transcripts and other documents can only detract from the legal objectives of judicial review and ultimately chill the frank and open debate between the Commissioners and its staff.

I.

THE COMMISSION'S ADJUSTMENTS TO EXPENSES FOR DATA PROCESSING SERVICES AND MATERIAL AND SUPPLIES OBTAINED FROM GTEFL AFFILIATES, GTE DATA SERVICES INCORPORATED (GTEDS) AND GTE SUPPLY INCORPORATED (GTES) ARE BASED ON COMPETENT SUBSTANTIAL EVIDENCE AND COMPORT WITH THE ESSENTIAL REQUIREMENTS OF LAW

It has been the policy of the Commission to subject a utility's transactions with its affiliates to a higher degree of scrutiny than transactions occurring in the open market place. In re: Petition of General Telephone Company of Florida to increase its rates and charges; Order No. 10418, 81 FPSC 11:233 (1981); In

re: Petition of ALLTEL Florida, Inc. to increase its rates and charges; Order No. 15627, 86 FPSC 2:19 (1986).

The reasons that affiliate transactions must be subject to a higher degree of scrutiny are obvious. The possibility of channeling a regulatory asset to the affiliate and cross-subsidization at ratepayers expense are always present. The reality of the affiliate relationship may be that the affiliate in fact exists only by virtue of its relationship to the utility. That is, an affiliate which supplies most of its services to the regulated utility might well have no independent existence as a market competitor, if it did not have the utility as its single large customer. The Commission has long been committed to monitoring affiliate relationships and in fact has adopted rules which require telephone companies and other utilities to regularly report affiliate transactions. Rules 25-04.018(2)(b), (c) and 25-4.0185(4), (5), F.A.C.; Rule 25-6.014(9)-(13), F.A.C., and Rule 25-7.014 (8)-(12), F.A.C.

GTEFL does not dispute that a higher standard of scrutiny applies to affiliate transactions. Yet, notwithstanding that GTEDS does some 90 percent of its business with the operating company, GTEFL claims that the Commission's decision to price these services at cost plus an 11.25 percent return on equity was improper. To contest the resulting $4,431,863 adjustment to expenses, GTEFL parades out a series of six separate arguments. These will be discussed in the order presented.

A. THE COMMISSION'S ORDER IS SUPPORTED BY COMPETENT SUBSTANTIAL EVIDENCE.

The undisputed testimony of Public Counsel's DeWard established that GTEDS did some 90% of its business with GTEFL. (T. 1328). On these transactions GTEDS shareholders earned a return of some 24 percent. (T. 1327). Only approximately 10 percent of GTEDS's business was with non-affiliates. (T. 1416).

Mr. DeWard stated his view that the market pricing mechanism utilized in the transactions between GTEFL and its affiliates "allows for abuse in that prices in excess of cost can be charged operating companies, generating excess profits for the non-regulated affiliated companies at the expense of the regulated companies." (T. 1327). Mr. DeWard expressed his belief that GTEFL affiliates were earning excessive returns on equity and advocated that the Commission investigate the Company's relationship with each of its affiliates. (T. 1358).

Testimony of GTEFL's witness McLeod indicated that GTEFL's affiliated interests were in fact being audited at the federal level by the Federal Communications Commission (FCC), with the audit focusing on the issue of market-based pricing versus cost-based pricing. (T. 102-103). GTEFL's witness Johnson also testified that GTEDS and GTES were being investigated by the FCC. (T. 1882-1883). Mr. Johnson also expressed his belief that the Georgia Public Service Commission had issued a request for proposals to audit affiliated transactions of the Company. (T. 1883).

Given the huge volume of business and interdependency between GTEFL and its affiliates, the essential question for the Commission was whether under these circumstances the ratepayer should be required to subsidize the profits of the affiliates. Notwithstanding that the Company presented evidence that GTEDS' non-affiliated business had been increasing and that other similar companies earned averages of over 26 percent on their equity, the Commission concluded that GTEDS' services should be priced at cost plus a return on equity of 11.25 percent. This is the adjustment advocated by Public Counsel's witness, DeWard. (T. 1327). Mr. DeWard testified that this adjustment allows GTEDS "a reasonable return on its investment but substantially reduces the excessive return earned by it during 1991." (Id.) Mr. DeWard also cited the fact that Central Telephone Company of Florida and United Telephone Company of Florida receive the same type of data processing service from their affiliates at cost as another reason he advocated the adjustment. (Ex. 130, pp. 38-39).

The adjustment made by the Commission is consistent with the procedure embodied in FCC's rule set out at 47 CFR Ch. I, Part 32.27(d). That rule requires that affiliate transactions be priced at cost where an affiliate provides "substantially all" of its services to the operating Company. (R. 7284; Ex. 148).

