

## BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of Citizens of the State of Florida for a limited proceeding to reduce General Telephone Company of Florida's authorized return on equity	)	DOCKET NO. 870171-TL
	)	
	)	
	)	
In re: Investigation into the proper application of Rule 25-14.003, F.A.C., relating to tax savings refunds for 1988 and 1989 for GTE Florida Incorporated	)	DOCKET NO. 890216-TL
	)	ORDER NO. 21925
	)	ISSUED: 9-20-89
	)	

Pursuant to Notice, a Prehearing Conference was held on September 13, 1989, in Tallahassee, Florida, before Commissioner Gerald L. Gunter, as Prehearing Officer.

## APPEARANCES:

THOMAS R. PARKER, Esq., JAMES V. CARIDEO, Esq., JOE W. FOSTER, Esq., & WAYNE L. GOODRUM, Esq., GTE Florida Incorporated, P. O. Box 110 MC 7, Tampa, Florida 33601 on behalf of GTE Florida Incorporated.

CHARLES J. BECK, Esq., CHARLES J. REHWINKEL, Esq., & JACK SHREVE, Esq., Office of Public Counsel, c/o The Florida Legislature, 111 West Madison Street, Room 801, Tallahassee, Florida 32399-1400 on behalf of the Citizens of the State of Florida.

DONALD L. CROSBY, Esq., & TRACY HATCH, Esq., Florida Public Service Commission, 101 E. Gaines Street, Tallahassee, Florida 32399-0862 on behalf of the Commission Staff.

PRENTICE P. PRUITT, Esq., Florida Public Service Commission, 101 E. Gaines Street, Tallahassee, Florida 32399-0862 on behalf of the Commissioners.

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PREHEARING ORDER

I. BACKGROUND

Docket No. 871206-PU is a generic docket that was opened to investigate the 1988 effects of the Tax Reform Act of 1986 (the Act) on all utilities under the Commission's jurisdiction. At the Agenda Conference on December 1, 1987, Staff recommended in this docket that the Commission order a portion of each utility's 1988 revenues be collected subject to refund pending the outcome of this generic investigation. The Commission deferred action on this recommendation until the utilities had an opportunity to offer protection to their ratepayers through an alternative to collecting revenues subject to refund.

On December 8, 1987, GTE Florida Incorporated (GTEFL) sent a letter to the Commission in which the company committed to make the 1988 effects of the Act retroactive to January 1, 1988, pursuant to the terms of the letter. By Order No. 18661, issued January 7, 1988, the Commission accepted GTEFL's commitment and excluded the company from any requirement that revenues be collected subject to refund. By Order No. 20269, issued November 7, 1988, the Commission proposed to adopt a cap of 14.25% on the 1988 and 1989 earnings of GTEFL. Order No. 20269 stated that GTEFL would be excused from further participation in Docket No. 871206-PU if the Proposed Agency Action were to become final.

The Office of Public Counsel (OPC) and the Florida Consumers for Responsible Utilities (FCRU) filed protests (the Protests) to Order No. 20269 on November 22, 1988. On December 27, 1988, GTEFL moved to strike the Protests, arguing that OPC and FCRU were improperly attempting to place return-on-equity (ROE) and earnings matters at issue in the generic investigation dealing with tax matters. OPC responded on January 9, 1989, asserting that its suggested return-on-equity and earnings issues are relevant to the application of Rule 25-14.003, Florida Administrative Code (the Tax Rule), which establishes procedures for dealing with changes in the corporate income tax laws.

On January 20, 1989, GTEFL amended its motion to strike, claiming that the company has returned to its ratepayers the

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savings it realized from the Act and that any action in Docket No. 871206-PU forcing it to dispose of additional revenues would expose the company to "double jeopardy." GTEFL also moved for the establishment of a two-phase procedural process under which, first, the company's action with regard to its tax savings could be considered, and second, a prospective ROE could be set for GTEFL. OPC filed its response to GTEFL's pleading on January 31, 1989, quarreling with the company's allegation that its tax savings have been "given back" to its customers.

By Order No. 20800, issued February 23, 1989, the Prehearing Officer denied GTEFL's motions to strike and rejected its proposed procedural process. Order No. 20800 held that all issues which led the Commission to open Docket No. 871206-PU need to be resolved and that their consideration is the proper focus of the generic investigation, including ROE and earnings issues which were deemed to be fundamental to this proceeding. The only issues rejected by Order No. 20800 as falling outside the scope of this proceeding were those dealing with the events (e.g., GTEFL's offer of a cap on earnings) that led up to the action proposed in Order No. 20269.

On October 20, 1988, OPC served a request for production of documents on GTEFL, and on December 9, 1988, GTEFL filed a response and objection to this request. OPC filed a motion to compel on December 13, 1988, and GTEFL responded on December 27, 1988. By Order No. 20799, issued February 23, 1989, the Prehearing Officer compelled GTEFL to produce for inspection the documents sought by OPC. Judgement was reserved in Order No. 20799 on the question of the appropriate treatment to be afforded these documents in the event that OPC seeks to take possession of copies of them.

On March 6, 1989, GTEFL filed separate motions for review of Orders Nos. 20799 and 20800 by the full Commission. GTEFL argued that ROE, capital structure and 1988 and 1989 earnings issues are irrelevant to this proceeding and should have been stricken by the Prehearing Officer. According to GTEFL, the Commission should decide the legal question involving its "double liability" argument before considering any factual issues. Similarly, the company complained that it should not have been compelled to produce documents sought by OPC which relate to cost of equity and earnings because they are irrelevant. Also on March 6, 1989, OPC filed a motion for

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reconsideration of Order No. 20800, charging that issues involving the action proposed in Order No. 20269 were improperly excluded from consideration in this proceeding by Order No. 20800. By Order No. 21208, issued May 9, 1989, the Commission denied these motions for review and reconsideration and affirmed Orders Nos. 20799 and 20800.

By Order No. 20857, issued March 6, 1989, the Commission transferred the Protests to a separate docket, Docket No. 890216-TL, set up to deal with GTEFL specifically and excused the company from further participation in Docket No. 871206-PU. OPC and FCUR were granted party status in Docket No. 890216-TL which was conferred upon them by the Protests filed in the generic investigation.

