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ORIGINAL

Decision No. 78133

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of General Telephone Company of California, a corporation, for authority to increase its rates and charges for telephone service.	Application No. 51904 (Filed May 15, 1970) (Amended July 17, 1970)
Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, separations, practices, contracts, service and facilities of General Telephone Company of California.	Case No. 9100 (Filed August 4, 1970)

Albert M. Hart, H. Ralph Snyder, Jr., Walter Rook, and John Robert Jones, Attorneys at Law, for applicant/respondent.
Shirley Goldinger, for Association of California Consumers, protestant.
Roger Arnebergh, City Attorney, by Charles E. Mattson, Deputy City Attorney, for City of Los Angeles; Louis Possner, for City of Long Beach; and Joseph R. Gallagher, in propria persona; interested parties.
Janice E. Kerr and Leonard L. Snaider, Attorneys at Law, Colin Garrity and John Gibbons, for the Commission staff.

INTERIM OPINION

By the above-entitled application, General Telephone Company of California (General) seeks to increase certain intrastate rates and charges applicable to telephone service within the State of California. It seeks to do this in two stages, initially through $13.5 million in interim rate relief, and ultimately through its total request of $66.5 million.

Specifically, General requests this Commission:

(1) To issue, after hearing held at the earliest possible date, an interim order authorizing General to place in effect for intrastate telephone service either of the alternative rate Proposals I and II set forth in Exhibit D-1 to the amendment to the application. Proposal I affects primarily Message Toll Telephone Service and Message Unit Service and yields General, by its estimates, additional annual revenues of $13,683,000 based on year 1970; Proposal II affects primarily Individual Line, Party Line, PBX Trunk Line and Semipublic service and yields General additional annual revenues of $13,425,000 based on year 1970.

(2) To issue, upon further hearings, an order authorizing General to place in effect the rates and charges designated "Proposed Rates" in Exhibit C to the application. Such proposed rates for intrastate telephone service yield General, by its estimates, a $66,468,000 increase in annual gross revenues over those at present rates based on year 1970.

Consolidated for hearing with General's application is the Commission's investigation under Case No. 9100. In addition, the Commission's investigation into rates, separations etc., of telephone utilities in California under Case No. 9045, consolidated with Application No. 51774 filed by The Pacific Telephone and Telegraph Company (Pacific) and related proceedings, bears upon General's application and also Case No. 9100, since intrastate message toll rate schedules apply to all California telephone utilities.

This interim decision relates solely to General's request for expedited interim rate relief.

Public Hearing

On August 19 and 20, 1970, public hearing was held before Commissioner Symons and Examiner Main at Los Angeles in response to General's request for expedited rate relief in the sum of approximately $13.5 million. Upon conclusion of oral argument on August 20, 1970, the revenue requirement portion, exclusive of rate spread, of the expedited rate relief sought in the amendment, filed July 17, 1970, to Application No. 51904 was submitted.

On November 12 and 13, 1970, public hearing was held in the Case No. 9045 portion of the consolidated proceedings in Application No. 51774 et al for the purpose of taking evidence concerning the rate spread of the interim rate relief sought by General. The record of said hearing[1/] has been incorporated by reference in the consolidated proceedings in Application No. 51904 and Case No. 9100.

General's Position

It is General's position that it must obtain the expedited rate relief it now seeks if it is to meet its financial obligations in the year 1970 and to enter 1971 with a minimally acceptable basis for attracting its capital requirements at reasonable terms. In revising its interim rate request of approximately $21 million in the application before amendment downward to approximately $13.5 million in the amendment filed July 17, 1970, General has reflected all of the rate-making adjustments adopted in its last rate proceeding, Decision No. 75873, dated July 1, 1969 in Application No. 49835.

1/ Exhibits Nos. I, II, II-A, III, IV, IV-A, V-A, VI, 2 and 2-A; and Transcript Volumes 33 and 34 in Application No. 51774 and related cases.

General's Evidence

In January 1969, December 1969, and June 1970, General sold its Series U, V, and W issues of first mortgage bonds. The U issue yielded net proceeds of $59,315,162 at an interest cost of 7.25 percent; the V issue, $59,787,343, at 9.29 percent; the W issue, $69,588,720, at 9.79 percent. These issues have raised General's embedded debt cost to 5.95 percent compared to an embedded debt cost of 5.08 percent used in Decision No. 75873.