The Commission could reasonably conclude that this adjustment should be made given the evidence before it. The essential facts supporting its decision were that GTED did 90% of its business with GTEFL and that GTED was earning approximately 24 percent on equity,

some 10 percent higher than the 13.6 percent return on equity GTE proposed in its filing. The Commission could also reasonably conclude that the relationship between affiliates and parents also warranted special scrutiny of the transactions between them. Mr. DeWard stated his belief that these transactions were not in fact arm's-length transactions. (T. 1327). The Company's own witness, Mr. Bastain, testified that all of the operating companies contract with the affiliates for the services they provide and that, so far as he knew, none of the operating companies actually relied on the free market place to obtain such services. (T. 1901). Ultimately, the operating companies and the affiliates are responsible to and serve the interest of the parent company. (T. 1900). This is such evidence as a "reasonable mind would accept to support a conclusion." De Groot v. Sheffield, 95 So.2d 912, 916 (Fla. 1957).

B. THE AUTHORITIES CITED BY THE COMMISSION SUPPORT ITS ORDER.

In its final order on reconsideration, the Commission noted that it had accepted Mr. DeWard's position that "charges from GTEDS should be at cost, which includes a reasonable return on investment" (R. 7284). The Commission went on to note this decision was "consistent with our decision set forth in Order No. 10418" (GTEFL's last rate case). The Commission further stated that the adjustment was also consistent with "a recent case involving United Telephone Company of Florida (United)". (Id.). In its brief, GTEFL tries to force the point that these cases do not support the Commission's decision in this case. (Brief at 17-18). It is true that in these cases the Commission did not

specifically apply an interstate rate return on investment to reduce GTEFL's and United's affiliate transactions to cost. However, the Commission did make precisely the same kind of adjustment, even though it did not specifically use a return equivalent to an interstate rate of return allowed by the FCC. In the United case, it adjusted affiliate costs to allow a return of 9.82 percent on payments to affiliates for General Services and Licenses (GS&L) expenses. The Commission concluded that "United should have to pay no more return on parent investment [in affiliates] than it does on its own" and adjusted GS&L allocations by ($72,875). Order No. 24049, 91 FPSC 1:638. The 9.82 percent return was equivalent to United's weighted cost of capital. (Id.).

GTEFL mistakenly identifies the United order referenced in the Commission's final decision as that found at Order No. PSC-92-0708-FOF-TL, 92 FPSC 7:555 (1992), (R. 6439-207; 7229-5). An adjustment for affiliate transactions does not appear to have been a contested issue in this more recent United rate case. Moreover, the Commission's point with reference to GTEFL's last rate case was not that it made an adjustment equivalent to the current adjustment for affiliate transactions but that GTEFL was put on notice that such transactions would be held to a higher degree of scrutiny than in the past. Under the facts of the 1981 case, the Commission was unable to conclude that an adjustment should be made. In its decision the Commission stated:

> "In view of the present movement to a competitive equipment and supply market sector in the telecommunications industry, concerns regarding procurement practices of the

telephone companies must occupy an even greater position of importance. For these reasons, we are inclined to require better cost and price justification for affiliate purchases in subsequent proceedings. More explicit price comparisons and evidence of active outside bid solicitations should accompany future transactions to insure reasonableness and prudency therein." (81 FPSC 11:233, 242).

The precedent established in these cases and in other Commission's decisions cited above are consistent with the Commission's treatment of affiliate transactions over the years. As indeed this case shows, the Commission had never taken the position that it will make certain adjustments no matter what the evidence shows. It has established a standard by which such transactions will be judged and it has applied that standard consistently.

There is no legal requirement that prevailing market prices be accepted as the standard of reasonableness for a utility's operating costs. General Telephone Company of Upstate New York, Inc. v. Lundy, 218 N.E.2d 274 (N.Y. 1966); 64 PUR 3d 302, 306 (N.Y. 1966). Indeed, as the Lundy case observes, where the combined buying power and volume of GTE operating companies allow them to virtually dictate the prices charged by their affiliated suppliers, " 'little , if any, weight' can be accorded to price comparisons in judging whether or not the petitioner was overcharged". (Citations omitted). (Id. at 307). This Commission could, as many other state commissions have done, reasonably set the operating company's affiliate expenses at cost plus a rate of return in line with the utility's own allowed return. See, Re General Telephone Company of

Illinois, 6 PUR 4th 90, 96 (Ill. Commerce Commission 1974) (Commerce Commission stated that it was "of the view that it is bound to apply to affiliate transactions a return equivalent to that hereinafter adopted as fair and reasonable for the utility."); Re Midstate Telephone Company, Inc., 10 PUR 4th 88, 90 (N.Y. P.S.C. 1975) (New York PSC found that material and supplies affiliate of Midstate, Buckeye Telephone and Supply Company, which acted as purchasing agent and was "integral part of the public utility operation" should be limited to rate of return of the utility system in prices it charged telephone operating company).

C. THE COMMISSION'S DECISION IS NOT ARBITRARY AND CAPRICIOUS SIMPLY BECAUSE IT MADE DIFFERENT ADJUSTMENTS FOR GTEDS AND GTES.

The Commission candidly acknowledges in its final order on reconsideration that there is an "inconsistency" in its adjustments to GTED and GTES expenses. (R. 7285). In the case of GTES, the Commission found, based on the evidence, that GTEFL should be allowed to claim expenses up to one-half the excess profit recovered by GTES in its sales to the operating companies. The Commission saw this as an incentive to reward the efficiencies and benefits to GTEFL from its supply affiliate. Presumably, GTEFL does not argue with the existence of such benefits and the appropriateness of an incentive in its dealings with GTES.