Several of the issues addressed in the Protests had been raised previously by OPC in a Petition seeking a limited proceeding to reduce GTEFL's authorized return on equity. Docket No. 870171-TL had been opened to resolve the issues raised in the Petition. By Order No. 19637, issued July 8, 1988, the Commission required GTEFL to answer OPC's Petition, and on July 18, 1988, GTEFL filed its Answer. Because of the apparent overlap of issues raised in the Protests and in the Petition, Order No. 20857 consolidated Dockets Nos. 870171-TL and 890216-TL into a single proceeding.

In a February 10, 1989 letter to the Commission, GTEFL committed to a January 1, 1989 effective date for the Commission's resolution of the 1989 effects of the Act pursuant to the terms of the letter. By Order No. 20857, the Commission accepted this commitment as being adequate protection for ratepayers in lieu of taking other action, e.g., ordering GTEFL to hold revenues subject to refund. Apart from accepting the company's offer to accept a retroactive application of our action in these consolidated proceedings, Order No. 20857 took no position on the arguments advanced by GTEFL in its February 10th letter.

In Order No. 21369, issued June 12, 1989, the Prehearing Officer established the prehearing procedure to govern this proceeding and adopted a tentative list of 13 issues to be addressed. On June 26, 1989, OPC moved to amend Order No. 21369 by substituting a list of 26 issues in place of the tentative list. In OPC's view, this proceeding had become

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disorganized and would remain so unless the requested action was taken.

GTEFL responded on July 7, 1989, opposing OPC's motion to amend and requesting that bifurcated hearings be held in this proceeding. The company alleged that it would be prejudiced by the disruption occasioned by a substitution of issues and that OPC's proposed issues would expand and complicate the proceeding. GTEFL suggested that the disorganization noted by OPC could be cured if the Commission would establish a two-phase proceeding.

By Order No. 21757, issued August 21, 1989, the Prehearing Officer denied OPC's motion to amend Order No. 21369 and GTEFL's motion to hold bifurcated hearings. On his own motion, the Prehearing Officer deleted two issues from the tentative list. The Prehearing Officer found that these issues were duplicative and also that they did not conform to Orders Nos. 20800 and 21208 because they involved matters that led up to the action proposed in Order No. 20269.

Prehearing Statements were filed by GTEFL, OPC and Staff on August 21, 1989. At a Pre-Prehearing Conference on September 1, 1989, GTEFL, OPC and Staff stipulated to a new list of 19 issues. Thereafter, GTEFL, OPC and Staff filed revised Prehearing Statements addressing the new list of 19 issues. FCRU has filed neither an original nor a revised Prehearing Statement.

## II. TESTIMONY AND EXHIBITS

Upon insertion of a witness's testimony, exhibits appended thereto may be marked for identification. After opportunity for opposing parties to object and cross-examine, the document may be moved into the record. All other exhibits will be similarly identified and entered at the appropriate time during hearing. Exhibits shall be moved into the record by exhibit number at the conclusion of a witness's testimony.

Witnesses are reminded that on cross-examination, responses to questions calling for a yes or no answer shall be answered yes or no first, after which the witness may explain the answer.

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III. ORDER OF WITNESSES

<u>Witness</u>	<u>Appearing For</u>	<u>Date</u>	<u>Issues</u>
<u>Direct</u>			
O'Donnell	GTEFL	9/25/89	17, 18, 19
Menard	GTEFL	"	1, 2, 3, 4, 5, 6, 7, 9, 10, 11, 12, 14, 15
Austin	GTEFL	"	8, 16
Johnson	GTEFL	"	7, 12, 13
Rothschild	OPC	"	8, 9, 10, 11, 15, 16, 17, 18, 19
Calley	OPC	"	8, 16
Montanaro	OPC	"	1, 3, 5, 6, 7, 12, 13, 14
Lee	Staff	"	5
Seery	Staff	"	8, 9, 10, 11, 15, 16, 17, 18, 19
Salak	Staff	"	1, 2, 3, 4, 5, 6, 7, 12
*Devlin	Staff	"	

\*In the event that Staff's Motion to Strike Portions of the Rebuttal Testimony of Beverly Y. Menard filed August 21, 1989, is denied, Staff has furnished notice that it intends to sponsor Timothy J. Devlin as a Surrebuttal Witness.

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IV. BASIC POSITIONS

GTEFL'S BASIC POSITION: It is GTEFL's basic position in this proceeding that it has appropriately disposed of all 1988 tax savings associated with the Tax Reform Act of 1986 and that the company should not be exposed to further liability as a result of this case. The Commission's Tax Rule, when applied appropriately, yields no refund amount. The attempts to produce a refund under the Tax Rule by the retroactive applications of a new return on equity established in 1990 back to January 1, 1988, are totally without merit and should be dismissed out of hand. The retroactive application of a new return on equity requires the express agreement of the Company and no party has proven or will prove that fact because GTEFL never agreed to such an arrangement. GTEFL's agreement to a January 1, 1988, effective date for the resolution of Docket No. 871206-PU was to give the Commission the necessary freedom to operate independently of the Tax Rule and nothing more. GTEFL's midpoint return on equity should be set in a range from 14.4% to 15.0% based on the existing capital structure of the Company for prospective application after the effective date of the Commission's final order entered in this proceeding.

The issue of tax monies associated with the Tax Reform Act of 1986 and the appropriate level of the Company's authorized rate of return has been in perpetual litigation before this Commission, in one form or another, since the fall of 1986. The Company's approach to such matters has been straightforward and simple: return the tax savings to its ratepayers in a manner to produce long-term ongoing benefits in lieu of one-time cash refunds in order to help reposition the Company to be a successful low cost provider in the emerging competitive environment. The wisdom of this approach for GTEFL's ratepayers is quantified by the fact the GTEFL's customers have received reduced rates and reductions to the rate base in excess of \$50,000,000 since 1987.

