

May 11, 2018

Mr. Tom Sullivan
Bureau Chief
International Bureau
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

FILED in IBFS

**Re: In-service Notification for Hawaii Interisland Cable System (HICS),
SCL-LIC-19921015-00008**

Dear Mr. Sullivan:

Pursuant to an International Bureau staff request Hawaiian Telcom, Inc. (“HTI”) by this letter provides support for its belief that the Hawaii Interisland Cable System (“HICS”), SCL-LIC-19921015-00008, was placed in service on or about July 31, 1994.

The original grant of authority to construct and operate the HICS submarine cable license is contained in *GTE Hawaiian Telephone Co.*, File No. S-C-L-93-003, 8 FCC Rcd 7605 (Com. Car. Bur., rel. Oct. 26, 1993).¹ GTE Hawaiian Telephone Co. (“GTE”) constructed the cable and began operating it. Since that time, ownership of the cable was transferred three times, and is currently held by HTI.²

Upon request of the International Bureau staff, HTI conducted a thorough search of its records, and because ownership has been transferred multiple times and personnel changes have occurred, it is unable to locate a copy of the original letter filed by GTE notifying the Commission of the date HICS was placed in service. Apparently, the Commission also cannot locate the original in-service letter. This document would have been filed at the Commission only on paper and pre-dated the Commission’s IBFS automated licensing system.

¹ The Commission subsequently changed the original license number to SCL-LIC-19921015-00008.

² Actions Taken Under Cable Landing License Act, Public Notice, DA No. 11-565, SCL-ASG-20110112 (Action Date Mar. 28, 2011) (transfer from GTE Hawaiian Telephone Co. to Verizon Inc. and transfer from Verizon Inc. to The Carlyle Group); Actions Taken Under Cable Landing License Act, Public Notice, DA No. 11-565, SCL-T/C-20110112-00003 (Action Date Mar. 28, 2011) (transfer from The Carlyle Group to Hawaiian Telcom Holdco, Inc.). This description omits the bankruptcy-related transfer associated with The Carlyle Group’s ownership interest and various pro form transfers that have been made in accordance with Commission filings.

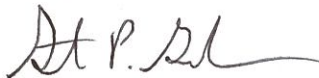
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HTI's determination that HICS was placed in service on or about July 31, 1994 is based on the attached order issued by the State of Hawaii Public Utilities Commission, which states that the HICS cable was completed in July 1994.³

Therefore, HTI respectfully requests that, based on the attached documentation, the Commission treat the in-service date of HICS as July 31, 1994.

Please let me know if you have any questions.

Respectfully submitted,



Steven P. Golden
Vice President, External Affairs

³ GTE Hawaiian Telephone Company, Inc. for Approval of Rate Increases and Revised Rate Schedules, Docket No. 94-0298, *et al.*, Decision and Order No. 15345, 14-15 (Haw. PUC, rel. Jan. 31, 1997) (attached as Exhibit A).

EXHIBIT A

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
GTE HAWAIIAN TELEPHONE COMPANY)
INCORPORATED)
For Approval of Rate Increases)
and Revised Rate Schedules.)

DOCKET NO. 94-0298

In the Matter of the Application of)
GTE HAWAIIAN TELEPHONE COMPANY)
INCORPORATED)
For Approval of Changes to its)
Depreciation Rates (Capital)
Recovery).)

DOCKET NO. 95-0194

(CONSOLIDATED)

DECISION AND ORDER NO. 15345

Filed January 31, 1997
At 11:00 o'clock A.M.

Leatrice G. Asahi
Chief Clerk of the Commission

ATTEST: A True Copy
LEATRICE G. ASAHI
Clerk, Public Utilities
Commission, State of Hawaii.

Leatrice G. Asahi

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BEFORE THE PUBLIC UTILITIES COMMISSION
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INCORPORATED)
For Approval of Changes to its)
Depreciation Rates (Capital)
Recovery).)

Docket No. 95-0194
(Consolidated)

Decision and Order No. 15345

DECISION AND ORDER

I.

INTRODUCTION

GTE HAWAIIAN TELEPHONE COMPANY INCORPORATED (GTE Hawaiian Tel or the company) seeks approval of a general rate increase and revisions to its rate schedules and rules, designed to produce additional revenues in the amount of \$74 million, or 21.9 per cent over intrastate revenues at present effective rates for a normalized 1995 test year. GTE Hawaiian Tel's request for a general rate increase is made pursuant to Hawaii Revised Statutes (HRS) chapter 269 and Hawaii Administrative Rules (HAR), title 6, chapter 61, subchapter 8.¹

¹GTE Hawaiian Tel originally filed an application for a rate increase of \$95.1 million in additional revenue on May 30, 1995. The proposed amount was based upon \$44.0 million that was pending

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Pursuant to HAR § 6-61-85, GTE Hawaiian Tel notified the commission on October 14, 1994, of its intent to file an application for a general rate increase. Also on October 14, 1994, GTE Hawaiian Tel filed a motion requesting (1) a waiver of the 12-month test year period mandated by HAR § 6-61-87(4)(A), and (2) authorization to utilize calendar year 1995 as the test year in its application for a general rate increase. Upon receipt of GTE Hawaiian Tel's notice of intent and motion, the commission opened Docket No. 94-0298.

On October 21, 1994, the Consumer Advocate filed a memorandum objecting to the use of calendar year 1995 as the test year in Docket No. 94-0298. The company filed a response to the Consumer Advocate's memorandum on October 31, 1994. By Order No. 13656, filed on November 29, 1994 the commission granted GTE Hawaiian Tel's motion and approved calendar year 1995 as the test year.

On September 29, 1995, GTE Hawaiian Tel filed its application for the general rate increase. GTE Hawaiian Tel also submitted written testimony, exhibits, and related workpapers. GTE Hawaiian Tel served copies of its application on the Consumer Advocate and the mayors of the four counties. On October 20, 1995, pursuant to HRS § 269-16(d), the Consumer Advocate informed the commission that it did not object to the completeness of

in the company's 1993 rate case and an additional \$51.1 million. GTE Hawaiian Tel subsequently withdrew the application pursuant to a stipulation with the Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs (Consumer Advocate), filed on July 6, 1995, to extend certain commission orders and to submit revised testimony.

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GTE Hawaiian Tel's application. Accordingly, the commission deemed the application complete as of the date of the revised filing.

HRS § 269-16(b) requires that the commission conduct a public hearing on any increase in public utility rates. Advertised public hearings, as prescribed by HRS § 269-12(c), were held on various islands throughout the State from November 27, 1995, through December 11, 1995.²

By letter dated May 12, 1995, GTE Hawaiian Tel requested that its rate case be bifurcated, with Phase I addressing GTE Hawaiian Tel's revenue requirement, and Phase II addressing the company's proposed rate design. By Order No. 13919, filed on May 19, 1995, the commission approved GTE Hawaiian Tel's request.

By Order No. 14312, filed on October 9, 1995, the rate case was consolidated with Docket No. 95-0194, which requests approval of changes to the company's depreciation rates.³

Motions to intervene in Phase I of this proceeding were filed by the Secretary of Defense on behalf of the consumer interests of the United States Department of Defense and all other Federal Executive Agencies (DOD)⁴; AT&T Communications of Hawaii, Inc. (AT&T); and GST Telecom Hawaii, Inc. (GST Hawaii).⁵

²Public hearings were held on Hawaii from November 27 through 30; on Molokai, Maui, and Lanai on December 4, 5, and 6; on Kauai on December 7; and on Oahu on December 11.