The Commission does not dispute that as a general proposition it should apply its policies in an even-handed manner and explain their development and modification. However, in this case it is not a question of inconsistent application of policy. The policy

is to carefully scrutinize the transactions as the Commission told GTE it would in its 1981 rate case. That is precisely the policy that was applied in this case to both GTEDS' and GTES' transactions. The Commission believed on the facts that the Company did deserve some incentive to continue development of its affiliate relationships, rather than transferring such operations in-house or procuring services only in the open market. (R. 7286).

The Company's witnesses presented detailed testimony on the virtues and benefits of GTEFL's relationship with GTES. (Brief at 19-20). The Commission could reasonably conclude that there were benefits present in the case of GTES which deserved an incentive. The Commission's discretion to reward favorable corporate policies by granting incentives was recognized by this Court in Gulf Power Company v. Cresse, 410 So.2d 492 (Fla. 1982). In that case the Commission granted Gulf a 10-basis point reward on its equity return for its conservation efforts. Conversely, the Commission penalized Gulf in Gulf Power Company v. Wilson (Fla. 1992) by imposing a 50-basis point penalty for mismanagement.

The important point concerning the adjustment to GTEDS' costs is not that the Commission found that GTES was entitled to something more than GTEDS. The significant point is rather that the Commission found that, given the GTEDS' 90 percent volume of business with GTE affiliates and a profit rate of some 24 percent, the Company's ratepayers should not be required to reward the parent Company with excess profits on its affiliate operations. GTE Corporation owns GTEDS. It also own the operating companies

like GTEFL, which supply virtually all the business to GTEDS. Given this circumstance, that the market created by the operating company drives the existence of the data processing affiliate, it is reasonable to conclude that the shareholders should not receive a substantially different return on their investment in the affiliate than in the operating company. (T. 1327).

D. THE COMMISSION'S DECISION DOES NOT CREATE A NEW POLICY.

The Commission's policy on affiliate transactions is and has been for a long time that, given the potential for abuse and cross subsidization, such transactions must be subjected to a higher level of scrutiny than those occurring in the open competitive market place. The Commission could not have made that more clear than in its order in GTEFL's 1981 rate case cited above. It is the application of this policy to the particular facts of this case which the Company in its brief has mistakenly labeled a change of policy.

The Commission noted in its 1981 order that there could be benefits and efficiencies occurring from the affiliate relationships. However, it also noted that it was another question as to "whether the fair proportional share of these benefits accrue to General Telephone's Florida subscribers . . . ." 81 FPSC 11:233, 242 (1981).

In view of the extent of the transactions between GTEDS and the GTEFL and the level of profits being charged to ratepayers by the GTEDS, the Commission did not feel that the benefits of this relationship justified the cost. In the final analysis, GTEFL's

argument seems to be that, because it has an affiliate which can sell huge quantities of its services to the operating companies, it ought to be able to recover any expense, if the prices are in the ballpark compared to prices in the market place. Presumably, ratepayers ought to have to pay the affiliate a 100 percent return on investment, if other non-affiliate companies can get that price. The Commission simply cannot accept that logic, given GTEDS small non-affiliate market share. It is clearly the ratepayers money that supports the existence of GTEDS, and that needs to be recognized, as it has been recognized by other commissions.

E. THE COMMISSION HAS NOT IMPOSED AN IMPOSSIBLE BURDEN OF PROOF ON GTEFL.

The expense allowances made in this case ought to be clear enough demonstration that the Commission has not imposed an impossible burden of proof on GTEFL as it argues. Moreover, the adjustment made to GTES shows that in a proper instance GTEFL can convince the Commission that the benefits of the affiliate relationships are such that the ratepayers ought to have to pay a higher return on investment to the affiliate shareholders even though it is fundamentally the ratepayers dollars which support the existence of the affiliate.

II.

THE COMMISSION'S ADJUSTMENT TO GTE SUPPLY EXPENSES IS SUPPORTED BY COMPETENT SUBSTANTIAL EVIDENCE AND COMPORTS WITH THE ESSENTIAL REQUIREMENTS OF LAW.

The record in this case shows that GTES did some 85% of its total business with affiliates such as GTEFL. The remaining 15% constituted sales to non-affiliated companies. (T. 1898). Sales

were made to approximately 2,000 non-affiliates amounting to some $100,000,000 out of total sales of some $600,000,000. (T. 1895-1899). GTEFL's witness, Bastain, admitted that this volume is driven by sales to the GTE operating companies such as GTEFL. (T. 1912).

GTEFL's witness, Mr. Banta, stated that GTES acts as GTEFL's agent in furnishing supplies and that under their agreement GTEFL would receive terms comparable to, or better, than those offered to other customers. (T. 863-64). Witness Bastain stated that an independent study demonstrated that the GTE operating companies received more favorable pricing from GTES than they could from other vendors. (T. 1912-15). He further stated that these prices are about 12% lower than the average of the two lowest price competing vendors. (T. 1915).

One of the other advantages cited by GTEFL's witnesses was that GTES maintains nationwide warehousing capabilities and standard information systems which contribute to efficiency and order processing and reduce administrative and transaction costs for GTEFL. (T. 1891-1892; 1901-1903).