The end result of the Company's responsible approach to regulation is that GTEFL is now faced with potential double liability for tax monies which have already been returned to its ratepayers. The double liability arises from Public Counsel and Staff positions that the Company's authorized return on equity should be reduced on a retroactive basis. The Company's good faith attempts to manage its business based on

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past Commission practices is now subjecting the Company to an unjustified financial liability of \$21,668,000.

GTEFL believes that any attempt to "double count" the tax monies associated with the Tax Reform Act of 1986 is unfair, unreasonable, inequitable and unlawful. The same is true of attempts to change its authorized return on equity on a retroactive basis. Therefore, GTEFL moves the Commission to adopt GTEFL's position on each and every issue herein.

OPC'S BASIC POSITION: GTE Florida, Incorporated, has not returned any of its 1988 tax savings to its customers. A depreciation adjustment taken during 1987 did not and could not "refund" its 1988 tax savings to its customers. The effect of the company's access charge rate reduction, even if relevant, was more than offset by rate increases for other services, local exchange rate group reclassifications, new revenues from new services, tariff filings, and stimulation.

The Commission should use the GTE Corporation consolidated capital structure consisting of 43.22% common equity to determine the company's total cost of capital. Based upon the consolidated capital structure, a cost of equity of 12.75% is appropriate for refunds and as an authorized midpoint return on equity. However, if the Commission uses the GTE Florida, Inc. capital structure rather than the GTE Corporation consolidated capital structure, the allowed return on equity should be no more than 11.75%.

The Commission should use the newly authorized return on equity and capital structure to determine the refund due customers under the Commission's tax rule. The Commission's Order No. 18661 dated January 7, 1988 reserved jurisdiction for any resolution of this docket. The Commission therefore has authority to use a current, more reasonable return on equity and capital structure to apply to the Commission's tax rule during 1988.

GTEFL's surveillance report understates its earnings during 1988, so appropriate adjustments should be made to the company's reported earnings to determine the amount of refund due customers.

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FCRU'S BASIC POSITION: None. [This party filed no Prehearing Statement.]

STAFF'S BASIC POSITION: Staff believes that GTEFL has collected 1988 revenues associated with certain tax savings that should be refunded to ratepayers pursuant to Rule 25-14.003, Florida Administrative Code. Certain revenues associated with 1988 tax savings were disposed of through prior Commission actions which satisfy in part this rule. At this time, Staff believes that GTEFL should refund \$20,099,000, which represents the final 1988 earnings in excess of the recommended midpoint of 12.55% plus interest. The return on equity which Staff recommends that the Commission authorize prospectively for GTEFL is 11.5%.

V. ISSUES AND POSITIONS:

1988:

ISSUE 1: Does Commission Order No. 18661, issued December 8, 1987, allow the application of a new return on equity for the purpose of implementing Commission Rule 25-14.003 during 1988?

POSITION OF PARTIES:

GTEFL'S: No. Commission Order No. 18661 merely incorporates the Company's agreement to a January 1, 1988, effective date for the disposal of the tax savings associated with the Tax Reform Act of 1986 independent of Commission Rule 25-14.003. GTEFL never agreed in any way to the establishment of a new return on equity in 1990 for retroactive application back to January 1, 1988.

Commission Order No. 18661 was the end result of a process initiated by the Commission Staff wherein, the Staff requested GTEFL to make the 1988 effects of the 1986 Tax Reform Act retroactive to January 1, 1988. The stated purpose of Staff's letter was to allow the necessary time to resolve the situation while protecting the interests of the ratepayer. GTEFL agreed to a January 1, 1988, effective date due to the Company's understanding that the purpose of Staff's request was to create a situation where the tax savings would be disposed of independent of Commission Rule 25-14.003. Indeed, GTEFL's

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December 8, 1987, commitment letter to such a proposal from the Staff explicitly stated:

According, GTEFL commits to a retroactive application of the incremental dollars associated with the full implementation of the Tax Reform Act of 1986 to January 1, 1988, to the extent that such dollars have not already been utilized in Order No. 17382. The foregoing commitment is premised on the company not being prejudiced regarding the amount, method of calculation, or method of disposing of effected revenues that may be considered in arriving at a final settlement. In addition, GTEFL's commitment in no way limits the company from raising other issues which are pertinent to this proceeding when arriving at a final settlement. (Emphasis added.)

As can be clearly seen, GTEFL never agreed to the retroactive application of a new return on equity for purposes of the Tax Rule. Rather, GTEFL expressly stated its understanding that it was agreeing to a procedure where the Commission would act independent of the Tax Rule. GTEFL only committed to dispose of "incremental dollars" which were not permanently disposed of in the 1987 settlement regarding the Tax Reform Act of 1986 by Commission Order No. 17382. Indeed, GTEFL reserved all options regarding the appropriate use of the tax savings. This would not have been possible under the Tax Rule. No one ever disputed GTEFL's position. Accordingly, GTEFL never agreed to a wide-open docket where only the positions of adversary parties set the boundaries for issues to be considered.

GTEFL's understanding and its position in this docket are supported by numerous other factors which are addressed by the testimony in this proceeding. By way of summary: 1) Order No. 18661 does not state that it is the Commission's intent to establish a new return on equity in 1990 for retroactive application to January 1, 1988, for purposes of inclusion in the Tax Rule; 2) If the Commission wanted to operate under the Tax Rule, Order No. 18661 was unnecessary; 3) The retroactive application of a new return on equity is inconsistent with the requirements and terms of the Tax Rule; 4) GTEFL had on file before this Commission a Motion to Dismiss which stated that the Commission cannot adjust a return on equity in a vacuum without the Company's consent; 5) This Commission had not

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applied the Tax Rule to GTEFL in 1987 as evidenced by Order No. 17382, to wit: "The Agreement ... is in lieu of the application of Commission Rule 25-14.003"; 6) The agreement to a retroactive application of a new return would subject GTEFL to double liability; and 7) The Commission did not apply the Tax Rule to various other utilities.

