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Decision No. 81836

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of CONTINENTAL TELEPHONE COMPANY OF CALIFORNIA and GOLDEN WEST TELEPHONE COMPANY for an order authorizing applicants to increase their rates for classified telephone directory advertising services.	Application No. 52805 (Filed August 11, 1971; amended January 10, 1972)
In the Matter of the Application of CONTINENTAL TELEPHONE COMPANY OF CALIFORNIA, a California corporation, for authority to increase its rates for telephone services.	Application No. 52859 (Filed September 13, 1971; amended February 4, 1972)
Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, practices, contracts, service, and facilities of CONTINENTAL TELEPHONE COMPANY OF CALIFORNIA, a California corporation; and of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and certain telephone corporations.	Case No. 9296 (Filed November 30, 1971)

Orrick, Herrington, Rowley & Sutcliffe, by James F. Crafts, Jr., and Robert Gloistein, Attorneys at Law, for Continental Telephone Company of California, applicant and respondent.

Robert E. Michalski, Attorney at Law, for The Pacific Telephone and Telegraph Company, interested party and respondent.

A. M. Hart, H. R. Snyder, Jr., and R. L. Swan, for General Telephone Company of California, respondent.

Neal C. Hasbrook, for California Independent Telephone Association; William L. Knecht, Attorney at Law, and Ralph O. Hubbard, for California Farm Bureau Federation; Robert H. Bigham, for Commercial Security Patrol; Edward A. Boehler, for Occidental Chemical Company; and Richard D. Vance, for Weaverville Miracle Mile Association; interested parties.

B. A. Peeters, Attorney at Law, James G. Shields, and John J. Gibbons, for the Commission staff.

OPINION

Introduction

Continental Telephone Company of California (CTCC) and Golden West Telephone Company filed Application No. 52805 on August 11, 1971 seeking to increase their rates for classified directory advertising in the amount of $934,687. Subsequent to this filing, CTCC acquired Golden West Telephone Company.[1/]

On September 13, 1971 CTCC filed Application No. 52859 seeking a general increase of $3,600,000 in local exchange rates and an increase in the statewide toll rates to produce an additional $1,650,000 in revenue settlements.

On November 30, 1971 on its own motion, the Commission ordered an investigation of CTCC, The Pacific Telephone and Telegraph Company (PT&T), and all other telephone corporations doing business in California, Case No. 9296.

1/ Decision No. 78709 dated May 25, 1972 in Application No. 52493, as amended by Decision No. 79987 dated August 24, 1972.

Applicant amended its showing on February 4, 1972. The revised showing reduced the local exchange revenue requirement by $1,072,000 due to the effect of changes in depreciation and investment tax credit. With respect to toll revenues, applicant estimated it would receive additionally $1,900,000 if PT&T's Application No. 52794 were granted.2/

The two applications were consolidated with the investigation for hearing.

2/ Decision No. 79873 dated April 14, 1972 in PT&T's Application No. 52794, modified by Decision No. 79941, increased PT&T's rates including statewide toll rates. CTCC benefited from these decisions by $1,900,000 annually through settlements with PT&T for toll operations. Petitions for review of these decisions were filed with the California Supreme Court.

On June 9, 1972 the California Supreme Court annulled Decision No. 78851 dated June 22, 1971 in Application No. 51774 wherein PT&T had been granted a general increase in rates in the amount of $143 million, which included toll rates. (7 C 3d 331 (1972).)

By Decision No. 80347 dated August 8, 1972, the Commission complied with the Supreme Court's order and authorized $55.4 million of increased revenues to PT&T. On the same day, the Commission issued Decision No. 80348 which restated the rate increase granted by Decisions Nos. 79873 and 79941. The Supreme Court denied review of these decisions on October 12, 1972.

Hearings commenced on February 25, 1972 and were held in ten different locations in applicant's service area, viz.: Victorville, Manteca, Gilroy, Sanger, Taft, Garberville, Weaverville, Ridgecrest, Bishop, and Blythe, as well as San Francisco. During the hearings testimony was taken from 56 of applicant's customers, the majority of whom either opposed the increase or had service problems.

During the course of the hearings, by Interim Decision No. 80214 dated June 28, 1972, the Commission granted the requested increased rates for classified directory advertising.

Applications Nos. 52859 and 52805 and Case No. 9296 were submitted on December 29, 1972 upon the receipt of opening and closing briefs after 36 days of hearing during which over 100 exhibits were received in evidence in addition to direct testimony, cross-examination, and rebuttal testimony.

This is the first time applicant has been before the Commission seeking a general increase in rates. CTCC is an amalgamation of twelve different telephone companies with varying rate structures, the last acquisition having been Golden West Telephone Company.

The last rate increase granted for a major part of applicant's service area was on July 2, 1962 to California Interstate Telephone Company by Decision No. 63885 (59 CPUC 761).

CTCC is a wholly owned subsidiary of Continental Telephone Corporation (CTC). CTC is the third largest independent telephone holding company in the United States. The parent corporation has many operating subsidiaries in 42 states of the United States, Canada, and in five Caribbean Countries. CTC has manufacturing, service, and leasing subsidiaries which provide services and equipment to CTCC.

Issues

The following issues will be considered in the order listed:

A. Rate of Return
B. Affiliated Transactions
C. Results of Operation
   1. Operating Revenues
   2. Expenses
      a. Maintenance, Traffic, and Commercial Expenses
      b. General and Other Expenses
      c. Wages
      d. Taxes
   3. Telephone Plant
      a. Telephone Plant-in-Service
      b. Construction Work In Progress (CWIP)
         i. Non-Interest Bearing CWIP
         ii. Interest During Construction
   4. Depreciation
   5. Rate Base
      a. Working Capital
D. Rate Spread
E. Directory Advertising Rates
F. Service
G. Accounting Practices

Differences between estimates of operating expenses, taxes, and rate base by CTCC and staff arise from differences in estimating procedures and from rate-making adjustments proposed by staff.

Exhibit No. 105 consolidates and sets forth the detail of amounts of differences in the estimates by CTCC and staff of the 1972 results of operation at present rates. The following tabulation compares CTCC and staff estimates of the results of total California interstate and intrastate operations in the test year 1972:

Test Year 1972
Total California Operations
Present Rates
(000 omitted)

	Company Position	Staff Estimating Difference	Staff Rate-making Adjustments	Staff Position
Operating Revenues				
Local Service Revenues	$ 11,478	$ 306	$	$ 11,784
Toll Service Revenues	40,397	725		41,122
Miscellaneous Revenues	1,649	2		1,651
Less: Uncollectibles	250	12		262
Total	$ 53,274	$ 1,021	$	$ 54,295
Operating Expenses and Taxes				
Maintenance	$ 8,498	$ (377)	$ (236)	$ 7,885
Depreciation/Amortization	9,593	(61)	(164)	9,368
Traffic	5,936	227	(162)	6,001
Commercial	3,217	(139)	(58)	3,020
Gen. Off. Salaries and Exp.	3,075	(166)	(38)	2,871
Other Operating Expenses	2,163	(178)	(300)	1,685
Total Operating Expenses	32,482	(694)	(958)	30,830
Operating Taxes: Fed. Income	1,254	720	518	2,492
Cal. Corp. Franch.	461	133	84	678
Other	5,519		(49)	5,470
Total Operating Expense and Taxes	$ 39,716	$ 159	$ (405)	$ 39,470
Balance Net Revenues	$ 13,558	$ 862	$ 405	$ 14,825
Avg. Net Plt., Cash, and M and S				
Tel. Plant in Service	$190,631	$ (543)	$(2,984)	$187,104
Tel. Plant Under Constr. (non-int. bearing)	7,462	(6,587)		875
Cash		3,143	(23)	3,120
Materials and Supplies		2,142		2,142
Investor Supplied Working Capital	7,531	(7,531)		
Less: Depreciation Reserve	27,867	(928)	(441)	26,498
Tax Deferral of Inter-Company Profit	2,571	(19)		2,552
Tax Deferral of Accelerated Depreciation	156			156
Total Rate Base	$175,030	$(8,429)	$(2,566)	$164,035
Rate of Return	7.75%	.91%	.38%	9.04%