In Exhibit No. 3, General sets forth its results of intrastate operation for year 1970 estimated. Such results at present rates and at proposed interim rates are tabulated below:

Results of Intrastate Operation

Item	Year 1970 Estimated		
	Present Rates	Proposed Interim Rates: Increase	Proposed Interim Rates: Total
	(Thousands of Dollars)		
Operating Revenues	$ 369,110	$13,494	$ 382,604
Operating Exp. & Taxes	290,927	6,968	297,895
Net Operating Income	78,183	6,526	84,709
Avg. Net Plant & Wkg. Cap.	1,133,544	-	1,133,544
Rate of Return	6.90%	-	7.47%

The above operational results reflect (1) elimination of the federal income tax surcharge, (2) current level of state corporation franchise tax (3) directory advertising rate and contract changes, (4) service connection depreciation rate of 13 percent, and (5) the rate-making adjustments adopted in Decision No. 75873. In view of the basis upon which the results of operation are stated, the

Commission staff supports their use for the purpose of evaluating General's request for expedited rate relief. General stresses that its use of the rate-making adjustments adopted in Decision No. 75873 should be without prejudice to its right to controvert those adjustments in its case in support of its over-all rate increase request in the amount of approximately $66 million annually.

General's rate of return of 7.47 percent, as developed above at its proposed interim rates, on its intrastate operations exceeds by 0.57 percent the 6.9 percent rate of return at present rates, and by 0.47 percent the 7.0 percent rate of return used to set the rates authorized in Decision No. 75873. In that decision, a rate of return range of 7.0 to 7.4 percent was found reasonable for General's intrastate operations. Rates were authorized therein to produce a 7.0 percent rate of return after levying a service penalty of 0.2 percent in rate of return.

To support the 0.47 percent increment in rate of return over the 7.0 percent used to authorize rates in Decision No. 75873, General presented in Exhibit 10-A the following comparison of composite costs of money:

General's Composite Costs of Money

	Ratio	Rate	Total
A. Calculation in Decision No. 75873:			
Long-Term Debt	51.6%	5.08%	2.62%
Bank Loans	1.1	6.50	.07
Preferred Stock	4.4	4.91	.22
Equity	42.9	10.00	4.29
Total	100.0%		7.20%
B. Calculation reflecting current interest rates:			
Long-Term Debt	51.6%	5.95%	3.07%
Bank Loans	1.1	8.00	.09
Preferred Stock	4.4	4.91	.22
Equity	42.9	10.00	4.29
Total	100.0%		7.67%
Increase			0.47%

Based on current capital ratios and costs, General's composite costs of money reflecting (1) a 10.00 percent return on equity and (2) a 7.67 percent composite cost are as follows:

	Ratio (7-31-70)	Rate	Total
Long-Term Debt	55.1%	5.95%	3.28%
Notes	3.4	8.00	.27
Preferred Stock	3.8	4.91	.19
Equity	37.7	10.00/10.42	3.77/3.93
Total	100.0%		7.51/7.67%

As a longer term objective General seeks to maintain an equity ratio of 40 percent. It plans an early 1970 equity issue in the amount of $58.5 million.

General's financial witness considers that its "A" bond rating is in jeopardy and that expedited interim rate relief is needed to forestall a downrating. He attributes this precarious situation primarily to the present long-term debt ratio of 55.1 percent and the decline in interest coverages. The times interest earned after taxes reflecting this decline are: 3.46 in 1964; 2.97 in 1965; 2.87 in 1966; 2.44 in 1967; 2.43 in 1968; and 2.35 in 1969. For 1970, he projects about 1.9 times interest earned without the expedited interim rate relief sought and about 2.1 with it.

According to this witness, a drop in bond rating to Baa probably carries an interest rate increment of .25 to .40 percent ($2,500 to $4,000 of additional interest cost per year per $1,000,000 of new bond issue), induces especially careful evaluation of the quality of new bond issues, precludes certain important investor participation because a large segment of investment funds are restricted to bond ratings of A and above, and jeopardizes short-term borrowings at the prime rate.

Staff's Position

Although a dire financial emergency does not exist as evidenced by General's expecting to earn a return of 6.9 percent on its intrastate operations for the year 1970, the large unexpected increase in embedded cost of debt occasioned by the issuance of $130 million in bonds since the Decision No. 75873 with a resultant decline in times interest coverage presents an extraordinary circumstance which requires the Commission's attention. In no event, however, should General's request for interim relief of $13.5 million be granted.

Some relief is warranted, nevertheless, to halt the decline in times interest coverage. Its extent should not exceed the high end of the range of return last found reasonable, that is 7 to 7.4 percent minus whatever service penalty may exist at the time of the decision herein.

Staff's Evidence

The staff witness, a financial expert of the Finance and Accounts Division, sponsors the Division's view that under certain circumstances expedited rate relief responsive to significantly increased costs of senior capital is warranted. In his judgment the expedited rate relief sought by General should be granted in part. Some of the important circumstances and factors bearing upon his judgment follow.