For GTEFL to be subject to the retroactive application of a new rate of return in 1990 back to January 1, 1988, there must be a clear, knowing and voluntary agreement on behalf of the Company to such a proposal. It is GTEFL's position that GTEFL never had any idea that it was the Commission's intent to take such action when Order No. 18661 was issued. Therefore, there was never the required "meeting of the minds" on the terms when GTEFL issued its commitment letter. (Menard)

OPC'S: Yes. The order reserved jurisdiction to use a January 1, 1988 effective date for any resolution of this docket. GTE Florida, Incorporated, also consented to the use of a January 1, 1988, effective date for any resolution of this docket. The staff recommendations preceding the issuance of that order made it clear that many companies' obsolete return on equity was a motivating force behind the Commission gaining the company's consent to a January 1, 1988 effective date for any resolution of the tax savings issues during 1988. (Montanaro)

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: Order No. 18661, accepting GTEFL's letter of December 8, 1987, requires that, whatever determination is made with respect to GTEFL's 1988 tax savings, the effects of the decision will begin January 1, 1988. (Salak)

ISSUE 2: Does Commission Order No. 18661, issued January 7, 1988, allow the application of a new capital structure for the purpose of implementing Commission Rule 25-14.003 during 1988?

POSITION OF PARTIES:

GTEFL'S: No. See response to Issue No. 1.

In addition, GTEFL submits that this issue and the position of Public Counsel to adjust the Company's capital structure clearly demonstrates that the adverse parties of

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record are misinterpreting the Company's commitment and Commission Order No. 18661. There is no mention of capital structure issues anywhere in Order No. 18661 or the Company's commitment. It is obvious that the adverse parties of record are taking a January 1, 1988, effective date to include any type of adjustment which produces their desired result under Commission Rule 25-14.003. To suggest that the Company agreed to a January 1, 1988, effective date so that the "double leverage" concept could be presented to the Commission is contrary to the facts and circumstances existing at the date of the Commission's Order. (Menard)

OPC'S: Yes. The order reserved jurisdiction to use a January 1, 1988 effective date for any resolution of this docket. GTE Florida, Incorporated, also consented to the use of a January 1, 1988, effective date for any resolution of this docket. This leaves open the issue of the company's capital structure just as it does the issue of the company's return on equity. (No Witness)

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: Order No. 18661, accepting GTEFL's letter of December 8, 1987, requires that, whatever determination is made with respect to GTEFL's 1988 tax savings, the effects of the decision will begin January 1, 1988. (Salak)

ISSUE 3: Does the application of a new return on equity or a new capital structure expose GTEFL to double liability if GTEFL returned tax savings during 1988 and GTEFL still earned above its midpoint return on equity during 1988?

POSITION OF PARTIES:

GTEFL'S: Yes. First, GTEFL notes that the application of Commission Rule 25-14.003 when correctly calculated does not produce any refund amount for the Company. In light of this fact, GTEFL disposed of the tax savings pursuant to past Commission practices for the benefits of its ratepayers. The reduction of access charges and zone rates, along with increased depreciation expense, disposed of all tax savings. See: Ex. No. BYM-4. Current attempts by the other parties of record to create unlawful and imaginative ways to produce a refund, after the fact, can place the Company in a double

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liability situation. GTEFL submits that these attempts are unjust, unreasonable, inequitable, and unlawful. (Menard)

OPC'S: The premise to this question is incorrect. The company has not returned tax savings to its customers during 1988. In addition, the company has consented to, and the Commission has asserted, jurisdiction to use a January 1, 1988 effective date for any resolution of this docket. There is no "double liability" to GTEFL. (Montanaro)

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: No. Staff believes that only a partial disposition of all 1988 tax savings has been accomplished and that the remaining tax savings should be disposed of in accordance with Rule 25-14.003. The application of this rule using a new return on equity and a new capital structure does not constitute "double liability" because Staff does not recommend disposition of revenues in excess of total 1988 tax savings. (Salak)

ISSUE 4: What is the total amount of tax savings for 1988 related to the Tax Reform Act of 1986 and how should it be calculated?

POSITION OF PARTIES:

GTEFL'S: The total tax savings for 1988 is \$36,074,000 and not \$41,631,000 as suggested by the Staff. The \$36,074,000 reflects the effective tax change from 46% to 39.95% in 1987 amounting to \$15,369,000 and the change from an effective rate of 39.95% to 34% in 1988 of \$20,705,000.

GTEFL's number is correct because it is calculated in accordance with Commission Rule 25-14.003 which contemplates an annual examination of tax savings so long as the rates being charged by the Company are those which were set at the time the old tax rate was in effect. Once the rates are reset to reflect the new tax rate, Commission Rule 25-14.003 becomes moot for future periods. GTEFL reduced rates in 1987 to account for the majority of the 39.95% effective tax rate change. Therefore, this part of the tax rate change has been considered and resolved for 1987 and all future periods. The amount to be considered for 1988 is from the effective rate of 39.95% to 34%. (Menard)

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OPC'S: The Citizens agree with the methodology and calculations used by staff witness Beth Salak. (No Witness)

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: The total amount of tax savings for 1988 is \$41,631,000 calculated to reflect the effect of the reduction in the corporate income tax rate from 46% to 34% based upon 1988 data. (Salak)

ISSUE 5: Does GTEFL's one-time intrastate depreciation expense adjustment of \$18,000,000 recorded in December of 1987 pursuant to Order No. 18584, issued December 21, 1987, satisfy in whole or in part the requirements of Commission Rule 25-14.003 for 1988?

POSITION OF PARTIES:

GTEFL'S: Yes. The increase in depreciation expense requested by the Company results in a disposal of tax savings to the benefit of the Company's ratepayers. GTEFL incurred this expense upon reliance on previous Commission actions. (Menard)

OPC'S: No. Changes in depreciation expense are irrelevant to the operation of Commission Rule 25-14.003. The rule calls for refunds if the company earns above its allowed return on equity, not depreciation adjustments. In addition, a depreciation adjustment made during 1987 certainly has no bearing on whether the company returned its 1988 tax savings to its customers. GTEFL made no depreciation adjustments during 1988. (Montanaro)

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: No, the 1987 one-time intrastate depreciation expense adjustment of \$18,000,000 does not satisfy in whole or in part the requirements of Commission Rule 25-14.003 for 1988. (Salak)

ISSUE 6: Do GTEFL's access charge reduction effected May 1, 1987, and zone charge reductions made during 1987 satisfy in whole or in part the requirements of Commission Rule 25-14.003 for 1988 and subsequent years?