(Red Figure)

The foregoing estimates of total California operations are separated into interstate and intrastate operations. Since both parties followed essentially the same procedures in effecting separation of their estimates, no substantial issue exists on the method of separation. The following tabulation compares CTCC and staff estimates in the test year 1972 of the results of California intrastate operations for which increased rates are requested:

A. 52805 et al. ek

Test Year 1972
California Intrastate Operations
Present Rates
(000 omitted)

	Company Position	Staff Estimating Difference	Staff Rate-making Adjustments	Staff Position
Operating Revenues				
Local Service Revenues	$ 11,478	$ 306	$	$ 11,784
Toll Service Revenues	28,940	118		29,058
Miscellaneous Revenues	1,649	2		1,651
Less: Uncollectibles	195	10		205
Total	$ 41,872	$ 416	$	$ 42,288
Operating Expenses and Taxes				
Maintenance	$ 6,511	$ (289)	$ (180)	$ 6,042
Depreciation/Amortization	7,593	(49)	(130)	7,414
Traffic	4,796	183	(131)	4,848
Commercial	2,922	(107)	(52)	2,763
Gen. Off. Salaries and Exp.	2,565	(138)	(31)	2,396
Other Operating Expenses	1,716	(141)	(238)	1,337
Total Operating Expenses	26,103	(541)	(762)	24,800
Operating Taxes: Fed. Income	682	364	410	1,456
Cal. Corp. Franch.	313	68	66	447
Other	4,369		(39)	4,330
Total Operating Expense and Taxes	$ 31,467	$ (109)	$ (325)	$ 31,033
Balance Net Revenues	$ 10,405	$ 525	$ 325	$ 11,255
Avg. Net Plt., Cash, and M and S				
Tel. Plant in Service	$150,885	$ (658)	$(2,361)	$147,866
Tel. Plant Under Constr. (non-int. bearing)	5,906	(5,215)		691
Cash		2,542	(18)	2,524
Materials and Supplies		1,753		1,753
Investor Supplied Working Capital	5,961	(5,961)		
Less: Depreciation Reserve	22,057	(856)	(349)	20,852
Tax Deferral of Inter-Company Profit	2,035	(17)		2,018
Tax Deferral of Accelerated Depreciation	123	1		124
Total Rate Base	$138,537	$(6,667)	$(2,030)	$129,840
Rate of Return	7.51%	.78%	.38%	8.67%

(Red Figure)

Rate Of Return

CTCC seeks a rate of return of 8.73 percent, the upper end of the 8.55 percent to 8.73 percent range which it deems reasonable. The related range of the earnings allowance for common equity is 12.25 percent to 12.75 percent. Conversely, the staff recommends a rate of return ranging from 7.70 percent to 8.00 percent as reasonable, which produces a common equity allowance of 10.00 percent to 10.80 percent.

Applicant's witness and the staff's witness on rate of return both use the same capital structure and differ only slightly with respect to the embedded cost of long-term debt and interim loans.

Applicant's California intrastate operations in the test year at present rates, as hereinafter adopted, will yield a rate of return of 8.61 percent. This return produces a common equity allowance of 12.42 percent. Applicant's operations at present rates produce a rate of return and allowance for common equity well within the range deemed reasonable by applicant. Even if we found reasonable for the purposes of this proceeding the range in rate of return and allowance for common equity urged by applicant, no increase in present rates would be justified. No useful purpose will be served in considering further at this time this issue inasmuch as applicant's request for increased rates is herein denied.

Affiliated Transactions

The Continental Telephone system, comprising approximately 145 foreign and domestic corporations, uses various wholly owned subsidiaries to enable it to provide telephone service in California. The major units are: Superior Continental Corporation (Superior) which performs the manufacturing and supply functions for the System; Continental Telephone Service Corporation (CTSC) which performs various services common to all operating companies; and Medusa Leasing Corporation (Medusa) which leases vehicles to the operating companies. These relationships are detailed in staff Exhibits Nos. 20, 21, and 22.

The Commission has often expressed its concern with affiliated interests and their impact on the cost of service furnished to the public. When a utility purchases services, commodities, capital equipment, the construction of new properties, and the use of funds from its parent or an affiliate, there is an absence of arm's length bargaining with the loss of all of the protection which independent bargaining affords both the investors and the consumers. The unregulated development of affiliated relationships with utilities subject to our jurisdiction forces us to scrutinize affiliated intercompany transactions when a rate case is being considered to safeguard the interests of consumers and investors. A special burden must be borne by the applicant in a rate case to demonstrate conclusively not only that affiliated intercompany transactions are reasonable in that they do not create a burden on the consumer, but that the affiliated relationships afford the maximum gains in efficiency or productivity and the greatest savings in costs to the consumer.

In this first general rate proceeding involving applicant as it is presently constituted, the consideration of affiliated transactions herein is of special significance. Although the last major rate proceeding involving any of applicant's component telephone companies was in 1962, affiliated transactions of concern herein have become sufficiently significant to give rise to proposed expense and rate base adjustments beginning with 1967. Even if the protection of investors should not be recognized as a valid object of utility regulation, the imposition of "disallowances" on the investor, if they accumulate repeatedly, must finally have the effect of increasing the cost of capital and decreasing the quality and quantity of service to the ultimate disadvantage of the consumer. Applicant must immediately become aware of, and participate in, only those types of affiliated transactions which are of demonstrable benefit to consumers if it wishes speedy rate relief.

Affiliated Service, Manufacturing, and Supply Operations

Continental Telephone Service Corporation. This company was organized in 1968 to service and advise Continental system operating companies in their business operations. The company had six operating divisions on September 1, 1971 serving the various major geographic areas covered by the domestic operating telephone companies. In addition the CTSC has a headquarters office in St. Louis, Missouri, and a data processing unit with three major data processing divisions. CTSC performs executive, engineering, traffic, commercial, treasury, legal, accounting, data processing, regulatory, and other management services for the operating companies.

Medusa Leasing Corporation. Medusa Leasing Corporation, a Delaware Corporation, is a wholly owned subsidiary of CTC and was incorporated on March 13, 1967 for the purpose of acquiring the assets and liabilities of Medusa Equipment, a division of CTC. The headquarters of Medusa is now located in Bakersfield, California. It is primarily in the business of leasing vehicles and work equipment to the operating subsidiaries of CTC.