Opposing the Company's sanguine endorsement of its affiliate transactions, Public Counsel's witness DeWard proposed the same adjustment for GTES than he had for GTEDS. That is, he proposed allowing GTEFL only a return on equity of 11.25 percent in the costs paid to GTES. This would result in an adjustment to operating expense of ($148,437). (T. 1329). Mr. DeWard also proposed that adjustments be made to remove excess cost of

materials and supplies which have been capitalized and included in plant and service. (Ex. 130).

Commission staff originally recommended reducing the return on equity in affiliate transactions with GTES to 11.25 percent as for GTEDS. Staff would have further made reductions to remove capitalized expenses and adjust depreciation also. (R. 6439-209). However, at the agenda conference the Commission, in full knowledge of the record before it and having heard the testimony of the witnesses on GTES' costs, and having questioned them directly, decided that in this instance it was appropriate to allow an incentive to GTEFL to take advantage of its relationship with the supply affiliate. In its order the Commission stated:

> We agree that GTES is entitled to a return on its investment in inventory. We do not agree that the general body of ratepayers should be subjected to potential predatory pricing by non-regulated affiliates. At the same time, we do not wish to discourage the efficiencies and economies of scale engendered through consolidation and affiliate transactions. Accordingly we find it appropriate to disallow one-half of GTES' embedded return on investment over the current FCC authorized overall rate of 11.25 percent." (R. 6740).[2]

The Commission had to weigh the obvious benefits to GTES of its close business ties to GTEFL against the benefits accruing to the ratepayers by virtue of the apparent efficiencies of the affiliate operations. It was a matter of discretion for the Commission to find that, on balance, it was better to continue to encourage the relationship between GTEFL and GTES by the granting

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[2]On reconsideration, the Commission withdrew its reference to predatory pricing as a relevant issue. (R. 7285).

of an incentive of one-half of the excess profits above the 11.25 percent return advocated by Mr. DeWard and recommended by staff. See, Gulf Power, supra.

What GTEFL is asking the Court to do in this case is to negate the Commission's exercise of judgment and substitute its own for that of the regulatory agency. The Commission was authorized to balance the competing evidence before it in light of its policy on affiliate transactions and to render a decision which it believed was appropriate for those transactions based on the facts presented. Another Commission might reach a different decision based on the evidence presented; however, that does not invalidate the Commission's exercise of judgment in this case.

III.

THE COMMISSION'S DEFERRAL OF $10,000,000 IN FAS 106 COST IS SUPPORTED BY COMPETENT SUBSTANTIAL EVIDENCE AND COMPORTS WITH THE ESSENTIAL REQUIREMENTS OF LAW.

In its final order, the Commission recognized that the implementation of FAS 106 required GTEFL to begin accruing some $21,000,000 in other post-employment benefits (OPEBs). (R.6746-6747). The Commission allowed $11,264,765 of the incremental intrastate FAS 106 expenses in cost of service. (R. 6755) However, it directed the Company to defer $10,000,000 of the expense until January 1, 1994. (Id.). The $10,000,000 in FAS 106 cost was treated as a regulatory asset producing an adjustment to the Company's working capital of $5,012,865. (Id.). The $10,000,000 will be amortized beginning in 1994 at the rate of $2.5 million per year. (Id.). This amount will be recognized each year

as a legitimate expense of the Company and will be considered in the Commission's ongoing evaluation of earnings through surveillance reports.

GTEFL raises a series of arguments in an attempt to have this Court second-guess the Commission's decision. They are without merit.

A. THE COMMISSION'S DECISION WAS SUPPORTED BY COMPETENT SUBSTANTIAL EVIDENCE.

In its order, the Commission found that, based on the financial data submitted by the Company, GTEFL should have increased earnings of approximately $23,000,000 beginning in 1994. (R. 6754). The Commission found that these projected earnings, along with considerations of the uncertainty of final FAS 106 costs, made it appropriate to defer $10,000,000 in OPEB expenses. It concluded "this will delay recognition of part of the FAS 106 cost until after the test year, when increased earnings will absorb the deferred cost, thereby mitigating the effect on GTEFL's ratepayers". (R. 6755).

The testimony of GTEFL's witness Wellemeyer supported the Commission's adjustment. Mr. Wellemeyer indicated that, beginning in 1994, GTEFL would not have to bear the cost associated with the FCC ordered phase-downs or shifts in Subscriber Plant Factor (SPF) and Dial Equipment Minute (DEM). (T. 926-927). Mr. Wellemeyer indicated that these costs, which had begun in 1986, had increased the Company's annual revenue requirement by $19.7 million per year in terms of 1991 dollars. (Id.) Mr. Wellemeyer further noted that the Company had never filed tariffs to seek to recover these costs

and that over the years it had been able to absorb the $102 million in expense without seeking a rate increase. (Id.)

Contrary to the position taken by GTEFL in its brief, there is a significant revenue impact for the Company beginning in 1994. It will no longer have to pay the costs associated with the phase-out of SPF and DEM. Public Counsel's witness DeWard testified that, assuming that GTEFL's revenue and expenses and investment in 1994 were essentially the same as in 1993, then one would expect intrastate earnings to improve from the removal of the SPF and DEM expenses. (T. 1440).