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POSITION OF PARTIES:

GTEFL'S: Yes. See response to Issue No. 4. (Menard)

OPC'S: No. The rule calls for refunds of tax savings if the company earns above its midpoint return on equity. See Rule 25-14.003 (5)(a). The use of the term "refund" in the tax rule does not contemplate the use of an access charge rate reduction as a "refund" because the rule states that the utility may make any refund either as a lump sum payment in billing or in monthly installments not to exceed 12 months. It also states that such refunds are to be made to or from customers of the utility at the time that such refunds are effected. See Rule 25-14.003 (5)(e). Neither access charge rate reductions for interexchange carriers nor zone charge rate reductions fit this description.

In addition, even if the company's access charge and zone charge rate reductions were relevant, those rate reductions are more than offset in 1988 by other rate increases, local exchange rate group reclassifications, revenues from new services, new tariff filings, and stimulation. (Montanaro)

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: Yes, GTEFL's access charge reduction and zone charge reductions should be considered as the disposition of \$19,893,656 of tax savings for 1988. (Salak)

ISSUE 7: Should other increases or decreases in GTEFL revenues, such as those resulting from stimulation, late payment charges, new services, local exchange regroupings, EAS or tariff filings be considered in determining whether the requirements of Commission Rule 25-14.003 have been satisfied in whole or in part for 1988 and subsequent years?

POSITION OF PARTIES:

GTEFL'S: Yes, in accordance with the Surveillance Report. Speculative changes which cannot be measured, such as stimulation, should not be considered. (Menard, Johnson)

OPC'S: These numerous rate increases are no less relevant than are the access charge and zone charge rate decreases. If the Commission considers the access charge and zone rate decreases

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as relevant to the tax rule, then so, too, should it consider those rate changes which increased the company's revenues.

However, the rule tax rule does not apply any of these rate changes - - not the access charge or zone reductions, nor the host of other rate increases - - in its application. The rule calls for refunds of tax savings if the company earns above its midpoint return on equity, regardless of any particular rate increases or decreases made outside of a full rate case. See Rule 25-14.003(5)(a).

In addition, the use of the term "refund" in the tax rule does not contemplate the use of access charge or zone charge rate reductions as "refunds" because the rule states that the utility may make any refund either as a lump sum payment in billing or in monthly installments not to exceed 12 months. It also states that such refunds are to be made to or from customers of the utility at the time that such refunds are effected. See Rule 25-14.003(5)(e). Neither access charge rate reductions for interexchange carriers nor zone charge rate reductions fit this description. (Montanaro).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: Increases or decreases in GTEFL's revenues should be considered as part of the earnings test contemplated by the tax rule. The increases and decreases should not be considered when determining the amount of tax savings that have been disposed of for 1988. (Salak)

ISSUE 8: What capital structure should be used for determining the return on equity earned by GTEFL during 1988?

POSITION OF PARTIES:

GTEFL'S: See response to Issue Nos. 1 and 2. The actual capital structure of the Company should be utilized for 1988. This is an improper issue that is contrary to Order No. 18661 and is beyond the scope of this proceeding. (Austin)

OPC'S: The GTE Corporation consolidated capital structure consisting of 43.22% common equity should be used to determine the return on equity earned by GTEFL during 1988. (Rothschild, Calley).

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FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: The company's actual capital structure adjusted to reflect all regulatory adjustments, including the removal of non-utility or non-regulated assets from equity, should be used. (Seery)

ISSUE 9: What return on equity was required by investors in GTEFL during 1988?

POSITION OF PARTIES:

GTEFL'S: See response to Issue No. 1. The appropriate return on equity to utilize for 1988 is GTEFL's authorized range in effect of 14.5% to 16.5%. While GTEFL is adamantly opposed to the retroactive application of a new return to 1988, if one is utilized at a minimum, it should be consistent with other returns used in 1988 for Tax Rule purposes. (Menard)

OPC'S: The GTE Corporation consolidated capital structure consisting of 43.22% common equity should be used to determine the total cost of capital. Based upon this consolidated capital structure, a cost of equity of 12.75% is appropriate. If, however, the Commission uses the GTE Florida, Inc., capital structure rather than the GTE Corporation consolidated capital structure, the allowed return on equity should be no more than 11.75%. (Rothschild).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: The return on equity required by investors during 1988 was 13.30%. (Seery)

ISSUE 10: What return on equity provides investors in GTEFL the opportunity to earn their required rate of return during 1988?

POSITION OF PARTIES:

GTEFL'S: See response to Issue No. 1. The appropriate return on equity to utilize for 1988 is GTEFL's authorized range in effect of 14.5% to 16.5%. While GTEFL is adamantly opposed to the retroactive application of a new return to 1988, if one is

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utilized at a minimum, it should be consistent with other returns used in 1988 for Tax Rule purposes. (Menard)

OPC'S: The GTE Corporation consolidated capital structure consisting of 43.22% common equity should be used to determine the total cost of capital. Based upon this consolidated capital structure, a cost of equity of 12.75% is appropriate. If, however, the Commission uses the GTE Florida, Inc., capital structure rather than the GTE Corporation consolidated capital structure, the allowed return on equity should be no more than 11.75%. (Rothschild).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: A 12.55% return on equity provides investors in GTEFL the opportunity to earn their required rate of return during 1988. (Seery)

ISSUE 11: What return on equity should be used as the midpoint for purposes of Rule 25-14.003 for GTEFL for 1988?