Superior Continental Corporation. Superior Continental Corporation is a wholly owned subsidiary of CTC and is headquartered in Hickory, North Carolina. It was formed on September 1, 1967 by the merger of Superior Cable Corporation, acquired by CTC on March 28, 1967, Communication Apparatus Corporation (CAC), acquired on February 28, 1967, and Central Western Supply Division of CTC, now called Continental System Supply Division of Superior. Superior draws copper rod into wire which is then annealed and insulated with polyethylene or other plastic materials. This wire is used in the manufacture of a wide variety of telephone and other communications wire and cable, electronic distribution systems, and other communications equipment which Superior sells to the telephone industry. Since it was formed, Superior acquired Supa Insulations, Inc. of Rocky Mount, North Carolina, in 1960; formed the system Equipment Division in 1962 to develop and manufacture telephone accessory products; and acquired S & G Manufacturing Company, New Orleans, Louisiana, in 1966. In 1964 Superior constructed a new cable plant at Brownwood, Texas, to serve the Southwest, Midwest, and West Coast markets. A fourth telephone cable plant was opened at Mt. Pleasant, Iowa, in 1967. In addition to its Cable and Equipment Division, Superior also operates Continental System Supply and Continental Telephone Laboratories as divisions.

Continental System Supply (CSS), as a division of Superior, distributes finished products to CTC subsidiaries, maintains inventory control and accounts receivable, and maintains accounting control over sales, transportation, and warehousing expenses. It accumulates information on future needs and advises suppliers of future requirements. CSS bills, collects, remits, warehouses, and accounts for products ordered from Superior and other manufacturers. It handles credits and adjustments, assists with claims for transportation damage, and handles complaints on defective materials and shortages. CSS analyzes product usage and performance for the Continental System Equipment and Materials Standards Committee to use in determining material standards for the Continental System. CSS also maintains a material and supply catalog to keep operating companies up to date on material and supply standard listings.

CSS is headquartered in Hickory, North Carolina, and has regional warehouses at O'Fallon, Missouri, and Reno, Nevada. Prior to August 1969 it was known as Superior Sales and Service Division. Its predecessor before September 1, 1967 was Central Western Company.

The Whitney Blake Division of Hamden, Connecticut, is the latest acquisition of CTC, having been acquired and merged into Superior in June of 1971. It is now a division of Superior and continues in the business of manufacturing insulated wire and cable. The division draws and strands copper wire and insulates wire with a wide variety of materials. It is a leader in the development and manufacture of retractile coil-cords such as are used on telephone handsets. The division has four principal plants. The main plant is located in Hamden, Connecticut, and manufactures chiefly insulated wire and cable. A second plant is located in Angier, North Carolina, and is used primarily for the manufacture of plastic telephone cables. The division's plant in North Walpole, New Hampshire, is used chiefly for the manufacture of cords. A fourth plant in Bellows Falls, Vermont, is used mainly for the manufacture of telephone cords and cord sets. Because there is no definitive history of Whitney Blake Company while under the control of CTC an analysis of this company is not included in this record.

Communications Apparatus Corporation was acquired by CTC in February 1967. A month after CTC acquired Superior, CAC was placed under its control and operated as its subsidiary. CAC supplies load coils, station apparatus, and related products to the telephone industry. CAC's manufacturing plant is located at Keller, Texas.

Continental Telephone Electronics Corporations, a subsidiary of Superior, is located at Euless, Texas. It manufactures electronic distribution systems and subscriber carrier systems.

VIDAR Corporation (VIDAR) was acquired by CTC in June 1970. VIDAR is headquartered at Mountain View, California, and produces VICOM digital transmission systems, VIDAR data acquisition and integration equipment, and Autolab gas chromatography equipment at plants at Mountain View and San Luis Obispo, California.

Metelpel Products, Inc. (Metelpel) is now a wholly owned subsidiary of CTC although it is considered to be under Superior for administrative supervision. Majority ownership in Metelpel was acquired in 1970 and complete ownership in 1971. Metelpel buys scrap cable and wire and recovers the copper to be reprocessed by Superior. In addition, Metelpel processes ferrous and nonferrous metal and paper scrap at its plant at Bettendorf, Iowa.

Because of the complexity of the financial transactions related to the acquisition and control of Metelpel and the insignificant effect that this operation now has on CTCC, no profit or loss was computed for Metelpel in this proceeding. The staff did not recommend any adjustment because of the operations of Metelpel.

Comm/Scope Corporation was established in 1967 to provide design engineering and construction supervision for CATV and other communications systems. Comm/Scope Corporation manufactures coaxial cable primarily for the CATV industry at a new plant at Sherrills Ford, North Carolina. This cable plant was constructed in 1967.

Markup

Certain items such as drop wire and inside wire manufactured by Superior Cable and Equipment Division are sold to independent distributors such as Graybar Electric Company, Inc. (Graybar). CTCC purchases these items from the independent distributors at competitive prices. Nearly all the products of Continental Telephone Electronics Corporation and Communications Apparatus Corporation are first sold to independent product distributors such as Graybar and then purchased at competitive prices by CTCC. In some instances, Continental System Supply Division (CSSD) of Superior purchases these same items back from the independent product distributors such as Graybar, and then adds a markup before selling them to CTCC. This practice results in a double markup on items purchased by CTCC.

Adjustments for Affiliated Transactions

Continental Telephone Service Corporation

For transactions between CTSC and CTCC, the staff in Exhibit No. 20 proposes for California operations an expense reduction of $85,000 and a rate base reduction of $126,000 as investor related and rate of return adjustments.

The staff position is that, since CTSC performs functions that are an integral part of CTCC's utility function in a rate proceeding, the operations and earnings of CTSC must be viewed and treated the same as CTCC's operations and earnings. The staff has used the same capital structure and cost of debt as CTCC's to determine the reasonableness of the earnings of CTSC. It is the staff's opinion that if CTCC were to perform these services for itself, the additional investment required would be obtained from the same sources and in the same proportion as is reflected in

CTCC's capital structure. Differing from the staff position, CTSC has been including in its costs which are allocated in part to CTCC a return of 12 percent on its beginning-of-year equity in its total balance sheet net investment and federal income tax associated with that return. CTC owns 100 percent of CTSC.

CTCC objected to the exclusion by the staff of about $2,000,000 from the 1972 fixed assets of CTSC which applicant classified as non-interest bearing construction work in progress. This issue stems from the then proposed move of the St. Louis Division of CTSC from St. Louis, Missouri, in part to Virginia and in part to Bakersfield. The St. Louis Division performed services for CTC and all of its subsidiaries.

Applicant failed after staff inquiry to inform the staff of anticipated changes in future costs which would result from the termination of operations in St. Louis, from the occupancy of a large building being constructed at Bakersfield, and from reduction of leased office space in Bakersfield. Not being able after repeated efforts to obtain a substantive estimate from applicant, the staff made its estimates as if operations were to continue in St. Louis.

In response to the staff adjustment CTCC introduced Exhibit No. 91 which merely recomputes the staff showing to include the construction work in progress without a definitive showing of increased or decreased costs resulting from the change in St. Louis operations. This record discloses that about $500,000 was incorrectly included by applicant in construction work in progress for a non-operative building in San Jose, California, and a small aircraft, and aircraft maintenance equipment received in exchange for a jet Commander aircraft owned by CTSC. This record does not disclose what St. Louis properties would become nonoperative or what other decreases in current costs would be effected by the change in operations. We find the staff adjustment of the CTSC construction work in progress reasonable.