³Order No. 14312 also made the Consumer Advocate a party to the consolidated proceeding.

⁴DOD's motion to intervene was filed through the Office of the Judge Advocate General, Regulatory Law Office, Department of the Army.

⁵Motions to intervene were filed by DOD, AT&T, and GST Hawaii (formerly known as Pacwest Telecommunications Corporation, Inc.) on March 7, December 20, and December 21, 1995, respectively.

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GTE Hawaiian Tel filed memoranda opposing the motions. By Order No. 14461, filed on January 12, 1996, the commission granted intervenor status to DOD and participant status to AT&T and GST Hawaii, specifically to assist in the formulation of the issues for the Phase I proceeding. The parties were ordered to submit a stipulated prehearing order outlining the issues and schedule of proceeding by January 26, 1996. A stipulated prehearing order was submitted for commission review by GTE Hawaiian Tel, the Consumer Advocate, and DOD on January 30, 1996.

AT&T and GST Hawaii made separate prehearing submissions on January 30, 1996, requesting continued participation in the Phase I proceeding.⁶ By Order No. 14589, filed on March 22, 1996, the commission granted AT&T's request for continued participation, but denied GST Hawaii's request. AT&T's participation in the Phase I proceeding was limited to subissues relating to inter-jurisdictional cost allocation and competitive impacts of competition. The parties were ordered to resubmit a stipulated prehearing order that included AT&T's subissues and AT&T as a signatory.

By Order No. 14623, filed on April 16, 1996, the commission granted GTE Hawaiian Tel's motion for reconsideration of AT&T's participation on the subissue of service quality, and denied GST Hawaii's motion for reconsideration of the commission's denial of GST Hawaii's request for continued participation. The commission also established the procedural schedule for the Phase I

⁶Order No. 14461 granted AT&T and GST Hawaii leave to request continued participation in the Phase I proceeding after the issues had been determined.

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proceeding, based on prehearing submittals made by the parties on April 4, 1996, and April 8, 1996. Also on April 16, 1996, the commission filed Prehearing Order No. 14624.

On July 26, 1996, GTE Hawaiian Tel, the Consumer Advocate, DOD, and AT&T submitted for commission approval a stipulated Agreement (the Agreement), which, among other things, waived the evidentiary hearing, grants GTE Hawaiian Tel a \$17.937 million interim rate increase, and sets forth remaining issues for commission determination.⁷

Based on the Agreement, the commission by interim Decision and Order No. 14833, filed on August 1, 1996, granted GTE Hawaiian Tel an interim rate increase of \$17.937 million in additional local network revenues, or an increase of 7.73 per cent over present rates.

Opening briefs were submitted by the Consumer Advocate and GTE Hawaiian Tel on September 3 and 4, 1996. AT&T and DOD did not file briefs in this phase of GTE Hawaiian Tel's rate case.

II.

ISSUES

As set forth in Prehearing Order No. 14624, the issues are as follows:

1. Is GTE Hawaiian Tel's proposed rate increase reasonable?
 - a. Are the revenue forecasts for test year 1995 under current effective and proposed rates reasonable?

⁷The Agreement was primarily negotiated between GTE Hawaiian Tel and the Consumer Advocate. AT&T and DOD generally agree to and accept the Agreement.

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- i. Whether the revenue forecasts accurately represent the existing and forecasted impact of competition on GTE Hawaiian Tel's revenues and traffic volumes.
 - b. Are the projected operating expenses for test year 1995 reasonable?
 - i. Whether GTE Hawaiian Tel has utilized the proper methodology and has properly accounted for its intrastate costs.
 - A) Are the costs subject to allocation between the international, interstate, and intrastate operations properly accounted for to ensure against cross-subsidization of any of these operations?
 - B) Are the costs directly or indirectly related to the non-regulated, international and interstate operations properly excluded from intrastate operations?
 - ii. Whether GTE Hawaiian Tel has properly applied jurisdictional separations and cost allocation rules to determine its intrastate costs.
 - c. Are the properties included in GTE Hawaiian Tel's rate base used or useful for public utility purposes, and otherwise proper for inclusion in rate base?
 - d. What are the appropriate depreciation accrual rates that should be applied to GTE Hawaiian Tel's plant-in-service for purposes of intrastate booking and determination of the intrastate regulated telecommunications revenue requirements?
 - e. Is the rate of return requested fair?
 - f. Whether GTE Hawaiian Tel's proposal to recover costs associated with the restoration and repair of facilities damaged as a result of Hurricane Iniki is reasonable.
 - g. Is GTE Hawaiian Tel's proposed 1995 intrastate revenue requirement reasonable?
2. What is the amount of the rate increase or decrease, if any, to which GTE Hawaiian Tel is entitled?

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3. Whether GTE Hawaiian Tel's proposed temporary surcharge to implement any approved revenue requirement increase or decrease on an interim basis is reasonable?

III.

INTERIM DECISION AND ORDER

By Interim Decision and Order No. 14833, we approved the Agreement of the parties, which was filed on July 26, 1996. The Agreement provided for an interim rate increase as follows:

Revenue Requirement	\$10.152 million
Depreciation Expense	<u>7.785 million</u>
	<u>\$17.937 million</u>

The interim revenue requirement amount was based on stipulated adjustments between the company and the Consumer Advocate⁸. The depreciation expense was calculated using GTE Hawaiian Tel's current booked depreciation rates, as agreed by the Consumer Advocate. For interim purposes, we adopted the stipulated adjustments agreed to by GTE Hawaiian Tel and the Consumer Advocate with respect to the following items:

- 1) Return on equity;
- 2) Separations adjustments;
- 3) Use of average vs. end of year rate base;
- 4) Interisland fiber optic cable investment;
- 5) Asynchronous transfer mode investment;
- 6) Pension asset;
- 7) Hawaii capital goods excise tax credit;
- 8) Deferred income tax reserve adjustment;
- 9) Revenue adjustments;
- 10) PUC surcharge revenues;
- 11) Restatement of pole and duct rental revenues;
- 12) Payroll;
- 13) Benefits;
- 14) GTE affiliates;
- 15) Hawaiian Telephone Insurance Company;

⁸Based on the agreed adjustments, the Consumer Advocate agreed to revise its revenue requirement upward from a reduction of \$16.572 million to an increase of \$10.152 million.

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- 16) GTE government system HITS contract;
- 17) Software expense;
- 18) GDPPI inflation factor;
- 19) Shared assets study;
- 20) Process re-engineering;
- 21) Advertising;
- 22) Public affairs;
- 23) Alakea restack lease savings;
- 24) Revenue taxes;
- 25) Interest synchronization;
- 26) Gross revenue factor;
- 27) Department of Defense contracts;
- 28) Phase I surcharge method; and
- 29) Elimination of paging.

With respect to the final decision in this Phase I proceeding, four disputed cost items remain for commission determination: (1) incentive compensation, (2) depreciation rates, (3) Hurricane Iniki restoration costs, and (4) interisland fiber optic cable investment.