Consistent with the Company's position taken in the Prehearing Order on Issue 25-I, GTEFL's witness Johnson stated that it was the Company's position that it did not know of anything which would cause the relationship of expenses, revenues and investments to change significantly from 1993 to 1994. (R. 5700; T. 1872). Mr. Johnson further stated that the Company had not completed a budget for 1994 and that he was "not even sure the Company has begun its 1994 budget process." (Id.).

The evidence before the Commission showed that GTEFL did not expect significant changes in its expenses or investments during 1994, when the deferral of the FAS 106 costs was to begin. Although the Company maintained that it expected no significant increase in revenues either, it did indicate that the SPF and DEM costs would no longer be incurred. Further, the Company did not provide the 1993 and 1994 budget information which would have supported a projection of financial conditions for those years.

Public Counsel's Mr. DeWard stated that he had requested budget data for 1993 and 1994 from the Company but had received only information relating to a strategic plan which was not actually the budget information. (T. 1443). GTEFL's criticism in its brief of Mr. DeWard's lack of budget information is hardly well-taken, since the Company did not provide any in response to his request. (Id.).

The Commission did not arbitrarily project a $23,000,000 increase in revenues for GTEFL. On the contrary, the basic information supporting this projection was provided by the Company itself. As shown in the staff's recommendation to the Commission, the projections adopted by the Commission in its order were derived from the Company's own minimum filing requirements. (R. 6439-249; 6754). Moreover, the attrition study which GTEFL refers to in its brief as "uncontested" is of no significance as an indication of GTEFL's 1994 earnings. In fact, the attrition allowance was never included in GTEFL's original $110,997,618 revenue request nor in its revised request for gross annual revenues of $65,994,207. (T.779; Ex. 103, Sched. 12; T. 783-785; Ex. 104). If the Company did not feel that attrition was significant enough to be part of its case, the Commission could hardly be expected to rely on the study to show the effect on 1994 earnings.

Another reason the Commission found to defer part of the FAS 106 costs beginning in 1994 was that "GTEFL itself could reduce FAS 106 cost." (R. 6754). GTE's witness Mr. Johnson testified that the Company intended to establish a Voluntary Employees' Beneficiary Association Trust (VEBAT) authorized by Section 501(c)

(9) of the Internal Revenue Code (IRC). (T. 845). GTEFL's VEBAT would be the subject of collective bargaining with the union representing some 75 percent of total GTEFL employees. (Ex. 36, p. 46; Ex. 44, p. 3; Ex. 143; Ex. 37, p. 36). Such retiree benefits are negotiated each time the union contract is renegotiated. The then current contract was to expire on July 31, 1993. (Ex. 44, p. 3-4). Witness Johnson testified that under the IRC, a bargaining unit VEBAT must be established at the time benefits are bargained for. (Ex. 37, p. 65).

Public Counsel's witness DeWard testified that the bargaining unit VEBAT has tax advantages over a non-bargaining unit VEBAT and gives employees a greater assurance that they will receive the benefits bargained for. (T. 1361-1362). Mr. DeWard also stated his belief that, because of the greater certainty of the realization of the benefits in the bargaining unit VEBAT, the Company could use it as leverage to lower costs for OPEBs, and perhaps other types of benefits. (Id.).

In its final order, the Commission concluded that the VEBAT issue interjected a note of uncertainty into the final determination of GTEFL's FAS 106 costs. (R. 6754).

Based on the foregoing evidence, the Commission could reasonably conclude that GTEFL could and should be required to defer $10,000,000 in FAS 106 costs beginning in 1994. Moreover, contrary to the Company's assertion in its brief, there is no meaningful difference between the basis of this decision and that made in the United Telephone Company of Florida's rate case

(United). (Order No. PSC-92-0708-FOF-TL, 92 FPSC 7:555, 590 [1992]).

In the United case, the Commission found that increased earnings and the fall-off of depreciation amortization would allow the Company to absorb $4,844,500 of FAS 106 costs. (Id.). The amortization period in the United case was 18 months. (Id.). The Commission made exactly the same kind of adjustment for United as it did for GTEFL in this case. It is no criticism of the Commission's decision that the evidence submitted by United on its 1993-1994 earnings was more complete than that presented by GTEFL. It was GTEFL's financial data and the testimony of its witnesses which led the Commission to believe that the Company would in fact experience enough increased revenue to absorb the deferred FAS 106 expense.

B. THE COMMISSION'S DECISION IS CONSISTENT WITH THE TEST YEAR CONCEPT, RATEMAKING POLICY AND APPLICABLE CASE LAW.

This Court has recognized that the test year is not a sacrosanct concept. It is an analytical device that measures the utility's current level of investment and income to determine what revenues will be necessary for a fair rate of return in the future. Citizens of Florida v. Hawkins, 356 So.2d 252, 256 (Fla. 1978); Gulf Power Company v. Bevis, 289 So.2d 401 (Fla. 1974). This Court has never held that the Commission is without discretion to make deferrals or otherwise modify recovery of expenses identified by a company in its test year. For example, in Southern Bell Telephone and Telegraph Company v. Florida Public Service Commission, 443 So.2d 92 (Fla. 1983), relied on by GTEFL in its brief for the

definition of a test year, the Court upheld the Commission's discretion to reject two pro forma adjustments representing what the Company characterized as "known and imminent changes." These amount to some $59,000,000 in increased costs for wages and benefits and settlement costs. (Id. at 95). Instead of allowing the adjustments to test year expenses, the Commission chose to calculate an attrition allowance of $12,700,000 (Id.). Similarly, in Florida Bridge Company v. Bevis, 363 So.2d 799, 801 (Fla. 1978) the Court recognized the Commission's discretion to amortize non-recurring legal fees over a period of five years and to amortize maintenance expense over a five-year period where it was found to be extraordinarily high.