The Commission has accepted as reasonable for many years the regulatory concept that customers should not be required to pay the costs which a holding company incurs as an investor in its operating companies. Staff Exhibit No. 20 indicates that such "investor related expenses" incurred by CTSC which should be charged to CTC increased from about $680,000 in 1968 to an estimated $1,600,000 in 1972. Applicant argues that it is improper to base such an adjustment on decisions dealing with the relationship between The Pacific Telephone and Telegraph Company and its parent since the relationship of CTC and CTCC is not the same as PT&T and AT&T. CTC maintains that items labeled investor interest costs, such as stockholder reports, registrar, transfer agent, trustee fees, and others, properly should be allocated in part to its subsidiary companies since they are virtually 100 percent owned by CTC and CTCC, and are not incurring these costs. CTC feels that since the subsidiary company receives the benefit of financing in the form of a ready accessible source of funds, the subsidiary company should bear a portion of these costs.

It is an elementary rule of regulatory law, generally speaking, that a utility must bear the burden of showing by satisfactory evidence that all charges to operating expense are reasonable and have been reasonably incurred. CTC has specifically commented in this proceeding on only Central Depository expenses and the airplane expense among those considered to be investor interest costs by the staff.

Witness for applicant carefully classifies Central Depository expenses as "a subsidiary function" without any convincing explanation either to the staff during its investigation or during this proceeding of how such expense redounded exclusively to the benefit of operating companies and their customers or of how the parent received no benefit from the depository.

The staff assigned 50 percent of airplane expense incurred by CTSC to investor interest costs since charges from the St. Louis Division and the Telephone Division were so commingled as to prevent comparison of the cost of CTC's owning or leasing airplanes with other alternatives. Applicant's showing in this proceeding on this issue does not establish the reasonableness of the airplane expense.

We find reasonable the staff proposed rate-making adjustment for CTSC investor related costs.

Applicant, based on a staff accounting recommendation, would increase CTSC operating expenses to reflect a long-term amortization of the cost of a data processing conversion which had been written off before the test year. It would be inappropriate to include such an adjustment which would allow a windfall in that an expense could be recovered twice.

We do not object to the formation of a separate entity specifically organized to provide more efficient service at lower costs. We do object, however, where such separate entities are used to the detriment of the ratepayer, rather than his benefit. Thus, we are concerned with the reasonableness of the costs incurred and the earnings on the investment required to perform services for the utility. The earnings on the investment required in these service type corporations should not be any greater than the earnings would have been had the service functions and the related investment thereon remained in the utility corporate structure. We find reasonable the staff adjustment for CTSC transactions with CTCC; however, 1972 operations have been recomputed at 8.61 percent rate of return as adopted for CTCC. This will result in an expense reduction of $80,000 and a rate base reduction of $125,000.

Medusa Leasing Company

The staff proposes a net revenue adjustment of $28,000 and a rate base adjustment of $157,000 to total California operations because it considered the service lives used by Medusa in determining depreciation cost to be too short and because Medusa's earnings exceeded the rate of return on net plant investment experienced by CTCC's California operations.

The following is a comparison of vehicle average service lives used by CTCC, Medusa, the staff, The Pacific Telephone and Telegraph Company, and General Telephone Co. of California:

Item	Comparison of Average Service Lives: For Applicant: Applicant's Economic Study	For Applicant: Medusa 12/1/70 Data	For Applicant: Used By Staff	Pacific Telephone and Telegraph Company	General Telephone Co. of California
Passenger Cars	3.00 Yrs.	3.28 Yrs.	4.57 Yrs.	7.00 Yrs.	6.50 Yrs.
Light Utility Trucks	4.00	4.56	6.42	7.30	8.00
Trucks 1-Ton & Larger	6.00	6.14	8.03	9.00	10.50

The staff's use of shorter average service lives for applicant than those used by PT&T and General is justified because applicant serves a more widely scattered and sparsely populated territory than either of the other two, resulting in more mileage per vehicle per year. Medusa's rates are considered by the president of Medusa to be comparable to rates charged by commercial leasing firms. Such unacceptable criteria for testing the reasonableness of prices to affiliates of regulated utilities is a classic example of the problems which arise from a complex holding company structure which is easily manipulated to conceal earnings and thus circumvent effective regulation.

We find reasonable the staff adjustments for transactions with Medusa Leasing Corporation, recomputed however at an 8.61 percent rate of return for test year 1972 operations. This results in a net revenue adjustment of $23,000 and a rate base adjustment of $152,000.

Superior Continental Corporation
Central Western Company
VIDAR Corporation

The staff in Exhibits Nos. 22, 84, and 105 proposes for California operations an expense reduction of $1,000 and a rate base reduction of $1,934,000 for supplies and manufactured items purchased through or from Superior, the Central Western Company before it became a part of Superior in 1968, and from VIDAR Corporation.

Applicant argues that there is no evidence that prices of materials and equipment sold by affiliates to CTCC are unreasonable. Moreover, the staff does not recognize what applicant calls "the actual value of the equity investment which Continental Telephone Corporation made in Superior when it acquired Superior". Applicant maintains that when the "actual value" of CTC's investment is recognized, the return on equity to CTC has been lower than that which it would be entitled under Commission decision. It is CTCC's position that payments to its affiliates were fair and reasonable and should be accepted without adjustment in this rate case. CTCC submitted Exhibits Nos. 12, 13, 14, 35, 70, 71, 72, 77, 78, and 79 to demonstrate the reasonableness of such prices on a price comparison basis and on the basis of the return on CTC's equity investment in its affiliates. Exhibits Nos. 13 and 70 set forth price comparisons and savings before and after intercompany profit elimination. Exhibit No. 70 is essentially the same as Exhibit No. 13, making a few changes in prices as the result of the staff's review of invoices and removing rebuilt telephones from the calculation of telephone set savings. Exhibit No. 70 indicates that before elimination of intercompany profit a savings of $45,539.37 would be made on twelve months usage of fifty items in comparison with Automatic Electric catalog prices to non-affiliates.

The staff, after reviewing actual invoices on the items, reduced in Exhibit No. 87 the amount of savings to $41,783.69. If the telephone sets, drop wire, and inside wire are eliminated from the comparison, remaining items would cost CTCC $1,149.84 more to purchase them from Superior than if the Automatic Electric catalog prices were paid. This record shows that an independent telephone company paid on at least one occasion $12.76 for telephone sets and $24.00 per 1,000 foot coil of inside wire.3/ If these prices are substituted for Automatic Electric catalog prices and if invoice prices to CTCC for the remaining 48 items are considered, it would cost CTCC $26,885.37 more to purchase the 50 items from Superior than it would from non-affiliates.

Applicant's Exhibits Nos. 13 and 70 do not demonstrate that the prices paid for materials and supplies acquired from its manufacturing and supply affiliates are reasonable in that they consistently result in lower cost plant or service than otherwise available. This record demonstrates that catalog prices are negotiable when CTCC deals with a non-affiliated supplier, that CTCC pays a double profit on products of Superior purchased through Superior's System Supply Division, and that CTCC on occasion has been able to make purchases from non-affiliates at lower prices than from affiliates.