POSITION OF PARTIES:

GTEFL'S: The appropriate midpoint return on equity is 15.5%. See responses to issues 1,2,8,9 and 10. (Menard)

OPC'S: If the Commission uses the GTE Corporation consolidated capital structure, the midpoint of the range of the authorized rate of return on equity for GTEFL should be set at 12.75%. If the Commission uses the GTE Florida, Inc., capital structure rather than the GTE Corporation consolidated capital structure, the midpoint of the range should be set at 11.75%. (Rothschild).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: A 12.55% return on equity should be used as the midpoint for purposes of Rule 25.14.003 for GTEFL for 1988. (Seery)

ISSUE 12: If the Commission applies Rule 25-14.003, how are earnings to be established for purposes of the rule?

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POSITION OF PARTIES:

GTEFL'S: It is GTEFL's position that the earnings are as set forth on the final Surveillance Report for 1988. GTEFL never agreed to being involved in a rate case in which the presentation of detailed accounting adjustments and double leverage presentations would be involved. GTEFL's reported earnings should only be subjected to adjustments made in its prior rate proceeding. New adjustments are improper and beyond the scope of this proceeding. (Menard, Johnson)

OPC'S: The company should be allowed all reasonable, prudently incurred expenses incurred during 1988 when determining what the company earned during 1988. The Commission need not and should not accept the surveillance report prepared by the company at face value without reviewing the reasonableness and propriety of the expenses included in the report. (Montanaro).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: The earnings to be established in the application of Rule 25-14.003 should be examined for prudence and reasonableness, and where appropriate, adjustments to earnings as reported by the company should be made. Such adjustments include, but are not limited to: (1) those made in the company's last rate case, (2) out-of-period items, (3) improper jurisdictional allocations, (4) non-regulated expenses or allocations, and (5) errors and mistakes. (Salak)

ISSUE 13: What was GTEFL's achieved return on equity for 1988 including any adjustments which should be made to the company's earnings?

POSITION OF PARTIES:

GTEFL'S: GTEFL's reported 1988 earnings were 13.86%. Any adjustments beyond those contained in the company's surveillance report or adjustments proposed by an audit finding are improper and should be rejected. See response to Issue 12. (Johnson)

OPC'S: The surveillance report of GTE Florida, Inc. for 1988 reports an earned return on equity of 13.86%, but this should be recalculated using the GTE Corporation consolidated capital structure consisting of 43.22% equity.

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Improper expenses should be eliminated for golf tournaments and car races, lounge skyboxes at Tampa Stadium, employee ticket sales projects for sporting events, lobbying, other non-regulated activities, national image advertising, expenses associated with the Home Shopping Network law suit, and certain pension expenses.

In addition, out-of-period revenue adjustments for claims by AT&T should be restated, and the company's intrastate adjustments on its surveillance report should be corrected.

Finally, GTEFL may not legally make an adjustment of \$20,057,000 to directory advertising gross profits as a reduction to 1988 revenues. (Montanaro)

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: GTEFL's achieved return on equity for 1988 is 14.36%. (No Witness)

ISSUE 14: What amount, if any, should be refunded, with interest, for 1988?

POSITION OF PARTIES:

GTEFL'S: GTEFL has no liability in this case as the tax savings have already been disposed of for the ratepayers benefit independent of the Tax Rule. In addition, a proper application of the Tax Rule produces no refund amount.

While GTEFL is adamantly opposed to the retroactive application of a new return on equity or the use of the Tax Rule in this case, the following data is presented for the Commission's consideration in evaluating the evidence in this docket. Under the Tax Rule, GTEFL has no liability under its existing authorized return. Under the 14.25% cap agreed to by Staff, GTEFL has no liability under the Tax Rule. Under a 13.6% return on equity, GTEFL has a hypothetical liability of approximately \$3,000,000 for 1988 under the Tax Rule. (Menard)

OPC'S: The full amount of the tax savings should be refunded, with interest, to the extent that GTEFL's earnings, properly calculated and using the GTE consolidated capital structure, exceeded a return on equity of 12.75%. (Montanaro).

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FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: The amount to be refunded for 1988 with interest is \$20,099,000. (No Witness)

1989:

ISSUE 15: What return on equity should be used as the midpoint for purposes of Rule 25-14.003 for GTEFL for 1989?

POSITION OF PARTIES:

GTEFL'S: See response to Issue 1. GTEFL's authorized midpoint of 15.5% should be used in 1989 if the Tax Rule is utilized for 1989. (Menard)

OPC'S: If the Commission uses the GTE Corporation consolidated capital structure, the midpoint of the range of the authorized rate of return on equity for GTEFL should be set at 12.75%. If the Commission uses the GTE Florida, Inc., capital structure rather than the GTE Corporation consolidated capital structure, the midpoint of the range should be set at 11.75%. (Rothschild).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: A 11.50% return on equity should be used as the midpoint for purposes of Rule 25-14.003 for GTEFL for 1989. (Seery)

PROSPECTIVELY:

ISSUE 16: What equity ratio should be used to determine the regulated earned return on equity on GTEFL?

POSITION OF PARTIES:

GTEFL'S: The appropriate basic capital structure and equity ratio to be used in this proceeding is discussed in the testimonies of Jerry L. Austin. In particular, Austin's Schedule 2 appended to his direct testimony sets forth the appropriate capital structure in this proceeding for return on equity. The addition of this new issue creates the need for an appropriate capital structure for the future which GTEFL will submit at its earliest opportunity. (Austin)

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OPC'S: The GTE Corporation consolidated capital structure consisting of 43.22% common equity should be used to determine the regulated earned return on equity of GTEFL. (Rothschild, Calley).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: The Company's actual capital structure adjusted to reflect all regulatory adjustments including the removal of non-utility or non-regulated assets from equity. (Seery)

ISSUE 17: What is the return on equity required by the investors in GTEFL?

POSITION OF PARTIES:

GTEFL'S: The appropriate return on equity required by investors in GTEFL is between 14.4% and 15.0%. In responding to this issue, GTEFL expressly notes that the foregoing return is presented in this proceeding for prospective application after the date of the Commission's final order in this proceeding. (O'Donnell)

OPC'S: The GTE Corporation consolidated capital structure consisting of 43.22% common equity should be used to determine the total cost of capital. Based upon this consolidated capital structure, a cost of equity of 12.75% is appropriate. If, however, the Commission uses the GTE Florida, Inc., capital structure rather than the GTE Corporation consolidated capital structure, the allowed return on equity should be no more than 11.75%. (Rothschild).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: The return on equity required by the investors in GTEFL is 12.15%. (Seery)

ISSUE 18: What return on equity provides investors in GTEFL the opportunity to earn their required rate of return?