In the last rate proceeding, Decision No. 75873, the Commission found a range in rate of return of 7.0 percent to 7.4 percent to be reasonable, and set the return at 7.2 percent before the .2 percent penalty reduction for poor service. Since the issuance of that decision in July 1969, applicant has experienced increases in cost of senior capital greater than could have been anticipated by any witnesses in that proceeding, to wit: the Series V Bonds sold December 23, 1969 at a coupon rate of 9½ percent and the Series W Bonds sold in June of this year at a coupon rate of 9 3/4 percent. It is not only significant to note the extremely high coupon rates that were required by the lenders but also the fact that $130,000,000 in additional debt has been issued since the last rate proceeding in 1969. This constitutes approximately 22% of applicant's total long-term debt.

Financial data maintained by the staff and published annually in its Comparative Statistical Data show that General's times fixed charges earned (after income taxes) has declined from 2.90 times in 1965 to 2.22 times at the end of 1969. Information recently secured indicates that the interest coverage at June 30, 1970 had declined to 2.18 times earnings, and that based on projections of current revenues and expenses it appears that the coverage will decline to 1.87 times by December of this year.

The ratio of earnings to fixed charges that General was required to report in its bond prospectus dated June 9, 1970, (which does not include payment of income taxes and only partial payments on rental or lease commitments) is shown at 4.22 times at the end of 1965 and 3.21 times as of March 31, 1970. Further, based upon the projections referred to in the previous paragraph, it is estimated that on this ratio of earnings to fixed charges it will have declined to 2.57 times by December 31, 1970.

For interim rate relief purposes it is not desirable to increase the return on General's common equity to the level which was indicated when rates were last set. If the return on common equity were to be changed from an opportunity to earn to a guaranteed result, the Commission would in effect be reducing the risk borne by common equity. This, in itself, would justify a lower rate of return on common equity than would otherwise be appropriate.

In light of the foregoing guidelines, the staff witness recommends that such expedited rate relief be granted as will yield a rate of return of 7.4 percent on General's intrastate operations, minus, perhaps, whatever service penalty is retained, but in no event, with or without service penalty, greater than 7.4 percent. A 7.4 percent rate of return requires $11.8 million of additional annual gross revenues based on year 1970, or $1.7 million less than the $13.5 million sought by General as expedited interim rate relief.

City of Los Angeles' Position

The City has reservations concerning General's need for interim rate relief, but defers to the judgment of the staff witness and the staff presentation. The City considers the bond rating matter a serious one requiring the exercise of judgment and observes that the public interest requires sound utilities.

Discussion

General is experiencing burgeoning growth and continuing demands for service improvement. It expects to add over $200 million in new plant, necessary for growth and service improvement, during 1970. Its new construction requirements for the next five years are expected to aggregate in excess of $1 billion.

From the evidence adduced thus far and in light of the time which may be required to develop an adequate record on which to base our eventual decision concerning General's total rate relief request of $66.5 million, it appears that public interest would be served by providing interim rate relief.

In recognizing, through definitive interim rate relief, the extraordinary circumstances of this case, we are attempting to arrest General's downward trend in interest coverage and to enhance its ability to attract its forthcoming capital requirements at reasonable terms. As to the extent of interim rate relief, the very limited evidence presented thus far on rate of return does not warrant going beyond the 7.0-7.4 percent range last found reasonable. General should have an opportunity, however, to earn a rate of return at the top of this range, minus the service penalty.

By Decision No. 77947 dated November 10, 1970, in Application No. 49835 (First Supplemental Application therein) the 0.2 percent rate of return penalty was reduced by one-half. Thus, the interim rate relief which we will authorize herein should be consistent with a 7.3 percent rate of return on General's intrastate operations. An interim additional annual revenue requirement of $7.1 million is needed to achieve that rate of return level based on year 1970 as estimated by General.

Rate Spread

General proposes two rate spread alternatives to achieve its objective of an additional $13.5 million per year as interim rate relief. Under Proposal I the increases are in rates for intrastate message toll service (applicable to all California telephone utilities), message unit service and local messages. Under Proposal II the increases are primarily in basic exchange rates. Either of these proposals can be adapted to fit the lower additional revenue requirement of $7.1 million which is the extent of interim rate relief we will authorize.

However, we are of the opinion that an appropriate rate spread for the interim relief should, to the extent practicable, neither cause increases in the rates of other California telephone utilities nor create a substantial differential in exchange rates of General and Pacific in the Los Angeles area. Accordingly, an interim supplemental charge in the form of a uniform percentage additive, not subject in whole or in part to intercompany settlements, to General's billings to customers for intrastate services is indicated.

At intrastate rates after modification pursuant to Decision No. 77947 supra, General estimates its gross intrastate billings would approximate $362.5 million on a year 1970 service-volume basis. A uniform percentage additive of 1.96 percent, applicable to intrastate service, on the bills rendered by General to its customers accordingly should produce $7.1 million of additional revenue.