3/ CTCC Exhibit No. 70 shows the cost to CTCC for telephone sets to be $13.45 and the cost of inside wire to be $25.20 per 1,000 feet.

CTC acquired Superior and VIDAR by exchanges of equity securities. Thereupon, CTC carried forward the recorded assets and liabilities of the merged corporations at their premerger recorded amounts. Applicant contends that the market value of the CTC stock issued to acquire Superior should be used as the basis of determining the earnings of Superior rather than the pooling of interest method used on the books of CTC. CTC acquired Superior and VIDAR without additional stockholder investment. The assets and liabilities as recorded before and after the merger did not change and in fact stockholder groups neither withdrew nor invested assets but in effect exchanged voting common stock in a ratio representing their respective interests in the combined corporation. If the market value of the stock exchanged is now applied for rate-making purposes to the combined corporation, a stockholder windfall is generated at the expense of the utilities' customers without any benefit accruing to the customers. We do not find any persuasive basis in this record, other than stockholder self interest, to support applicant's position. Applicant should be aware that if it generates apparent increases in earnings by acquiring corporations by the exchange of stock and by recording the combination by the pooling of interests method, then, it cannot reasonably expect to justify higher costs of materials, supplies, and services in a rate proceeding merely by arbitrarily revaluing the stock involved. We find reasonable the use of the investment recorded on the books of CTC as the proper basis for application of the rate of return in determining a reasonable level of earnings for Superior and VIDAR.

The foregoing staff adjustments for affiliated transactions were predicated upon a return on common equity of 12 percent for manufacturing operations, a rate of return of 8 percent for service and supply operations, and original cost as reflected on the books and published financial statements of CTC. If the return on common equity for manufacturing operations is limited to the 8 percent assumed by the staff for service and supply operations, the staff rate base adjustment would increase $98,000 for total company operations and $77,000 for intrastate operations. The expense adjustment would not be significant.

Exhibit No. 22 shows on Table II-A that CTC on December 31, 1970 was the third largest independent telephone company. Table II-B shows that from 1967 through 1970 total sales of Superior increased from $41,948,000 to $94,760,000 while the sales to the Continental system increased from $17,335,000 to $42,076,000. Although about 56 percent of Superior's sales were to non-system companies, clearly system companies dominate Superior by furnishing a large share of Superior's market and by cooperative efforts inherent in affiliated relationships.

The applicant in its closing brief states that the staff remained silent on the matter of elimination of the intercompany profit for federal income tax purposes. Applicant further stated that due to its method of computation the tax deferral is "...greater than the net income earned by the affiliates, because the profit eliminated is gross profit rather than net profit". Applicant and its parent are acting in a reasonable and prudent manner in filing the consolidated income tax return. However, this method of filing the parent's consolidated federal income tax return does not in any way reduce the profits of Superior and its subsidiaries, or the parent corporation's share of those profits. The tax deferral, while resulting in a source of interest free temporary capital to the applicant, cannot be employed as justification for unreasonably high profits on affiliated transactions since the manufacturing and supply affiliates are in no way affected by using these tax advantages available to the parent corporation under the current tax laws.

Applicant has not convincingly demonstrated in this proceeding that transactions between CTC and its affiliates have redounded to the benefit of the customers of CTC in the form of increased efficiencies, lower costs, or advantageous availability of supplies and material to satisfy expeditiously customer growth and service demands. Without the demonstration of such customer benefits we find no basis for including in customer rates an allowance for affiliated manufacturing, supply, and service operations rates of return greater than that included for the utility.

We find that the rate-making adjustments proposed by the staff for transactions between applicant and its manufacturing affiliates are reasonable if the rate base adjustment for intrastate operations is increased by $74,000, on an 8.61 percent rate of return for these affiliated operations for test year 1972.

Affiliated Interest Report

The protracted hearings and the company reorganization led to a complicated record and the inability for the staff and company to reach a meeting of the minds as to specific issues involved in the area of affiliated interests. Therefore, the Commission adopts the staff's rate-making adjustments, without prejudice, for the purposes of setting rates at this time. The Commission will require that the company prepare a report that will clearly describe its affiliated company relationships and transactions, as well as the accounting for those transactions. This report will be prepared in conjunction with the Commission staff and will be submitted to the Commission within 180 days after the effective date of this order.

Results of Operation

Operating Revenues

Local Revenues

CTCC's estimate for local revenues for the 1972 test period amounts to $11,478,000. The staff's estimate amounts to $11,784,000 which is $306,000 more than CTCC's local revenue estimate.

The staff based its estimates on graphs of twelve months moving totals of the various revenue accounts, utilizing recorded data for 1969, 1970, and 1971 through August. The staff estimated four months of 1971 and all of 1972. CTCC based its estimate on a computer program that projected 1972 local revenues at present rates on an exchange by exchange basis. This computer program incorporated historical data on revenues per station, station growth projections, individual circumstances relating to each exchange and judgment factors furnished by exchange managers. This computer program is utilized in projecting revenue for CTCC's budget.

CTCC's Exhibit No. 58 shows that with regard to total company local revenue estimates, the budgeted 1971 revenues exceeded actual by 1/10th of 1 percent. In prior years budget expectations exceeded actual results as follows: In 1970, 6.6 percent; in 1969, 3.5 percent; and in 1968, 1.0 percent. In 1967 actual revenues exceeded budget revenues by 7/10ths of 1 percent. In rebuttal, the staff pointed out that, with respect to total California operations in 1971, the Company's estimate was exceeded by recorded local revenues by $143,000 or 1.3 percent over budgeted estimate. The difference between the staff estimate for 1971 and recorded results was $3,000, or a variance of less than .03 percent for four months of 1971.

We are not impressed by the results of CTCC's computer considering that estimates for budget purposes may or may not have the same judgment factors in the program as those used for rate-making estimates. We are impressed by the annualized accuracy of the staff estimate. We will adopt the staff estimate of local revenues.

<u>Toll Revenues</u>

CTCC's estimate for 1972 intrastate toll revenues amounts to $28,940,000. The staff's 1972 estimate amounts to $29,058,000, which produces a difference of $118,000.

The staff estimate is predicated upon CTCC's estimates for settlement expenses and rate base rather than upon staff estimates for results of operation. CTCC maintains the toll revenue estimate for the test year 1972 should be derived directly from the rate base and operating expense levels which are adopted by the Commission. Neither position is correct. Toll revenue settlements are the result of expenses, rate base, and settlement ratios which correspond neither to recorded actual amounts nor to amounts allowed in rate proceedings. For instance, adjustments of expenses and rate base are not made for affiliated transactions in arriving at settlements; and whole life tax depreciation is used for settlement although CTCC actually uses liberalized tax depreciation. For this proceeding we must determine as accurately as possible from the available evidence the toll revenue settlements that will be received by CTCC under the conditions assumed for the test period. It is appropriate to use CTCC's expense and rate base estimates to the extent they do not include rate-making adjustments such as those for affiliated transactions and wage increase adjustments. The staff results of operation estimates, however, include lower operating expense estimates amounting to $492,000 before taxes and depreciation for intrastate operations, which are not reflected in the estimates of CTCC. Since we are hereinafter largely adopting staff estimates as being the best estimates of the expenses applicant will actually experience in 1972, and most probably those which actually will be used for settlement purposes, it is appropriate that the adopted toll revenue estimate reflects the lower operating expenses estimated by the staff with the exception of the wage adjustment which hereinafter we do not accept for this proceeding. Similarly, since the staff did include its proposed wage adjustment in its determination of toll revenues, it is necessary to exclude this adjustment for settlement purposes. We shall adopt the staff toll revenue estimate but shall add $383,000 to eliminate the effect of the staff wage adjustment and to reflect adopted lower expense estimates. We find $29,441,000 to be a reasonable estimate of intrastate toll revenues in the test year.