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POSITION OF PARTIES:

GTEFL'S: The appropriate return on equity required by investors in GTEFL is between 14.4% and 15.0%. In responding to this issue, GTEFL expressly notes that the foregoing return is presented in this proceeding for prospective application after the date of the Commission's final order in this proceeding. (O'Donnell)

OPC'S: The GTE Corporation consolidated capital structure consisting of 43.22% common equity should be used to determine the total cost of capital. Based upon this consolidated capital structure, a cost of equity of 12.75% is appropriate. If, however, the Commission uses the GTE Florida, Inc., capital structure rather than the GTE Corporation consolidated capital structure, the allowed return on equity should be no more than 11.75%. (Rothschild).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: A 11.50% return on equity provides investors in GTEFL the opportunity to earn their required rate of return. (Seery)

ISSUE 19: What should be the minimum, midpoint and maximum of the authorized return on equity for GTEFL for all regulatory purposes?

POSITION OF PARTIES:

GTEFL'S: The appropriate range for return on equity on a prospective basis should be with the following spread:

Minimum - 13.4% - 14.0%  
 Midpoint - 14.4% - 15.0%  
 Maximum - 15.4% - 16.0%

(O'Donnell)

OPC'S: If the Commission uses the GTE Corporation consolidated capital structure, the minimum, midpoint and maximum authorized rate of return on equity for GTEFL should be set at 11.75%, 12.75% and 13.75, respectively. On the other hand, if the Commission uses the GTE Florida, Inc., capital structure rather than the GTE Corporation consolidated capital structure, the

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minimum, midpoint and maximum of the range should be set at 10.75%, 11.75%, and 12.75%, respectively. (Rothschild).

FCRU'S: None. [This party filed no Prehearing Statement.]

STAFF'S: Returns on equity of 10.50%, 11.50%, and 12.50% should be the minimum, midpoint, and maximum, respectively, of the authorized return on equity for GTEFL for all regulatory purposes. (Seery)

VI. EXHIBIT LIST

<u>Witness</u>	<u>Proferring Party</u>	<u>Exh. No.</u>	<u>Title</u>
O'Donnell	GTEFL		JLO-1: Risk return relationship chart
	GTEFL		JLO-2: Total annual returns 1926-1988
	GTEFL		JLO-3: Return on annual investment in telephone company (excluding AT&T) common stock; return on annual investment in newly issued long-term telephone bonds; and return on annual investment in telephone common stock v. telephone bonds

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<u>Witness</u>	<u>Proferring Party</u>	<u>Exh. No.</u>	<u>Title</u>
O'Donnell	GTEFL		JLO-4: Return on annual investment in Moody's 24 utilities common stock; return on annual investment in Moody's utilities common stock; return on annual investment in newly issued long-term utility bonds; return on annual investment in newly issued long-term utility bonds; return on annual investment in utility common stock vs. utility bonds
	GTEFL		JLO-5: Risk diversification graph
	GTEFL		JLO-6: Risk measures for three former Bell associated telephone companies
	GTEFL		JLO-7: Risk measures for four independent telephone holding companies
	GTEFL		JLO-8: Risk measures for four independent telephone holding companies

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<u>Witness</u>	<u>Proferring Party</u>	<u>Exh. No.</u>	<u>Title</u>
O'Donnell	GTEFL		JLO-9: Risk measures for fifteen nonregulated barometer firms
	GTEFL		JLO-10: Required market yield for three former Bell associated telephone companies
	GTEFL		JLO-11: Required market yield for four independent telephone holding companies
	GTEFL		JLO-12: Required market yield for seven former Bell associated telephone holding companies
	GTEFL		JLO-13: Required market yield for 15 nonregulated barometer firms
Menard	GTEFL		BYM-1: December 8, 1987 letter from B.Y. Menard to Tim Devlin
	GTEFL		BYM-2: October 23, 1986, Staff Recommendation
	GTEFL		BYM-3: November 16, 1986, Staff Recommendation

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<u>Witness</u>	<u>Proferring Party</u>	<u>Exh. No.</u>	<u>Title</u>
Menard	GTEFL		BYM-4: Disposal of tax savings schedule
	GTEFL		BYM-5: September 22, 1988, Staff Recommendation
Austin	GTEFL		JLA-1: Moody's AA Rated utility bond yields since 1-87
	GTEFL		JLA-2: GTE Florida capital structure, 12-month average as of 12/31/88.
	GTEFL		JLA-3: Common "equity ratios for comparable companies
	GTEFL		JLA-4: Revised telecommunications benchmarks
	GTEFL		JLA-5: Interest coverage ratios for comparable companies
Johnson	GTEFL		BAJ-1: New products revenue
	GTEFL		BAJ-2: Operating expenses less depreciation
Rothschild	OPC		JAR-1: Series of Schedules Nos. 1-11
	OPC		JAR-2: Testifying Experience

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<u>Witness</u>	<u>Proferring Party</u>	<u>Exh. No.</u>	<u>Title</u>
Rothschild	OPC		JAR-3: Schedules Nos. 1 & 2
Calley	OPC		NOC-1: Series of Schedules Nos. 1-13
Montanaro	OPC		VM-1: New Services - 1988 Information
	OPC		VM-2: Late-Filed Menard Deposition Exhibit No. 2
	OPC		VM-3: Rec. dated 11/17/87, Rec. dated 12/09/87, and Order No. 18661
Lee	Staff		PSL-1: Order No. 18584
	Staff		PSL-2: GTEFL Supplemental Petition filed 10/1/87 for add. depr. in 1987
	Staff		PSL-3: Excerpts from Menard Transcript (7/7/89)
Seery	Staff		SS-1: Consumer Price Index - Average Annual Percent Changes & Five-Year Moving Average
	Staff		SS-2: Yield on "AA" Utility Bonds - Annual Ave. Percent Changes & Five-Year Moving Ave.