There is no essential difference in this type of deferral and the deferral of FAS 106 cost in GTE's rate case. It is a matter of the Commission's discretion to determine how expenses should be recognized where appropriate circumstances exist. Whether it is an unusually high expense appearing in the test year, or a non-recurring costs, the Commission must consider what level of expense will be recognized in rates, taking into account the Company's financial condition, the interest of the ratepayers and the shareholders. That is precisely what the Commission did in this case, based on its best estimate that GTE's earnings would be sufficient to absorb the deferred cost. After all, GTEFL's ratepayers stood to receive a considerable wallop from the $21,000,000 in additional FAS 106 costs.

GTEFL's reliance on Broward County Traffic Association v. Mayo, 340 So.2d 1152 (Fla. 1977) is misplaced. In that case, the Court found that the Commission had erred for exactly the opposite reason than what occurred in this case. In Broward County, the Commission granted the carriers rate relief which they had not even requested to account for inflationary factors supposedly occurring after the application was filed. The Court rejected these adjustments. It found that the Commission had abused its discretion by recognizing an out of period adjustment which was based on "undocumented conclusions as to general economic conditions". (Id. at 1153).

As discussed above, the Commission had an evidentiary basis, reflected in the Company's own data and testimony, on which to base its deferral of FAS 106 costs. It was not speculating about "general economic conditions", but was analyzing specific conditions related to the Company's revenues, expenses and investments. The Commission neither handed GTEFL's shareholders a bonus nor arbitrarily deprived them of the opportunity to earn a fair return. The Commission was balancing those interests as is its duty to do. FPC v. Hope Natural Gas Company, 32 U.S. 591, 64 S.Ct. 281, 88 L.ED. 333, 345 (1944). As the U. S. Supreme Court observed in the Permian Basin Area Rate Cases, 390 U.S. 747, 88 S.Ct. 1344, 20 L.ED. 2d 312, 337 (1968), the "investors' interests provide only one of the variables in the constitutional calculus of reasonableness". (Citations omitted).

C. **THE COMMISSION'S DEFERRAL OF FAS 106 COSTS NEITHER VIOLATES PROCEDURAL NOR SUBSTANTIVE DUE PROCESS.**

The Company's claims that it did not receive adequate notice of a possible deferral of FAS 106 costs is exaggerated. The issue of treatment of FAS 106 costs in 1994 and beyond was clearly raised in Issue 25-I of the Commission's Prehearing Order. That issue and the Company's position were as follows:

> **ISSUE 25-I:** Should the Company be allowed to recover the cost of providing post-retirement benefits other than pensions, beginning in 1993, showing expected earnings and returns in 1994?
>
> **GTEFL's POSITION:** The Company has not produced any 1994 budget data and is unaware of any changes occurring in 1994 relative to the 1993 rate year which will produce any significant changes in the level of earnings. Therefore, the Company should be allowed to recover the cost providing post-retirement benefits as depicted in the Company's revised direct case. (Johnson) (R. 5700).

Clearly, the issue as presented raised the question of what effect 1994 earnings would have on recognition of FAS 106 expenses. The Company's rather self-serving position on the issue seems to be directed toward avoiding the question. It strains credibility for GTEFL to say that it could not have known that deferral of some of the costs was an option. This is especially true in light of the Commission's decision in the United case. The final order in that case was issued on July 24, 1992, and the prehearing conference took place on September 18, 1992. Moreover, Public Counsel took the position on this issue that the Company should not be allowed to collect any FAS 106 costs. (R. 5700).

GTEFL's claim that it was unfairly surprised by staff's recommendation for deferral of FAS 106 costs is without merit.

Staff's job is to analyze the evidence presented by the parties in an proceeding and to make a recommendation to the Commission for final disposition of the case. Based on what was presented by the Company and others in this case, after it had reviewed the voluminous record and filings of the parties, staff recommended deferral of $10,000,000. It is not a violation of due process that the staff, which was not an advocate on this issue, did not take a position on FAS 106 costs until after the evidence was heard. In any case, it should also be noted that the issue of deferral was raised in staff's cross-examination of Public Counsel's Mr. DeWard (T.1449). The issue of 1994 earnings and the effect of the SPF and DEM phase-out was broached by the Company's own witness Mr. Johnson. (T. 1872).