We address below these four cost items, and review a number of the cost items agreed to by GTE Hawaiian Tel and the Consumer Advocate.

IV.

OUTSTANDING ISSUES

A. Incentive Compensation

Initially, GTE Hawaiian Tel maintained that all incentive compensation expenses should be fully recoverable for ratemaking purposes. Thus, GTE Hawaiian Tel contended that it should be allowed to recover costs associated with the pay earned by its employees as part of the Executive Incentive Plan (EIP) and Management Incentive Compensation System (MICS) plans.

The Consumer Advocate argued that GTE Hawaiian Tel's test year expense projection for MICS and EIP should be eliminated on

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the grounds that (1) GTE Hawaiian Tel has not countered the commission's long-standing policy of denying the recovery of incentive compensation, and (2) there are significant deficiencies in GTE Hawaiian Tel's current service quality.

GTE Hawaiian Tel agreed to remove its proposed EIP expense from the test year expenses. However, GTE Hawaiian Tel and the Consumer Advocate still disagree on the ratemaking treatment of the company's proposed intrastate MICS expense of \$1,909,783. The Consumer Advocate continues to maintain that the MICS expense should be disallowed. GTE Hawaiian Tel argues that the MICS expense proposed in this proceeding is dissimilar to the incentive compensation expenses disallowed in prior commission decisions,⁹ and, thus, should be allowed.

We will disallow GTE Hawaiian Tel's projected intrastate MICS expense of \$1,909,783. In doing so, we reiterate our position (stated in prior decisions) that a utility employee, especially at the executive or management level, should perform at an optimum level without additional compensation or incentives. GTE Hawaiian Tel has failed to convince us otherwise.¹⁰ Ratepayers should not

⁹GTE Hawaiian Tel started the MICS program in 1992. The program was implemented over a four-year period, which transitioned a 100 per cent "base only" compensation structure to a 90 per cent base and 10 per cent incentive structure at the end of 1995. Over the four-year period, GTE Hawaiian Tel reduced merit increases by 2.5 per cent of the salary base component. By doing so, GTE Hawaiian Tel claims that it has lowered base salaries by 10 per cent, which results, on average, in a total compensation structure of 90 per cent base salary and 10 per cent incentive for employees in the MICS program.

¹⁰GTE Hawaiian Tel provided testimony regarding, among other things, that (1) its management salaries are at market levels, (2) the MICS program does not provide a bonus or compensation over and above normal market salary levels, (3) the MICS program is different from other incentive plans ruled on in past rate cases,

be burdened with additional costs for an expected level of service.¹¹

Further, incentive compensation is premised on achieving a level of service quality that is already required under General Order No. 8 (G.O. 8), Standards for Telephone Service in the State of Hawaii and chapter 6-80, HAR. Thus, such costs should not be passed on to ratepayers.

With respect to EIP, the exclusion of such expense is consistent with our prior decisions.¹² Thus, we find the agreement to remove the EIP expense from the test year expenses to be reasonable.

B. Depreciation Rates

GTE Hawaiian Tel proposes test year depreciation expense of \$124,826,692. The Consumer Advocate proposes a 1995 depreciation expense of \$99,493,325. The difference is due to the use by GTE Hawaiian Tel of accelerated depreciation rates, and the lowering of current rates by the Consumer Advocate.

GTE Hawaiian contends that accelerated depreciation is necessary in a regulated competitive environment. GTE Hawaiian Tel argues that (1) a competitive environment already exists, as

(4) GTE Hawaiian Tel focuses on service quality, (5) the MICS program benefits ratepayers, and (6) the MICS program does not put ratepayers at risk.

¹¹See Decision and Order No. 11317, Docket No. 6531 (1991); Decision and Order No. 13950, Docket No. 7579 (consolidated) (1995); and Decision and Order No. 14859, Docket No. 94-0097 (1996).

¹²See Decision and Order No. 13950, Docket No. 7575 (consolidated) (1995) and Decision and Order No. 11317, Docket No. 6531 (1991).

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evidenced by the increasing number of entrants into the Hawaii's telecommunications market; (2) it must be able to respond to competitive pressures by installing newer technology and having a fair opportunity to recover that investment through shortened service lives; and (3) traditional analysis of past mortality data is no longer relevant for accounts driven by technological changes.

The Consumer Advocate calculated its proposed depreciation rates by using traditional straight-line depreciation practices, which considered, among other things: (1) the changes caused by competition and expected competition in Hawaii; (2) the mix of technologies; (3) historical retirement data; (4) analysis of trends, expected retirements and additions based upon GTE Hawaiian Tel's construction plans; and (5) the expected operating environment. The Consumer Advocate argues that GTE Hawaiian Tel's use of accelerated depreciation rates is inconsistent with regulatory standards, and is based upon an assumed level of future retirements that are excessive and inconsistent with company's own budget projections. The Consumer Advocate believes that its depreciation rates are moderate, yet acknowledge changing circumstances by incorporating 1995 retirements higher than actually experienced or projected for budgeting purposes.

We reject GTE Hawaiian Tel's proposed depreciation rates. Although there are many new entrants authorized to provide telecommunications service, we do not find that competition exists to such a degree that the accelerated depreciation proposed by GTE

Hawaiian Tel is warranted.¹³ We also find it unnecessary to lower the depreciation rates, as proposed by the Consumer Advocate.

We find that the current depreciation rates are reasonable in light of the growing competition in the telecommunications market. Thus, we will retain the existing depreciation rates in this proceeding.

C. Hurricane Iniki Restoration Costs

In Docket No. 7525, we addressed GTE Hawaiian Tel's application, filed on November 10, 1992, for authority to modify its accounting practices to deal with expenses related to the destruction caused by Hurricane Iniki. On December 18, 1992, GTE Hawaiian Tel and the Consumer Advocate filed a stipulation settling all matters in that proceeding, conditioned upon our approval of the stipulation as a whole. The stipulation allowed GTE Hawaiian Tel to include in its rate base the deferred amount of extraordinary expenses, and to accrue earnings on the deferred amount of extraordinary expenses at the rate of return authorized in the company's next rate case. Recognition of the earnings was to commence at the time GTE Hawaiian Tel began amortizing extraordinary expenses. The earnings were to be calculated on the average unamortized balance of extraordinary expenses at the authorized rate of return.

¹³Most of the new providers are resellers of interexchange and long distance services and are not direct competitors of GTE Hawaiian Tel's local exchange service. And although several carriers are authorized to provide local exchange service, to date none of these carriers are able to provide service since they are still negotiating interconnection agreements with GTE Hawaiian Tel and are dependent upon the company's system and services in order to provide their own service.

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By Decision and Order No. 12104, filed in Docket No. 7525, on December 30, 1992, we approved the stipulation with the following conditions regarding extraordinary expenses: (1) recovery of GTE Hawaiian Tel's Hurricane Iniki-related extraordinary expenses would be deferred to its next rate case; (2) the amortization period would be determined by the commission in the company's next rate case; and (3) the amount and type of extraordinary expenses and the propriety and treatment of extraordinary expenses would be reviewed in the company's next rate case.