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<u>Witness</u>	<u>Proferring Party</u>	<u>Exh. No.</u>	<u>Title</u>
Seery	Staff		SS-3: Interest & Inflation Rates
	Staff		SS-4: AA/Aa Rated Telecom. Util. Investment Risk Characteristics
	Staff		SS-5: Moody's Natural Gas Distribution Index Investment Risk Characteristics
	Staff		SS-6: DCF Model Equation
	Staff		SS-7: Non-Constant Growth, Quarterly Compounded Discounted Cash Flow Model
	Staff		SS-8: Non-Constant Growth, Quarterly Compounded Discounted Cash Flow Analysis for Bell Regional Holding Company Index
	Staff		SS-9: Risk Premium Equation
	Staff		SS-10: Estimated Monthly Risk Premiums Moody's Natural Gas Distribution Index
	Staff		SS-11: Bond Yield Differential

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<u>Witness</u>	<u>Proferring Party</u>	<u>Exh. No.</u>	<u>Title</u>
Seery	Staff		SS-12: Standard & Poor's Financial Benchmarks
	Staff		SS-13: Selected Financial Ratios
	Staff		SS-14: Ratemaking Rate of Return Equation
	Staff		SS-15: Summary of Cost of Equity Analysis
	Staff		SS-16: Staff Estimate of GTEFL's Cost of Common Equity Capital
	Staff		SS-17: Derivation of the Non-constant Growth Quarterly Compounded DCF Model
	Staff		SS-18: Effective vs. Nominal Proof
	Salak	Staff	
Staff			BWS-2: GTEFL's 1987 Tax Savings Report
Staff			BWS-3: GTEFL's 1988 Tax Savings Report using 39.95% as the old tax rate

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<u>Witness</u>	<u>Proferring Party</u>	<u>Exh. No.</u>	<u>Title</u>
Salak	Staff		BWS-4: Refund Orders using Rule 25-14.003
	Staff		BWS-5: Petition of GTE Florida Incorporated filed January 28, 1988
Devlin	Staff		TJD-1: Transcript of Agenda Conference (10/18/88)

VII. STIPULATIONS:

No stipulation between the parties has been reached.

VIII. PENDING MOTIONS:

The only motion that is currently pending is Staff's Motion to Strike Portions of the Rebuttal Testimony of Beverly Y. Menard filed on August 14, 1989. GTEFL filed a Response on August 21, 1989.

IX. RULINGS:

There have been no rulings at this time.

X. PROCEDURE FOR HANDLING CONFIDENTIAL INFORMATION:

In the event it becomes necessary to handle confidential information, the following procedure will be followed:

1. The Party utilizing the confidential material during cross examination shall provide copies to the Commissioners and the Court Reporter in envelopes

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clearly marked with the nature of the contents. Any party wishing to examine the confidential material shall be provided a copy in the same fashion as provided to the Commissioners subject to execution of any appropriate protective agreement with the owner of the material.

- 2. Counsel and witnesses should state when a question or answer contains confidential information.
- 3. Counsel and witnesses should make a reasonable attempt to avoid verbalizing confidential information and, if possible, should make only indirect reference to the confidential information.
- 4. Confidential information should be presented by written exhibit when reasonably convenient to do so.
- 5. At the conclusion of that portion of the hearing that involves confidential information, all copies of confidential exhibits shall be returned to the owner of the information. If a confidential exhibit has been admitted into evidence, the copy provided to the Court Reporter shall be retained in the Commission Clerk's confidential files.

If it is necessary to discuss confidential information during the hearing the following procedure shall be utilized.

After a ruling has been made assigning confidential status to material to be used or admitted into evidence, it is suggested that the presiding Commissioner read into the record a statement such as the following:

The testimony and evidence we are about to receive is proprietary confidential business information and shall be kept confidential pursuant to Section 364.093, Florida Statutes. The testimony and evidence shall be received by the Commissioners in executive session with only the following persons present:

- a) The Commissioners
- b) The Counsel for the Commissioners
- c) The Public Service Commission staff and staff counsel
- d) Representatives from the office of public counsel and the court reporter

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- e) Counsel for the parties
- f) The necessary witnesses for the parties
- g) Counsel for all intervenors and all necessary witnesses for the intervenors.

All other persons must leave the hearing room at this time. I will be cutting off the telephone ties to the testimony presented in this room. The doors to this chamber are to be locked to the outside. No one is to enter or leave this room without the consent of the chairman.

The transcript of this portion of the hearing and the discussion related thereto shall be prepared and filed under seal, to be opened only by order of this Commission. The transcript is and shall be non-public record exempt from Section 119.07(1), Florida Statutes. Only the attorneys for the participating parties, Public Counsel, the Commission staff and the Commissioners shall receive a copy of the sealed transcript.

(AFTER THE ROOM HAS BEEN CLOSED)

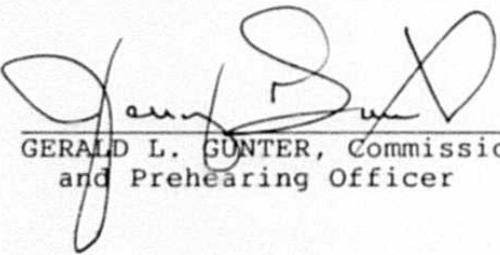
Everyone remaining in this room is instructed that the testimony and evidence that is about to be received is proprietary confidential business information, which shall be kept confidential. No one is to reveal the contents or substance of this testimony or evidence to anyone not present in this room at this time. The court reporter shall now record the names and affiliations of all persons present in the hearing room at this time.

It is therefore,

ORDERED by Commissioner Gerald L. Gunter, as Prehearing Officer, that this Prehearing Order shall govern the conduct of these proceedings as set forth above unless modified by the Commission.

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By ORDER of Commissioner Gerald L. Gunter, as Prehearing  
Officer, this 20th day of SEPTEMBER, 1989.



GERALD L. GUNTER, Commissioner  
and Prehearing Officer

( S E A L )

DLC