GTEFL's arguments that its substantive due process rights have been violated are equally suspect. GTEFL asserts that the expense of the $10,000,000 in deferred FAS costs will be borne by GTE shareholders. However, there is not even an allegation in the argument presented in the Company's brief that it would in fact earn below its authorized range of return on equity. It does state that its "return will be reduced starting in 1994 due to the unfunded amortization." (Brief at 39). The Company's claim can be considered little more than speculation. It even acknowledges that it is not without remedy, should it choose to pursue a rate increase. (Id.). Moreover, the alleged harm to the utility will not begin until 1994 when amortization of the deferred amount begins. It has essentially had the entire year of 1993 to

determine if it should pursue rate relief for these costs, and it has not done so.

In the final analysis, the Company would again have the Court second-guess the Commission's decision based on the Court's interpretation of the evidence presented. As the Court is well aware, that is not its role. Citizens of Florida v. Public Service Commission, 435 So.2d 784 (Fla. 1983).

IV.

THE COMMISSION'S REMOVAL OF GTEFL'S INVESTMENT IN ITS SUBSIDIARY, GTECC, ENTIRELY FROM EQUITY IS SUPPORTED BY COMPETENT SUBSTANTIAL EVIDENCE AND COMPORTS WITH THE ESSENTIAL REQUIREMENTS OF LAW.

A. THE COMMISSION'S ADJUSTMENT TO REMOVE GTECC INVESTMENT 100% FROM EQUITY IS SUPPORTED BY THE RECORD AND INVOLVES FUNDAMENTALLY DIFFERENT REGULATORY CONSIDERATIONS THAN THE PARENT-DEBT ADJUSTMENT RULE.

GTEFL seizes upon language in the Commission's parent-debt adjustment rule, Rule 25-14.004, Florida Administrative Code, to argue that Commission should always presume that the capital structure of a non-regulated subsidiary reflects the mix of equity and debt in the parent's capital structure. The weakness of this argument is that the parent-debt adjustment and the adjustment made in GTEFL's rate case to remove non-regulated investment 100% from equity involve fundamentally different ratemaking considerations.

As this Court recognized in its decision rejecting GTEFL's 1984 challenge to the parent-debt adjustment rule, the basic purpose of the allocation of interest expense to the subsidiary is to determine an "income tax expense figure which realistically reflects the actual cost incurred by the utility". General

Telephone Company of Florida v. Florida Public Service Commission, 446 So.2d, 1063, 1069 (Fla. 1984). The basis of the adjustment is simply that the debt of the parent used to finance the equity of the subsidiary generates interest which is taken into account in the filing of a consolidated tax return. To ignore that interest effect would be to ignore the advantages the subsidiary receives in its tax expense through the filing of the consolidated return with the parent.

The Court noted in its General Telephone opinion that, in setting income tax expense, "the PSC attempts to ascertain a pragmatic figure which reflects the actual cost to the utility of providing service to the ratepayers." (Id. at 1068). The Court also observed that the "PSC is not bound to any predetermined formula for calculating any cost of service expense, but instead it is free to use any method which will enable it to ascertain the actual cost to the utility." (Id.).

The equity adjustment in the GTEFL rate case was not an attempt to allocate expense effects of the parent's capital structure to the subsidiary. As the Commission explained in considerable detail in its final order, and in its order on reconsideration, the purpose of removing the GTECC investment 100% from equity was to "balance the increased equity ratio GTEFL must maintain due to the riskier investment." (R. 6704; 7298).

There is ample support in the record of this proceeding for the Commission's adjustment. Public Counsel's witness DeWard advocated that the GTECC investment be removed 100% from equity

consistent with the Commission's past practice.[3] (T. 1313) Mr. DeWard stated in his deposition that, as a general proposition, he believed non-regulated investment should be assumed to have come from equity capital sources only. (Ex. 130, p. 16). Mr. DeWard also said that investors required a higher return for riskier investments and that GTECC was a riskier investment than the operating company, GTEFL. (Id.). Public Counsel's witness, Cicchetti, testified that investments in an unregulated activity increased the business risk of the regulated utility. (T. 658). GTEFL's witness Johnson also conceded in his deposition that investors require higher returns for riskier investments and that GTECC's operations were more risky. (Ex. 36, p. 12). GTEFL's witness Hanley also conceded that, as a general matter, unregulated business activities were more risky than regulated activities and that the Company would tend to increase it equity ratio in response to the increasing business risk. (T. 563).

Public Counsel witness Cicchetti further noted that GTEFL's actual equity ratio, according to its latest surveillance report at the time of the rate case, was 54.9% equity and that in its revised filing it was asking for 58.25% in investor capital. (T. 613). Mr. Cicchetti cautioned that regulators should be aware of and address the manipulation of the capital structure which could cause

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[3] For example, Order No. 23573 (Gulf Power Company rate case), 90 FPSC 10:195, 215 (1990) (higher risk non-utility investments removed 100% from equity); Order 24013 (City Gas Company), 91 FPSC 1:395, 414 (1991) (non-utility plant and working capital removed consistent with policy of removing non-utility investments 100% from equity).

ratepayers to subsidize the riskier non-utility investments made by the utility's parent or affiliates. (T. 613). Such subsidization can occur either through higher cost of capital to cover the riskier investments or through higher equity ratios than would be necessary for the utility operations alone. (T. 613-614). Mr. Cicchetti further testified that GTEFL's parent, GTE Corporation, had an incentive to rely on the earnings of its regulated affiliates to support its higher risk investments in non-regulated businesses. (T. 637).