Results of Operation

Expenses

Maintenance, Traffic, and Commercial Expenses

CTCC's estimate of intrastate maintenance, traffic, and commercial expenses for 1972 test year amounts to $14,229,000, whereas the staff estimate of these expenses, before rate-making adjustments, amounts to $14,016,000, or $213,000 less than CTCC's estimate.

CTCC made its estimate of 1972 operations in June 1971 before it prepared its 1972 budget in October 1971. Its estimate of maintenance expense, for example, was $238,000 greater than its 1972 budget estimate. However, CTCC did not change its estimate on the basis that the total for its operating accounts was close to the budget total for these same accounts.

The staff's estimates were primarily based on a review of the budget. Where warranted, adjustments to a normal level of expenditure were made, as for example, the staff's estimate of total California maintenance expense was $138,000 less than the company's 1972 budget due to normalization of certain of these expenses. We find reasonable the staff estimate of maintenance, traffic, and commercial expenses.

General and Other Expenses

CTCC's estimate for the test year 1972 for total California general and other operating expenses amounts to $5,238,000. The staff estimated $4,894,000 for the same period. Thus the staff's estimate is $344,000 less than CTCC's before rate-making adjustments and $682,000 less after rate-making adjustments.

In general, to arrive at its 1972 estimate, CTCC considered the actual expenses of the first three months of 1971 and the budgeted amounts for the last 9 months. The staff annualized the actual charges during the first eight months of 1971.

We are not impressed by applicant's general method of estimating these expenses. For example, we note that trade dues in 1971 were budgeted for $81,818 and that applicant's witness testified that $15,328 was actually recorded during the first eight months of 1971. Merely because an amount is budgeted or even recorded in the books of account does not establish, per se, that the amount is reasonable and should or will be allowed or adopted for rate-making purposes. Applicant has not demonstrated why, for example, Account No. 665, "Other General Office Salaries and Expenses" increased 31.9 percent between 1970 and 1971, the year in which the applications herein considered were filed.

We shall adopt the staff estimates for general and other operating expenses after adding $46,000 to compensate for a minor inconsistency in estimating trade dues[4/] and adding $53,000 to general and revenue accounting expenses.

Wages

CTCC's calculation of its expenses included increases in wages at the rates of 9 percent for management employees and 11 percent for non-management employees. The staff's estimates for wages for 1972, predicated upon the 5-1/2 percent guidelines set forth in the Price Commission's regulations, result in a reduction of $276,000.

The staff adjustment will not be adopted in this proceeding.

4/ Instead of the $81,818 and $39,048 trade dues budgeted in 1971 and 1972 and used by the staff in estimating Account No. 665, we shall use $15,328 annualized, for both years.

Taxes

Applicant states that it and the staff are in agreement on all operating taxes, except taxes based on income. Except for the estimated difference between whole life and remaining life depreciation accruals, the difference in tax estimates is a function of other estimating and rate-making differences.

Telephone Plant

Telephone Plant-in-Service

CTCC's estimate for Telephone Plant-in-Service used in California operations is $190,631,000. The staff estimate, before rate-making adjustments, is $190,088,000 or $543,000 less than CTCC's estimate. Applicant maintains that the staff estimate would have been $7,071,329 greater if a number of alleged errors were corrected and consequently applicant's estimate should be adopted.

The staff used 1971 recorded data for its 1972 beginning-of-year plant. CTCC, on the other hand, used an estimated figure for beginning-of-year 1972 plant based on four months of 1971 recorded data.

Further, the staff's 1972 net additions to plant estimate was based upon the utility's recorded amounts as a percentage of its budgeted amounts for the two latest recorded years (1970 and 1971) which was then applied to the utility's 1972 construction budget to derive the staff's 1972 estimate. CTCC analyzed the budget on a project-by-project basis.

This record indicates that neither estimate is precise. Applicant's estimate has not been revised to reflect available 1971 recorded data. Likewise the staff did not revise its relative factors to reflect available 1971 recorded data. However, we are not convinced that the 1972 construction budget is realistic.

We note that applicant's 1971 construction budget increased five percent over that of 1970 and that applicant's 1972 construction budget is 22 percent greater than that of 1971. We find the staff estimate of telephone plant-in-service reasonable.

Construction Work in Progress (CWIP)
Non-Interest Bearing Work in Progress

CTCC included $7,046,000 for beginning-of-year non-interest bearing construction work in progress in its calculation of its 1972 California operations rate base. Applicant's Exhibit No. 92 shows the $4,366,214 to be the recorded amount on December 31, 1971. Of the recorded amount, $798,524 represented non-interest bearing construction work in progress, $2,134,921 represents construction work that had been completed but not charged to plant, and $1,432,769 represents overheads not charged to work orders. Such unapplied overheads consist mainly of engineering costs, contract, supervision, and supply loading. The overheads are initially accumulated in a special permanent work order as a part of construction work in progress and are subsequently allocated to interest bearing work orders. Thereafter, interest during construction on the overheads is charged on a monthly basis until the date the construction is completed and the plant is in operation. Thus, interest during construction on overheads becomes a component of the plant accounts which are included in rate base.

For rate-making purposes, interest bearing construction work in progress is not included in the rate base since the interest provides investors a return allowance on funds during construction; but non-interest bearing construction work in progress is included in the rate base in lieu of a return on funds utilized during the period of construction. Applicant would include the unapplied overheads in rate base, and the staff recommends that unapplied overheads be excluded from the rate base. The staff is correct in its position that to include these charges in rate base would result in applicant earning an immediate return through the rate of return allowance in rates until the next rate proceeding and would also earn another return upon the allocation of overheads to interest bearing construction work orders and the capitalization of the interest thereon. This doubling of the return is unreasonable.

Applicant argues that its present practice over a period of years has resulted in a lower rate base because of the lag in application of overheads and in lower accounting expenses. Such argument is not persuasive. The practice penalizes stockholders by omission. This Commission prescribes uniform accounting and allows adequate expenses to perform this function in the interest, among others, of the ratepayer in regulation of utilities. If applicant desires to compensate its investors for the use of funds represented by unapplied overheads, it may do so by promptly clearing overheads to interest bearing construction work orders. Such preliminary work that is included in the overheads should be cleared to expense accounts. We find reasonable that unapplied overheads be excluded from the rate base and adopt the staff estimate of non-interest bearing construction work in progress.

Interest During Construction

CTCC has capitalized interest on construction work in progress at the rate of 9.4 percent in 1969, 9.925 percent in 1970, and 9.18 percent in 1971. Other major public utilities in California use rates generally ranging from 6.75 percent to 7.5 percent.