Findings and Conclusion

The Commission finds that:

1. General is in need of interim rate relief.

2. The limited evidence presented thus far on reasonable level of rate of return does not warrant interim relief which would exceed the upper limit of the 7.0-7.4 percent range last found reasonable for General minus the 0.1 percent service penalty which has been retained.

3. An interim additional intrastate annual revenue requirement of $7.1 million is justified.

4. An interim supplemental charge in the form of a uniform 1.96 percent additive, not subject in whole or in part to intercompany settlements, to General's billings for intrastate service is the most appropriate means of providing the $7.1 million of interim relief and will be authorized.

5. The interim rate, a 1.96 percent intrastate billing charge, is justified and reasonable and will be in effect only until decision by this Commission on applicant's entire rate increase request.

The Commission concludes that General's request for interim relief should be granted to the extent set forth in the foregoing findings and in the order which follows and in all other respects denied.

The action taken herein is solely for the purpose of granting interim rate relief, and is based on the record as developed at the public hearings thereon which were held prior to November 24, 1970. On that date, however, in Decision No. 77984, in Application No. 51774 et al., involving The Pacific Telephone and Telegraph Company, this Commission enunciated the policy to be adopted in utilizing accelerated tax depreciation with normalization as defined in the Tax Reform Act of 1969, and in accordance therewith we do not deem it necessary to provide for possible refunds to General's customers of part or all of the revenues attributable to the interim rate herein authorized. By not making such provision, we are in effect recognizing, in the interim rate relief granted, the policy set forth in the aforementioned Decision No. 77984. Our eventual decision concerning General's pending total rate relief request, which is based in part on accelerated tax depreciation with normalization and which relates to operational results in test year 1970, will be made in light of and consistent with Decision No. 77984.

INTERIM ORDER

IT IS ORDERED that:

1. General Telephone Company of California is authorized to file with this Commission, on or after the effective date of this

order, a tariff schedule establishing on an interim basis an increase of 1.96 percent applicable only to the intrastate service portion of each customer's bill. Such filing shall comply with General Order No. 96-A. The effective date of the interim schedule shall be five days after the date of filing. The interim schedule shall apply only to service rendered on and after the effective date thereof.

2. The revenues derived from the 1.96 percent intrastate billing charge shall not be subject to intercompany settlements.

The effective date of this order shall be ten days after the date hereof.

Dated at San Francisco, California, this 22nd day of DECEMBER, 1970.

J P Vukasin Jr.
Chairman

William Symons, Jr.

Vernon L. Sturgeon
Commissioners

J P Vukasin Jr.
Chmn.
I will file a concurring opinion.

I will file a concurring opinion.
Thomas Moran

I will file a concurring opinion.
Gatov

A. 51904, C. 9100 mm

THOMAS MORAN, COMMISSIONER, Concurring:

I concur.

I concur despite the language in the third full paragraph on page 13 hereof respecting accelerated depreciation and normalization because, in my opinion, said language is gratuitous, unnecessary, and irrelevant so far as this interim order is concerned and, furthermore, has no legal effect or meaning whatsoever.

THOMAS MORAN
Commissioner

Dated: San Francisco, California
December 22, 1970

A. W. GATOV, COMMISSIONER, Concurring:

I concur with one exception. On Mimeo Page 2, the majority enunciates in clear language that this interim decision relates solely to General's request for expedited interim rate relief. Why then the following language on Mimeo Page 13?

"The action taken herein is solely for the purpose of granting interim rate relief, and is based on the record as developed at the public hearings thereon which were held prior to November 24, 1970. On that date, however, in Decision No. 77984, in Application No. 51774 et al., involving The Pacific Telephone and Telegraph Company, this Commission enunciated the policy to be adopted in utilizing accelerated tax depreciation with normalization as defined in the Tax Reform Act of 1969, and in accordance therewith we do not deem it necessary to provide for possible refunds to General's customers of part or all of the revenues attributable to the interim rate herein authorized. By not making such provision, we are in effect recognizing, in the interim rate relief granted, the policy set forth in the aforementioned Decision No. 77984. Our eventual decision concerning General's pending total rate relief request, which is based in part on accelerated tax depreciation with normalization and which relates to operational results in test year 1970, will be made in light of and consistent with Decision No. 77984."

There is absent any evidence in the record to support this gratuitous offering of the rate payer's money. The concession was not requested by the applicant, the staff or any other party and not one word in the decision makes clear why it was included. The paragraph above quoted should have been deleted from the decision.

Commissioner

Dated at San Francisco, California,
December 22, 1970

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J. P. VUKASIN, JR., CHAIRMAN, CONCURRING OPINION

I concur in the foregoing opinion despite my reservations regarding the granting of interim rate relief. The obvious financial needs of this applicant, as clearly set forth in the record, justify this interim order.

J. P. Vukasin, Jr.
Chairman

San Francisco, California

December 22, 1970