Pursuant to the approved stipulation, GTE Hawaiian Tel proposes in this case to fully recover Hurricane Iniki repair and restoration costs from ratepayers and amortize the restoration costs over a five-year period. GTE Hawaiian Tel supports its position with updated Iniki restoration costs, which compare and adjust the actual capital costs and expenses against the 1993 rate case estimates.

The Consumer Advocate's Iniki restoration cost proposal includes all known capital and non-capital restoration costs (adjusted for a forecasting error), and reflects a 10-year amortization period in the cost of service. The Consumer Advocate contends that its proposal is consistent with the commission's Decision and Order No. 14859, filed on August 7, 1996, in Docket No. 94-0097, Citizens Utilities Company, Kauai Electric Division's last rate case.

The Consumer Advocate recommends that if 100 per cent ratepayer responsibility is adopted, (1) GTE Hawaiian Tel's year-end projections of Hurricane Iniki plant-in-service depreciation

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reserve and deferred income tax reserve be restated to recognize the average 1995 test year approach agreed to by the parties, and (2) the company's proposed annual amortization recovery of \$3,123,318 and rate base inclusion of \$5,106,553 of net regulatory asset be adjusted to reflect a 10-year amortization of the costs.¹⁴

We agree with the Consumer Advocate's adjustments and adopt its recommendations. GTE Hawaiian Tel's year-end projections of Hurricane Iniki plant-in-service depreciation reserve and deferred income tax reserve are already embedded in the Consumer Advocate's adjustments and, with the inclusion of the Hurricane Iniki costs in rate base, require no further adjustment. The amortization period will be adjusted to reflect a 10-year cost in service. This adjustment lowers the depreciation and amortization expense from \$3.158 million to \$2.086 million.

In addition, we determine that the Iniki restoration costs should be further adjusted by deleting depreciation expense in the amount of \$1,701,206 from GTE Hawaiian Tel's proposed deferred asset of \$16,718,954, to avoid double recovery caused by the inclusion of extraordinary, noncapital expense in rate base. With the adjustments, we find GTE Hawaiian Tel's inclusion of a "Hurricane Iniki deferred asset" account in rate base to be reasonable.

D. Interisland Fiber Optic Cable

GTE Hawaiian Tel filed an application on June 9, 1992, in Docket No. 7327, to install a 12-strand fiber optic cable

¹⁴The figures reflect total company amounts including interstate portions.

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connecting the islands of Kauai, Oahu, Maui, and Hawaii. The project includes approximately 300 miles of underwater fiber optic cable, as well as on-island terminals, trunking, fiber and metallic cables, digital radios, and support structures, at an estimated construction cost of \$21 million. The purpose of the project is to provide capacity for future interisland voice, data, video, and special circuits, since the existing interisland microwave radio systems are reaching their capacity limits. The fiber optic cables will also improve transmission quality. The project was completed in July 1994 at a final cost of \$29.9 million.

GTE Hawaiian Tel contends that all of the interisland fiber optic cable costs should be recoverable and included in rate base. The company reports that every link of the interisland fiber is presently in use, and at the present rate of growth, the Oahu to Maui link will provide capacity to meet the State's needs only through the year 1998.

Based on the evidence presented in this proceeding and in Docket No. 7327,¹⁵ the Consumer Advocate claims that only 35.6 per cent of the total cost of the fiber optic project should be included in the company's rate base. The Consumer Advocate contends that only that portion of the project that is reasonably used or useful in providing intrastate telecommunications services should be reflected in the rates GTE Hawaiian Tel charges for intrastate service. This, according to the Consumer Advocate, is

¹⁵In the Agreement filed on July 26, 1996, GTE Hawaiian Tel and the Consumer Advocate agreed that the issue was fully addressed in Docket No. 7327, that their respective positions were fully presented for resolution in that docket, and that the issue may be resolved in this proceeding.

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the ratio of working to available voice frequency (VF) circuits, which is obtained by dividing the 19,368 working VF equivalent circuits by the 54,432 available VF equivalent circuits. The Consumer Advocate argues that because the remaining percentage of total capacity on the digital fiber optic network has been deployed for purposes other than the production of intrastate telephone services, such capacity should not be the responsibility of the general ratepayers.

We believe that only that portion of the fiber optic cable facilities that was reasonably used or useful in providing intrastate telecommunications services in test year 1995 should be included in rate base. Contrary to GTE Hawaiian Tel's contention that all of the interisland fiber optic cable costs are "necessary or useful for public utility purposes" within the meaning of Rule 2.3.d(2) of G.O. 8, we determine that only 35.6 per cent of the facilities was used or useful for the provision of intrastate telecommunications services during the test year. The remaining 64.4 per cent constituted other uses of the facilities, as well as dark fiber.¹⁶ We, thus, will allow only 35.6 per cent of the project costs to be included in rate base.

¹⁶In Docket No. 96-0329, AT&T arbitration proceeding, GTE Hawaiian Tel argued that it did not have to give AT&T access to dark fiber since it was not a "network element," subject to unbundling under the Act. We declined to designate dark fiber as a network element and deferred the matter to the infrastructure proceeding, Docket No. 7702. See Decision No. 15229, Docket No. 96-0329 (1996).

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V.

STIPULATED ITEMS

A. Based on Adoption of Consumer Advocate's Position

Agreement on the following items resulted from GTE Hawaiian Tel's adoption of the Consumer Advocate's position or adjustments: Hawaii Capital Goods Excise Tax Credit (HSCGETC), Deferred Income Tax Reserve Adjustment, Payroll, Benefits, Hawaiian Telephone Insurance Company, GTE Government Systems HITS Contract, Shared Assets Study, Process Re-engineering (PR), Advertising, and Alakea Restack Lease Savings. We accept the stipulations of GTE Hawaiian Tel and the Consumer Advocate on these items as reasonable.

B. Based on Compromise of the Parties

1. Revenue Adjustments

GTE Hawaiian Tel agreed to accept one-half of the dollar value of the Consumer Advocate's proposed adjustments. The adjustment results in a \$3,222,000 reduction in the company's test year revenue requirement.

2. Pension Asset

GTE Hawaiian Tel and the Consumer Advocate agreed to include only the 1995 pension costs in the test year.

3. GTE Affiliates

The Consumer Advocate proposed adjustments relating to: (1) GTE Laboratories, on the grounds that selected research projects were not beneficial to the ratepayer; (2) GTE Service

Corporation, on the grounds that certain costs did not directly benefit Hawaii ratepayers or were duplicative of services provided within GTE Telephone Operations; and (3) GTE Data Services and GTE Supply, on the grounds that prices paid for the services and products received should have been lower and that the affiliates were earning unreasonably high returns.

GTE Hawaiian Tel agreed to certain adjustments related to GTE Laboratories' projects. In turn, the Consumer Advocate agreed not to pursue its other proposed affiliate adjustments.

4. Software Expense

The Consumer Advocate proposed to reduce the level of software expense included in the test year. As a compromise, the parties agreed to include the 1995 actual level of software expense in the test year.

5. GDPPI Inflation Factor

While GTE Hawaiian Tel and the Consumer Advocate agreed that an estimate for inflation or productivity offset should be included, they could not agree on a specific level of inflation or productivity offset to included in the test year. The parties arrived at a compromise and agreed to adopt one-half of the adjustments originally proposed by the Consumer Advocate.