It is the staff's position that reasonable rates should have been 7 percent in 1969, 7.5 percent in 1970, and 7.5 percent in 1971. Based on the foregoing recommended rates, the staff has proposed an adjustment in the amount of $375,840 for excessive capitalization on interest. It is the staff's position that interest during construction bears a minimum risk and should not be used as a device to guarantee a return on funds invested in CWIP in excess of or even equal to, a fair rate of return allowed by this Commission on investments included in a utility's rate base. For the test year 1972, the staff made a $15,000 downward adjustment in expenses and $349,000 reduction in rate base for total California operations.

CTCC's management, without the customary notice to the Commission after discussion with the staff, computes yearly an interest during construction rate based on management's estimates of the then current cost of capital. In estimating the current composite cost of funds necessary to meet estimated construction expenditures, applicant has assumed a 12 to 13 percent return on equity funds and has estimated a rate for borrowed funds.

The purpose of the allowance of interest on construction work in progress is not to give a utility profits before operations begin and the plant becomes revenue producing, but it is an acknowledgement of the fact that capital funds cannot be employed without the loss of interest that might have been earned had they been otherwise invested. Since it is not the purpose of the allowance to provide profits before operations are begun, the rate should be confined to the minimum cost necessary to command the funds required. The common stockholder is fairly treated if the allowance on common equity funds used in construction is limited to an amount sufficient to pay current dividends. It is unnecessary for the allowance to be sufficient to provide accretions to retained earnings. The allowance to be equitable must consider the total financial circumstances of the utility, including the source of funds and flow of cash.

We find that applicant capitalized excessive interest on construction work in progress and we adopt the staff adjustments for this item. Applicant should be prepared at any subsequent rate proceeding to fully justify the rates it uses for interest during construction.

Depreciation

The staff reviewed the depreciation rates submitted by CTCC and considers them to be reasonable with the exception of the rates for buildings.

The issue here pertains to the adjustment that was made by the staff for the lives of certain concrete block buildings. The staff assigned a normal total life expectancy of 45 years to most of the buildings. CTCC has buildings of this general type in service which are older than 45 years. Under the remaining life theory of depreciation, the lives of these buildings can be either shortened or lengthened if future circumstances or conditions so warrant.

With respect to the depreciation rates themselves, the staff recommends that the applicant be ordered to establish and maintain memorandum records showing depreciation expenses with the related depreciation reserve by accounts on the straight-line remaining life basis beginning with January 1, 1971; that applicant should also be ordered to submit annually to this Commission a copy of such records along with its annual reviews of the straight-line remaining life depreciation rates; that applicant be ordered to use the depreciation rates set forth in Table 14-C of Exhibit No. 49 for the years 1971 and 1972; and that for 1972, and subsequent years, the depreciation rates shown in Table 14-B of Exhibit No. 49 should be used until such time as the Commission approves any revisions to these rates.

The staff used an average of the utility's experience over the latest three-year period to derive the depreciation rate for station connections. It is a long-standing rule that the depreciation accruals for the stations connections account should so closely equal retirements in any particular year as to maintain the depreciation reserve, assignable to this account substantially at zero. The staff recommends that the 8.50 percent rate calculated as described above for station connections and used for the estimated year 1972 be adopted for the purposes of this proceeding. We find the depreciation recommendations of the staff reasonable.

Rate Base

Working Capital

Various issues related to rate base have heretofore been discussed. The remaining major rate base issue is the allowance to be included in the rate base for working capital. CTCC claims $7,531,000 should be included in the total California rate base for working cash and for materials and supplies. This contrasts with the staff recommendation of $5,262,000.

Applicant's method of determination of the working cash and materials and supply allowance in essence was based on the assumptions that all capital is furnished by investors, and that the amount of investor furnished capital can be determined by subtracting net fixed assets from fixed capital. These assumptions are incorrect in that capital is also furnished by other than investors through the time relationships of current assets and liabilities. Applicant's method of determination of working cash is without validity. The staff estimate of the allowance for working cash and materials and supplies will be adopted for the purposes of this proceeding.

Adopted Results

The following tabulation sets forth the summary of intrastate operations for the test year 1972 at present rates, which we find reasonable for the purposes of this proceeding.

Test Year 1972
Adopted California Intrastate Operations
(000 omitted)

	Intrastate At Present Rates
Operating Revenues	
Local Service Revenues	$ 11,784
Toll Service Revenues	29,441
Miscellaneous Revenues	1,651
Less: Uncollectibles	207
Total	$ 42,669
Operating Expenses and Taxes	
Maintenance	$ 6,170
Depreciation/Amortization	7,412
Traffic	4,979
Commercial	2,815
Gen. Off. Salaries and Exp.	2,510
Other Operating Expense	1,450
Total Operating Expenses	25,336
Operating Taxes: Fed. Income	1,372
Cal. Corp. Franch.	433
Other	4,356
Total Operating Expense and Taxes	$ 31,497
Balance Net Revenues	$ 11,172
Avg. Net Plant, Cash, and M and S	
Tel. Plant in Service	$147,788
Tel. Plant Under Constr. (non-int. bearing)	691
Cash	2,524
Materials and Supplies	1,753
Less: Depreciation Reserve	20,844
Tax Deferral of Inter-Company Profit	2,018
Tax Deferral of Accelerated Depreciation	124
Total Rate Base	$129,770
Rate of Return	8.61%

Rate Spread

Exhibit No. 7 sets forth the multiplicity of rates presently effective for the various areas served by applicant. Both CTCC and staff agree on the desirability of establishing uniform rates in all exchange areas served by applicant in California.

There are extreme variations in existing rates for the same grade of service among the applicant's serving areas. For this reason, establishment of uniform rates would result in increasing rates for subscribers having low rates and reducing rates for subscribers having high rates.

In addition to rate changes applicant proposes to separate the following exchanges into the indicated separate exchanges, adding incremental charges for extended area service, where appropriate, between the newly established rate centers:

Present Exchange	Proposed Exchanges
1. Barstow	1. Barstow, Yermo
2. Boron	2. Boron, North Edwards
3. San Joaquin	3. San Joaquin, Cantua Creek, Tranquility
4. Taft	4. Taft, Fellows, Maricopa
5. Victorville	5. Victorville, Adelanto, Apple Valley, Hesperia

Applicant also proposes to establish extended area service between Ripon and Manteca, with no incremental rate since it is presently a 10 cent toll rate.

It is the staff recommendation that applicant's proposal to divide areas should not be authorized. If CTCC still believes that it is necessary to divide these exchanges, separate, thorough studies should be made of each area. The present subscribers should be given an opportunity to express a preference for extended area service or for limiting service to the local community. Size alone is not the determining factor in establishing new exchanges.

We shall not authorize herein extended area service between Ripon and Manteca. However, since a rate increase is not involved here, applicant should effect this change by an appropriate tariff filing.

The applicant has grown over the years by acquisition of a number of small independent telephone companies in California. Each of these companies, when acquired, added a different rate structure based on its individual rate history. As a result, the rate structure of applicant presents a large number of different rate levels for similar services, thereby presenting administrative and other problems. For example, the rate for one party residential service ranges from a low of $3.00 per month in the McFarland Exchange to a high of $6.60 per month in the Big Pine Exchange.