Based on the evidence before it, the Commission could reasonably conclude that the GTECC represented a riskier investment in GTEFL's capital structure which tended to increase the utility's cost of capital. It could also reasonably conclude that it was appropriate to make an adjustment to remove the GTECC investment from equity capital to prevent subsidization by the ratepayers of the non-regulated entity's operation. This adjustment is entirely consistent with the Court's finding in General Telephone, supra, that the Commission is not bound to any particular formula to determine any cost of service expense. Rather the Commission is "free to use any method which will enable it to ascertain the actual cost to the utility". 446 So.2d 1068.

The Commission's adjustment was necessary to approximate the actual cost of capital that the utility ratepayers should bear in the Company's rates. That has little to do with the parent-debt adjustment which embodies the methodology to calculate a reasonable tax expense for the regulated entity. There is certainly no legal

requirement that the Commission adhere to the methodology contained in its tax expense rule to determine a reasonable equity capital ratio for the regulated entity.

B. THE COMMISSION'S DECISION TO REMOVE THE GTECC INVESTMENT 100% FROM EQUITY WAS CONSISTENT WITH ITS DECISION IN UNITED TELEPHONE OF FLORIDA'S 1992 RATE CASE.

In United's last rate case, the Commission removed the utility's non-regulated investment pro rata from the capital structure instead of 100 percent from equity. The Commission carefully explained its reasons for not removing United's non-regulated investment 100 percent from equity, as Public Counsel had advocated, and as had been the Commission's past practice. It stated

> We recognize that regulated utilities are of relatively low risk and have correspondingly lower costs of capital. We also recognize that UTF's non-regulated investments increase the Company's risk, and its cost of capital, above what may be necessary for the provision of regulated telephone service. Therefore, UTF's investments in UTLD and other non-regulated activities do increase the riskiness of UTF. However, by reducing the ROE to 12.5 percent, which is analogous to that of comparable risk companies, and adjusting the equity ratio to 57.5 percent, we can alleviate concerns regarding financial cross subsidization through the cost of capital and ensure that only the fair and reasonable cost of providing regulated telephone service is passed on to the ratepayers. Accordingly, we find that UTF's non-regulated investments be removed from the capital structure pro rata from the investor-supplied sources of capital. (92 FPSC 7:555, 601-602 (1992).

The Commission stated in its United order that it believed that the problem of ratepayers bearing unnecessary risks of non-regulated investments had been alleviated by its reduction of the

Company's return on equity and reduction of the equity component of the capital structure to 57.5 percent. In its order on reconsideration in GTEFL's case, the Commission discussed the nature of its adjustment in the United case and further explained that

> "[i]n the UTF proceeding, because the equity ratio adjustment was in excess of the amount of the non-regulated investment which could have been removed from equity, the non-regulated investments from equity adjustment was unnecessary. (R. 7298)."

Both the United and the GTEFL adjustments to equity accomplished the same goal of establishing a reasonable cost of service for ratepayers. The Commission acted within its discretion in applying a methodology which did not apply "double-hit" to United's equity capital. The effect of the adjustment in United was to remove enough equity from the capital structure so that the resulting level was at, or actually below, that which would have resulted had the non-regulated investments been taken entirely out of equity. GTEFL certainly does not have any basis to complain that it wasn't treated the same way that United was. Even if it were, it was within the Commission's discretion to make slightly different adjustments based on the facts presented. General Telephone, supra.

CONCLUSION

GTEFL has made an exhaustive presentation to the Court of essentially the same arguments that it presented to the Commission on reconsideration. Protestations to the contrary notwithstanding, GTEFL has asked the Court to look at the decision again and substitute its judgment for that of the Commission. That, as the Court well knows, would be inappropriate. Citizens, 435 So.2d 784. GTEFL has failed to establish that the Commission acted outside the bounds of its ratemaking discretion or that its decision was not supported by the record. It has failed to meet its burden to overcome the presumption of correctness which attaches to Commission's orders. City of Tallahassee v. Mann, 411 So.2d 162 (Fla. 1981). The Commission's Order Nos. PSC-93-0108-FOF-TL and PSC-93-0818-FOF-TL should be affirmed.

Respectfully submitted,

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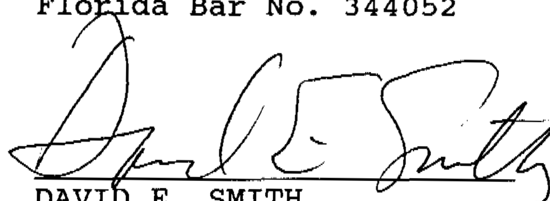

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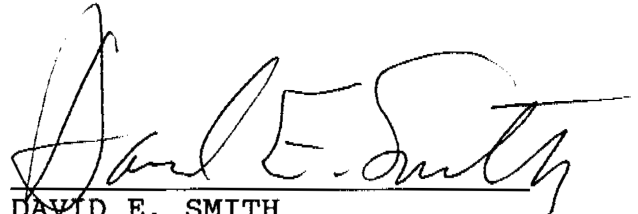
Dated: September 23, 1993

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and accurate copy of the foregoing has been furnished by United States mail this 23rd day of September, 1993 to the following:



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