6. Public Affairs

The Consumer Advocate proposed to disallow certain GTE Hawaiian Tel public affairs expenses on the grounds that the expenses were related to activities that did not provide direct

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tangible benefits to ratepayers. As a compromise, the parties agreed to adopt one-half of the adjustments originally proposed by the Consumer Advocate.

We accept the stipulations of GTE Hawaiian Tel and the Consumer Advocate on these compromise items as reasonable.

C. Other Items

1. PUC Surcharge Revenues

The Consumer Advocate proposed an adjustment to GTE Hawaiian Tel's test year to eliminate the PUC special fund surcharge. The parties agreed that while the elimination of the surcharge may be reasonable, it would be more appropriate for the issue to be addressed in Phase II of this rate proceeding. In 1994 and projected test year 1995, GTE Hawaiian Tel billed and collected the increase in the PUC fee as a surcharge on customers' bills, in accordance with HRS § 269-30(c). The surcharge was to cover the additional PUC fee imposed on gross revenues on and after September 1, 1994, and was to remain in effect until new rates were approved and the surcharge could be rolled into the new base rates. In this case, we included the revenue tax recovery for the PUC fee at 0.50 per cent per annum in base rates. However, after reviewing GTE Hawaiian Tel's projection of local network revenues, we found that the company included \$1,116,808 in present rates for the PUC fee surcharge. In other words, GTE Hawaiian Tel continues to collect the PUC fee surcharge in its present rates.

Although we defer this issue to Phase II, we note here our concern as to how GTE Hawaiian Tel will adjust its rates to account for the elimination of the PUC fee surcharge. We also have

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concerns regarding GTE Hawaiian Tel's application of the interim additional revenues of \$17.7 million, and its impact, if any, on how the PUC fee surcharge should be eliminated and whether any over- or under-collection has occurred.

2. E911 Surcharge

In Decision and Order No. 13950, we ordered that the E911 surcharge rate of \$0.27 per access line per month shall continue until the company's next rate case, and that the surcharge shall be folded into the company's rates when the commission makes a final determination on the company's rate schedule. Since we will be determining the company's rate schedule in Phase II of this proceeding, we will defer this matter to Phase II.

3. Surcharge A

In Decision and Order No. 13950, we ordered that Surcharge A, which was being assessed upon GTE Hawaiian Tel's ratepayers pursuant to Act 226, 1994 Hawaii Session Laws, shall continue in effect until the surcharge is folded into GTE Hawaiian Tel's rates in its next rate case. Since we will be determining the company's rate schedule in Phase II of this proceeding, we will also defer this matter to Phase II.

4. Revenue Taxes

Both parties apparently agree on the methodology in computing these taxes. GTE Hawaiian Tel and the Consumer Advocate both use 5.885 per cent for the Public Service Company Tax and

EXHIBIT A

0.5 per cent for the Public Utility Fee. We find the tax rates used in this case to compute revenue taxes to be reasonable.

VI.

RATE BASE

In Interim Decision and Order No. 14833, we approved, for interim purposes only, a total rate base amount of \$639,118,000. That rate base includes, among other items, \$1,229,666,000 in telecommunications plant-in-service (TPIS), \$490,632,000 in depreciation and amortization reserve, and a resulting net plant of \$739,034,000.

With respect to the costs of GTE Hawaiian Tel's fiber optic project, we understand that the approved interim rate increase already contains 35.6 per cent of the project's costs, and that GTE Hawaiian Tel is requesting the balance of the total costs, or the remaining 64.4 per cent of the costs, in the final decision and order. In light of our ruling in section IV.D above, no further adjustment to rate base is necessary for this cost item.

With respect to the Hurricane Iniki restoration costs that are to be included in rate base, we make the following adjustments:

1. Net Plant

The interim net plant of \$739,034,000 shall be increased by Hurricane Iniki net plant of \$20,837,000, which is the sum of \$18,426,000 in TPIS and (\$2,411,000) in depreciation and amortization reserve.

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2. Deferred Asset

As discussed earlier, we adjust the Hurricane Iniki deferred asset by removing, as an extraordinary cost item, \$1.7 million of depreciation expense. The adjustment lowers the deferred asset from \$5.967 million to \$5.360 million.

3. Deferred Income Taxes

In light of the reduction in the deferred asset, we make a corresponding decrease in the deferred income taxes associated with the Hurricane Iniki restoration costs. The adjustment lowers the deferred income taxes from \$3.153 million to \$2.914 million.

VII.

RATE OF RETURN

A. Introduction

In determining a fair rate of return, we adhere to the guidelines set forth in Bluefield Waterworks and Improvement Co. v. Pub. Serv. Comm'n, 262 U.S. 679 (1923), and Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944). Accordingly, a fair rate of return must:

- (1) Be commensurate with returns on investment in other enterprises having corresponding risks and uncertainties;
- (2) Provide a return sufficient to cover the capital costs of the business, including service on the debt and dividends on the stock; and
- (3) Provide a return sufficient to assure confidence in the financial integrity of the enterprise to maintain its credit and capital-attracting ability.

GTE Hawaiian Tel, DOD, and the Consumer Advocate stipulated that GTE Hawaiian Tel should be permitted to earn an

EXHIBIT A

overall rate of return of 9.73 per cent on its average rate base for test year 1995. The rate of return is based on the following costs and capital structure:

	<u>Capital Structure</u>	<u>Cost Rate</u>	<u>Weighted Cost of Capital</u>
Short-Term Debt	5.0%	6.05%	0.30%
Long-Term Debt	43.0%	7.66	3.29
Common Equity	<u>52.0%</u>	<u>11.80</u>	<u>6.14</u>
Total	100.0%		9.73%

Before the agreement, by its revised filings on June 21, 1996, GTE Hawaiian Tel sought an overall rate of return of 10.151 per cent. This overall rate was based on the stipulated capital structure and the stipulated costs of short-term and long-term debt. The rate, however, was based on a cost of common equity of 12.6 per cent.¹⁷

The Consumer Advocate's proposal as of May 10, 1996, was for an overall rate of return of 9.19 per cent. This rate of return was based on the stipulated capital structure and the stipulated costs of short-term and long-term debt. It was also based on 10.75 per cent cost of common equity.

In its submittal filed on May 8, 1996, DOD recommended that GTE Hawaiian Tel be granted no rate increase.

The stipulation reflects acceptance by GTE Hawaiian Tel and DOD of the Consumer Advocate's proposed capital structure and

¹⁷Initially, on September 29, 1995, GTE Hawaiian Tel requested an overall rate of return of 10.391 per cent, based on (1) a capital structure of 4.6 per cent short-term debt, 43.13 per cent long-term debt, and 52.27 per cent common equity; and (2) costs of 7.534 per cent for short-term debt and long-term debt and 13.0 per cent common equity.

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the acceptance by DOD and the Consumer Advocate of GTE Hawaiian Tel's costs of short-term and long-term debt. It also reflects a compromise on the cost of common equity. The 11.8 per cent cost of common equity lies near the mid-point between GTE Hawaiian Tel's proposed 12.6 per cent and the Consumer Advocate's proposed 10.75 per cent.

We accept the stipulated rate of return of 9.73 per cent as reasonable. We have concluded that the stipulated rate is reasonable after a review of the stipulated capital structure and costs of debt and equity. Our findings in this review are outlined below.

In our review, we considered post-stipulation events relating to GTE Hawaiian Tel's actual capital structure, such as an \$50 million infusion of capital from GTE Corporation in July of 1996. Otherwise, we based our review on conditions as they existed at the time of the stipulation. This is a departure from our usual practice of evaluating the reasonableness of the proposed capital costs in light of the most recent data available to us at the time of the issuance of our decision and order. Reliance on the data available at the time of the stipulation is reasonable for purposes of this docket, since the parties entered into the stipulation in good faith, and there has been no material change in conditions since the stipulation. For instance, the risks of GTE Hawaiian Tel have remained the same and short-term interest rates have remained stable. Additionally, although long-term interest rates have decreased by approximately 25 basis points, that decrease did not

materially affect results of the parties' cost of capital analyses.¹⁸

B. Capital Structure

The stipulated capital structure reflects the Consumer Advocate's proposed capital structure as of May 10, 1996. GTE Hawaiian Tel's actual 1995 average year capital structure was 17.04 per cent short-term debt, 35.39 per cent long-term debt, and 47.57 per cent common equity.¹⁹ Although the actual ratios more than nominally deviate from the agreed-upon structure, we note that GTE Hawaiian Tel's capital figures include a write-down of assets in connection with its parent corporation's restructuring program (begun in 1994) and an accompanying write-down of equity capital. Moreover, we recognize that the proposed capital structure anticipated a \$50 million capital infusion from GTE Corporation.²⁰

At year-end 1995, GTE Hawaiian Tel's actual capital structure (not averaged and accounting for the write-down of equity of \$22,481,120) was 4.92 per cent short-term debt, 46.17 per cent long-term debt, and 48.92 per cent common equity, demonstrating significant movement toward the agreed upon capital structure. In 1996, with the \$50 million capital infusion, the capital ratios

¹⁸The parties used forecasted long-term United States Treasury bond rates ranging from 6.7 per cent to 6.75 per cent. The long-term bond rate at the time of the stipulation was approximately 7.0 per cent. It is currently 6.75 per cent.

¹⁹These ratios are based on GTE Hawaiian Tel's response to CA-IR-310.

²⁰The capital infusion occurred in August 1996.

moved closer to the stipulated structure. We, thus, accept the capital structure as agreed to by the parties.

C. Cost of Debt

The stipulated 6.05 per cent cost of short-term debt reflects the cost at the time of the stipulation. The stipulated 7.66 per cent cost of long-term debt is the embedded composite cost of GTE Hawaiian Tel's long-term debt. We accept these stipulated costs as reasonable. The stipulated costs are the same as those proposed by the Consumer Advocate and GTE Hawaiian Tel immediately before the stipulation.

D. Cost of Common Equity

1. Generally

We also accept the parties stipulated 11.8 per cent cost of common equity. As noted above, the 11.8 per cent lies near the mid-point between GTE Hawaiian Tel's proposed 12.6 per cent and the Consumer Advocate's 10.75 per cent. Our conclusion that the 11.8 per cent is reasonable is supported by our review of the parties' separate analyses of the cost of common equity. With appropriate adjustments, the results of the parties' analyses appear to converge and to confirm the reasonableness of the 11.8 per cent cost of common equity.

GTE Hawaiian Tel proposed a cost of common equity of 12.6 per cent, based on calculations applying the discounted cash flow (DCF) method and the capital asset pricing model (CAPM). GTE Hawaiian Tel applied the methodologies to two groups of comparable companies: (1) a group consisting of the seven regional Bell

EXHIBIT A

operating companies (RBOCs); and (2) a group of three independent local exchange carriers (Independents).

The use of comparable companies in estimating the cost of common equity is appropriate, particularly where, as here, the utility (GTE Hawaiian Tel) is a wholly owned subsidiary of a parent company (GTE Corporation), and its stock is not publicly traded. The comparables technique calculates the cost of common equity for a portfolio of companies whose risks are deemed comparable to the utility in question and assumes that the rate of return on common equity for the comparable companies is a valid estimate of the common equity return for the utility in question. Some reasonable adjustments may be made to account for differences in financial, operating, and business characteristics between the utility and the comparable companies.

The Consumer Advocate based its recommended 10.75 per cent rate of return on common equity on calculations using the DCF model and employing the CAPM, modified earnings-price ratio (MEPR), and market-to-book ratio (MTB) methodologies as a check of its DCF results. The Consumer Advocate applied the DCF model and the other methodologies to: (1) the RBOCs; and (2) a group of companies consisting of all 11 gas distribution companies (Gas Utilities).

DOD based its recommendation for no rate increase on its comparison of GTE Hawaiian Tel's performance to the telecommunications industry in general and to the RBOCs in particular. DOD concluded that GTE Hawaiian Tel's poor profitability is due to its poor operating performance.

We have recognized the DCF model and the CAPM as appropriate methodologies to be used in estimating the cost of

EXHIBIT A

common equity.²¹ Experts differ as to the relative merits of each method. For instance, GTE Hawaiian Tel acknowledged that neither method should be relied upon entirely and averaged its DCF and CAPM results. On the other hand, the Consumer Advocate relied primarily on the DCF model, although it made a downward adjustment based on the results of its application of the other methodologies. We recognize the shortcomings of each method, but nonetheless we have consistently held that both of these methodologies are appropriate in estimating the cost of common equity.

We have not, however, accepted the MEPR and MTB methodologies as appropriate techniques for estimating the cost of common equity. Additionally, we did not accept the conclusions drawn by DOD based on its "performance comparison" analysis. Accordingly, in our review of the reasonableness of the stipulated cost of common equity, we disregarded all of the results of the Consumer Advocate and DOD based on these methods.

We also did not consider the results of the application by the Consumer Advocate of the various methodologies to the Gas Utilities. The Gas Utilities do not meet the criteria established

²¹The DCF model is a stock valuation approach in estimating the cost of common equity. Under the DCF model, the required rate of return is the sum of (1) the current divided yield, represented by the ratio of expected next-period dividends to current stock prices, and (2) the expected constant dividend growth rate.

The CAPM is a variation of the risk premium model. The required rate of return on common equity under the CAPM is the sum of (1) the risk-free component (usually the return on long-term United States Treasury bonds) and (2) the risk premium to which is applied the appropriate beta to derive a value for the nondiversifiable risk. Beta is a measure of the relative risk of a security compared to the risk of the average market stock. The beta for the market is set equal to 1.0. Stock with beta greater than 1.0 is more risky than the average market stock, and a stock with a beta less than 1.0 is less risky than the average market stock.

by this commission in the selection of comparables. In numerous prior decisions, the commission stated that a comparable company should be similar to the utility in question in terms of industry type, size, operation, business environment, and financial and capital attraction characteristics. We have acknowledged that at times and under changing industry circumstances, the strict application of our criteria may not produce a sample of carriers sufficiently large in number to provide meaningful cost of equity results. We have, thus, held that under certain circumstances, the commission's criteria may need to be applied advisedly. However, in this instance there are adequate comparisons in the telecommunications industry such that the use of comparables from another industry is unwarranted.

2. GTE Hawaiian Tel's Analysis

GTE Hawaiian Tel's application of the DCF model to the RBOCs produced a range of cost of common equity of 12.3 per cent to 12.5 per cent. Its application of the DCF model to Independents produced a range of 13.5 to 13.8 per cent. GTE Hawaiian Tel used the average of the Value Line earnings per share growth rates and the Institutional Brokers Estimate Service (IBES) projected growth rates. While we do not believe that the use of earnings per share growth rates is appropriate and prefer the use of dividends per share growth rates, we will, nonetheless, consider GTE Hawaiian Tel's DCF results.

In its CAPM analysis, GTE Hawaiian Tel used the Blue Chip consensus forecast of the 30-year United States Treasury bond rate of 6.7 per cent as the risk free rate. For the market risk

premium, GTE Hawaiian Tel relied on data from Stocks, Bonds, Bills and Inflation - 1996 Yearbook, Ibbotson Associates, and Value Line. GTE Hawaiian Tel first calculated a forecasted three-to-five year total annual market return of 13.2 per cent, using data from Value Line Summary and Index for the four weeks ending May 10, 1996. From the total market return, GTE Hawaiian Tel subtracted the long-term Blue Chip forecasted 30-year United States Treasury bond yield of 6.7 per cent to arrive at a market risk premium of 6.5 per cent. GTE Hawaiian Tel, then, calculated the market risk premium indicated by the Ibbotson 1996 Yearbook. That is, it took the Ibbotson-calculated market premium of 7.0 per cent for the period 1926 to 1995 (the market return of 12.5 per cent less the long-term government security yield of 5.5 per cent). GTE Hawaiian Tel averaged the Value Line indicated risk premium (6.5 per cent) and the Ibbotson risk premium (7.0 per cent), and arrived at a market risk premium of 6.8 per cent (6.75 per cent rounded).

For betas, GTE Hawaiian Tel used the Value Line betas. Applying the company-specific betas to the risk premiums, GTE Hawaiian Tel calculated the average risk premium for both the RBOCs and Independents at 5.45 per cent. The resulting CAPM-derived cost of common equity was 12.1 per cent.

3. The Consumer Advocate's Analysis

The Consumer Advocate's application of the DCF model to the RBOCs using sustainable growth rates for each company produced a cost of common equity of 11.58 per cent.

The Consumer Advocate's application of CAPM model to the RBOCs using two different risk premiums and two different risk free

EXHIBIT A

rates produced a range of common equity of 9.88 per cent to 11.47 per cent (historic data) and 10.47 per cent to 10.9 per cent (projected data). The Consumer Advocate used betas reported in Value Line. For our purposes here, we adjusted the Consumer Advocate's calculation of the cost of common equity applying the CAPM, as follows.

First, the Consumer Advocate used an historic average arithmetic risk premium and an historic average geometric risk as reported in Stocks, Bonds, Bills and Inflation - 1995 Yearbook, Ibbotson Associates, together with an average of the then current short-term United States Treasury bill rate and short-term United States Treasury bill futures rates as the risk free rate (4.75 per cent). However, we have held in the past that the use of an historic average geometric risk premium is not proper and that only the historic average arithmetic risk premium should be used in calculating the cost of common equity based on the CAPM model. We also have consistently held that the appropriate risk-free government security to be used in an CAPM analysis is the 30-year United States Treasury bond. Hence, in our review, we discarded the results of the Consumer Advocate's CAPM application that relied on the historical average geometric risk premium and short-term United States Treasury bill rates.

When we used the historic average arithmetic risk premium and long-term government bond return reported in the Ibbotson 1995 Yearbook (12.2 per cent - 5.2 per cent = 7.0 per cent), the Consumer Advocate's average of the RBOCs beta (.79), and the 30-year United States Treasury bond rate as of May 10, 1996

EXHIBIT A

(7.01 per cent), we arrived at a CAPM cost of equity of 10.96 per cent.

Second, the Consumer Advocate used a forecasted risk premium of 12.0 per cent which is the average of the results of the its DCF analyses using Value Line projections and IBES projections for the Standard & Poor's 500. In this instance the Consumer Advocate used both annualized average forecasts (for the period from March 1996 through March 1997) of United States Treasury bill rates and United States Treasury bond rates as the risk free rates (4.73 per cent and 6.73 per cent respectively). While we disregarded the results obtained using the forecast of the short-term United States Treasury Bill, we considered the CAPM cost of equity of 10.9 per cent obtained by using the long-term United States Treasury bond rate.

In deciding on its recommended cost of common equity for GTE Hawaiian Tel, the Consumer Advocate took its DCF result of 11.58 per cent and made a downward adjustment to 10.5 per cent to 11.0 per cent based on its CAPM and other results for the RBOCs and Gas Utilities. The mid-point of the Consumer Advocate's adjusted range is 10.75 per cent.

When we average the CAPM cost of equity obtained using historical data and long-term United States Treasury bond rates (10.96 per cent) and the CAPM cost of equity using projected data, and the long-term United States Government bond rate (10.9 per cent), we arrive at a CAPM cost of equity of 10.93 per cent. The CAPM equity cost does not warrant an adjustment of 83 basis points made by the Consumer Advocate to its DCF result to arrive at its recommended 10.75 per cent return on common equity.

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The average of the Consumer Advocate's DCF result (11.58 per cent) and CAPM results of 10.93 per cent is 11.3 per cent. If we average that result with GTE Hawaiian Tel's recommended 12.6 per cent cost of equity we arrive at a cost of equity of 11.77 per cent. We, thus, find that the stipulated 11.8 per cent cost of common equity is reasonable.

E. Overall Return on Rate Base

Based on our findings that the stipulated capital structure and the stipulated costs of the various components of the structure are reasonable, we find that the stipulated overall rate of return of 9.73 per cent is reasonable.

VIII.

QUALITY OF SERVICE

In Decision and Order No. 13950, filed in Docket No. 7579, the company's prior rate case, we stated that we would review the quality of the GTE Hawaiian Tel's service in its next rate case. We expressed our expectation that the company will show improvements in achieving, if it did not fully achieve, the quality standards. We further stated that we would, in particular, evaluate GTE Hawaiian Tel's performance in terms of those standards that GTE Hawaiian Tel had failed to meet previously.

GTE Hawaiian Tel contends that it either meets or is showing improvement in all service measurements. The Consumer Advocate apparently agrees, for in the Agreement, the Consumer Advocate withdrew its earlier recommendation that a service quality penalty and additional monitoring procedures be imposed.

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Based on the reported data, we conducted our own examination of GTE Hawaiian Tel's performance in each of the 12 service standards that we discussed in Decision and Order No. 13950. We found the following:

1. GTE Hawaiian Tel appears to be meeting or exceeding the standards for installation commitments completed, installation (service) orders completed within three days, customer trouble reports, operator assistance answer time, calls processed (dial service results), and dial tone speed.

2. GTE Hawaiian Tel has shown some improvement in achieving the standards for held primary service orders, held regrade service orders, directory assistance operator answer time, interruptions of service, repair answer time, and service office answer time.

In summary, we conclude that although the company has made progress in meeting its quality standards since its last rate case, problems persist with respect to the company's long-term performance, the completeness of its reports, and the accuracy of the data reported. The company has not been consistent in meeting the quality standards in a number of areas since its last rate case, and because the reports do not reflect all central offices and excludes extraordinary events, we question the completeness of the reports and the accuracy of the data filed.

Where GTE Hawaiian Tel currently meets or exceeds the standard, we expect the company to maintain its quality of service in a consistent manner. Where it has improved its performance but has not yet achieved its standards, we expect GTE Hawaiian Tel to show substantial improvement, if not the achievement of the quality

EXHIBIT A

standards, by the next rate case. In this regard, we will continue to monitor GTE Hawaiian Tel's service quality closely and will review its service quality for the following standards in particular in its next rate case: held primary service orders, held regrade service orders, directory assistance operator answer time, interruptions of service, repair answer time, and service office answer time.

IX.

ULTIMATE FINDINGS AND CONCLUSIONS

The commission makes the following ultimate findings of fact and conclusions of law.

1. The recovery of incentive compensation in rate base is not justified.
2. The current depreciation rates are just and reasonable.
3. The inclusion in rate base of 35.6 per cent of the interisland fiber optic project costs is reasonable.
4. The recovery of extraordinary, noncapital Hurricane Iniki restoration costs in rate base is reasonable. Among other items the associated costs include: (1) net plant costs in the amount of \$20.837 million; (2) deferred asset, restoration costs for extraordinary, noncapital expenses in the amount of \$5.360 million; (3) deferred income taxes in the amount of \$2.914 million; and (4) depreciation and amortization expense of \$2.086 million adjusted for a 10-year cost in service.

EXHIBIT A

5. The operating revenues, operating expenses, and operating income for the test year, as set forth on Exhibit A, are reasonable.

6. The use of an average test year rate base is reasonable.

7. The test year average depreciated rate base under approved rates is \$662,973,000. See Exhibit B.

8. Under existing rates, GTE Hawaiian Tel's income for the test year would provide a rate of return of 7.12 per cent on the average rate base.

9. The capital structure for the test year is as follows: short-term debt, 5 per cent; long-term debt, 43 per cent; and 52 per cent for common equity. A fair rate of return for the test year is 9.73 per cent.

10. GTE Hawaiian Tel is entitled to a final total rate increase that will produce a revenue increase of \$23,589,000.

11. The interim increase of \$17.937 million granted under Interim Decision and Order No. 14833, effective September 1, 1996, was necessary, just, and reasonable. No refunds are required.

12. An additional increase of \$5,652,000 over and above the interim increase is necessary, just, and reasonable.

X.

ORDER

THE COMMISSION ORDERS:

1. GTE Hawaiian Tel may increase its rates to produce a final total annual sales revenue increase of \$23,589,000, as


EXHIBIT A

shown on Exhibit A, or a rate of return of 9.73 per cent on an averaged rate base for the 1995 test year. The effective date of the rate increase is February 5, 1997. This increase supplants the increase previously approved by the commission on an interim basis in this docket.

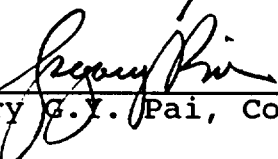
2. Within 48 hours of the date of this decision and order, GTE Hawaiian Tel shall submit for commission review and approval a revised schedule of rates and charges, reflecting the increase in rates allowed by this decision and order. GTE Hawaiian Tel shall serve a copy of the revised schedule upon the parties and participants.

DONE at Honolulu, Hawaii this 31st day of January, 1997.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Yukio Naito, Chairman

By 
Dennis R. Yamada, Commissioner

By 
Gregory G.Y. Pai, Commissioner

APPROVED AS TO FORM:



Anthony D. Valdez
Commission Counsel

EXHIBIT A

DOCKET NO. 94-0298

GTE HAWAIIAN TEL

RESULTS OF OPERATIONS
(\$ IN 000'S)

	PRESENT RATES	ADDITIONAL AMOUNT	APPROVED RATES
	-----	-----	-----
Operating Revenues:			
Local Network	231,921	23,589	255,510
Network Access	6,306		6,306
Long Distance Network	51,743		51,743
Miscellaneous	45,966		45,966
	-----	-----	-----
Total Operating Revenues	335,936	23,589	359,525
	-----	-----	-----
Operating Expenses:			
Plant Specific	66,870		66,870
Plant Nonspecific	24,913		24,913
Depreciation & Amort.	81,131		81,131
Customer Operations	34,836		34,836
Corporate Operations	36,122		36,122
Other Op. Inc. & Exp.	(28)		(28)
Int. on Customer Deposits	56		56
Uncollectible	5,103	311	5,414
	-----	-----	-----
Total Operating Exp.	249,003	311	249,314
	-----	-----	-----
Op. Income Bef. Taxes	86,933	23,278	110,211
	-----	-----	-----
Taxes:			
Taxes Other Than Income Tax	20,345	1,506	21,850
Income Taxes	19,375	4,458	23,833
	-----	-----	-----
Total Taxes	39,720	5,964	45,683
	-----	-----	-----
Net Operating Income	47,213	17,313	64,527
	=====	=====	=====
Average Depreciated Rate Base	662,973	0	662,973
	=====	=====	=====
Rate of Return	7.12%		9.73%
	=====		=====

EXHIBIT A

DOCKET NO. 94-0298

GTE HAWAIIAN TEL

ANALYSIS OF RATE INCREASE
(\$ IN 000'S)

	AMOUNT =====	% INCREASE =====
RATE INCREASE:		
LOCAL NETWORK REVENUES	23,589	10.17%
TOTAL INCREASE	----- 23,589	-----
LESS:		
INTERIM RATE INCREASE (D&O No. 14833)	17,937	7.73%
TOTAL REDUCTION	----- 17,937	-----
FINAL INCREASE	5,652 =====	2.44%

EXHIBIT A

DOCKET NO. 94-0298

GTE HAWAIIAN TEL

AVERAGE DEPRECIATED RATE BASE
(\$ IN 000'S)

	1/1/95	12/31/95	AVERAGE BALANCE
	-----	-----	-----
Net Plant in Service	759,871	759,871	759,871
Additions:			
Materials & Supplies	1,786	1,786	1,786
Prepaid Expenses	340	340	340
Employee Pension Plan Asset	16,284	16,284	16,284
Capitalized Int. During Const	22,330	22,330	22,330
Iniki Deferred Asset	5,360	5,360	5,360
	-----	-----	-----
Total Additions	46,100	46,100	46,100
	-----	-----	-----
Deduct:			
Deferred Income Taxes	141,489	141,489	141,489
SFAS 112 Liability	379	379	379
Customer Deposits	1,130	1,130	1,130
	-----	-----	-----
Total Deductions	142,998	142,998	142,998
	-----	-----	-----
Average Depreciated Rate Base - Approved Rates			662,973
			=====

EXHIBIT B

EXHIBIT A

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 15345 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
DIVISION OF CONSUMER ADVOCACY
P. O. Box 541
Honolulu, HI 96809

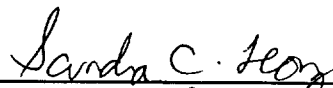
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Sandra C. Leong
Clerk

DATED: January 31, 1997

EXHIBIT A

SERVICE LIST

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DATED: Honolulu, Hawaii, March 6, 1997.



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COMPANY INCORPORATED