Under Section 728 of the Public Utilities Code, the Commission is required to take into consideration any evidence offered concerning the quality and rates of adjacent areas for comparable service. In contrast to the highly variable rate levels in applicant's exchanges, the Commission in 1972 adopted basically uniform exchange rate levels for the largest telephone operator in California, The Pacific Telephone and Telegraph Company. The rates of that company are identical throughout California with the exception of certain large extended service areas outside of the five largest metropolitan areas. Although in this decision the Commission is providing no change in the revenue of applicant, it is appropriate that such averaging of rates as may be accomplished with minimum impact on customers be implemented. The Commission staff Exhibit No. 95, presented proposed basic rates that would limit any increase to a maximum of 50¢ per month on residence rates, and $1.50 per month on business rates. This proposal, adopted herein, is a first step towards achieving a uniform rate level. The service connection rates proposed by applicant, $10.00 residence and $15.00 business, fall far short of meeting the costs of such service connections. In order to balance the effects of having a limit on the amount of rate increase in the averaging discussed above, the service connection charges authorized herein will be at the level of $12.00 for residence, and $20.00 for business.

Directory Advertising Rates

By interim Decision No. 80214 the Commission authorized increases in directory advertising rates pending the submission of Application No. 52859. Nothing has occurred in this proceeding to bring about any change in the rates authorized. The staff recommends a clarification of the interim order to avoid the interpretation that automatic increases in rates would result from the application by the utility to change rate groups. The staff recommendation is reasonable.

Service

Of the 56 customers appearing at public hearings in 10 service areas, most were concerned with the serving arrangements in their locality, rather than service deficiencies, namely, institution of extended area service, changes in the provision of foreign exchange service, and elimination of existing mileage charges. The latter can only be accomplished by expanding existing base rate areas or the establishment of special rate areas. Applicant's policy with respect to extended area service is outlined in Exhibit No. 103. Applicant has indicated its willingness to undertake studies on the Weaverville-Hayfork, Alpine-Gardnerville, Lone Pine-Independence, and Lucerne Valley-Victorville routes. We will expect said studies without further order.

The staff, after field investigation of service, concluded generally that applicant is successfully identifying sources of trouble and is taking corrective action. However, to insure continued improvement in service, the staff recommends that applicant be ordered to meet prescribed levels of performance as evaluated by the relative number of customer trouble reports and by the length of toll operator answering time. During the proceeding, applicant did not object to the staff recommendation, but in its brief, applicant requested that it be bound only by General Order No. 133 which sets standards of telephone service. The General Order specifically provides that it should not be interpreted as a vehicle by which service may be degraded. The staff recommendation merely follows applicant's present objectives as testified to by applicant's witness in this proceeding. We find the staff recommendations reasonable.

Accounting Practices

During its review of CTCC's records and practices in preparation for this proceeding, the staff had an opportunity to observe in some detail the accounting practices of applicant for the first time. As a consequence, the staff made certain recommendations regarding applicant's accounting practices and procedures that are at variance with the provision of the Uniform System of Accounts for Class A and B Telephone Companies. These recommendations are set forth in detail in paragraphs 8 and 10 on page 4-3, paragraph 8 on page 5-2, and paragraph 6 on page 6-2 of Exhibit No. 49.

In its brief, applicant objected only to the staff recommendation that Account 674 be utilized as prescribed for recording amounts payable for services received under a license agreement, a general service contract, or other arrangement providing for the furnishing of general accounting, engineering, financial, legal, patent, and other general services. Applicant does not use this account. Applicant maintains that if the costs for affiliated service functions were charged to Account 674, distortions in financial reporting would be incurred and toll settlement calculations would be substantially more complex and costly because reallocation of the charges to appropriate accounts would have to be made for settlement-study purposes.

It is essential to effective regulation that a central account for service charges from affiliates be utilized. It is intended that such charges be reallocated to appropriate accounts either directly if identifiable or by overheads if not identifiable. We find that staff accounting recommendations are reasonable.

Findings and Conclusions

A. Rate of Return

1. CTCC's intrastate rate of return, at present rates after rate-making adjustments, is 8.61 percent.

2. A rate of return of 8.61 percent produces for CTCC a common equity allowance of 12.42 percent.

B. Affiliated Transactions

3. Superior Continental Corporation, VIDAR, Continental Telephone Service Corporation, and Medusa Leasing Corporation are wholly owned subsidiaries of Continental Telephone Corporation. Continental Telephone Company of California is also a CTC subsidiary. Central Western Company was a wholly owned subsidiary of the Continental System performing supply functions for the system operating companies prior to 1968.

4. Continental Telephone Company is a vertically integrated company comprised of telephone operating companies, manufacturing and supply, and service companies.

5. CTCC has not demonstrated the reasonableness of its affiliated transactions with Superior, VIDAR, CTSC, Medusa, and Central Western.

6. CTCC's price comparison tests do not establish the reasonableness of the transactions with affiliates.

7. For the rate-making purposes of this proceeding, goods and services provided by an affiliate should be valued at system cost and include a rate of return no greater than that permitted the operating utility.

8. The profits of Superior, VIDAR, CTSC, Medusa, and Central Western on their transactions with CTCC have been excessive.

9. It is reasonable to reduce the total California expenses by $1,000 and rate base by $2,029,000 because of the excessive profits of Superior, VIDAR, and Central Western.

10. The reasonable rate-making adjustment for CTSC services to total California operations is a reduction of expenses in the amount of $80,000 and a reduction to rate base in the amount of $125,000.

11. The reasonable adjustments for Medusa are to reduce total California expenses by $23,000 and rate base by $152,000.

12. CTCC has not justified its claimed expenses for aircraft operations.

C. Results of Operations

13. The staff's estimate of intrastate local revenues at present rates in the amount of $11,784,000 is reasonable for the test year 1972 and will be adopted.

14. Intrastate toll revenues at present rates in the amount of $29,441,000 is reasonable for the test year 1972 and will be adopted.

15. The staff's estimate of maintenance, traffic, and commercial expense is reasonable.

16. The staff proposed limitation of wage increases to 5.5 percent is unreasonable in this proceeding.

17. The adopted estimates, previously discussed herein, of intrastate operating revenues, operating expenses, and rate base for the test year 1972 reasonably indicate the results of applicant's operations in the near future under present rates.

D. Rate Base

18. $4,366,214 is the recorded beginning-of-year 1972 non-interest bearing construction work-in-progress. $1,432,769 of this amount is actually unapplied overheads that will subsequently bear interest. Therefore, $1,432,769 should be excluded from rate base.

19. The staff's estimate of $147,788,000 if computed at 8.61 percent for intrastate plant-in-service is reasonable and will be adopted.

20. CTCC has capitalized interest on construction work-in-progress at rates of 9.4 percent, 9.925 percent, and 9.18 percent for 1969, 1970, and 1971.

21. Reasonable interest rates during construction for CTCC are 7 percent for 1969, 7.5 percent for 1970, and 7.5 percent for 1971.

22. A total California reduction in expenses in the amount of $15,000 and a reduction in rate base in the amount of $349,000 is necessary to reflect the above interest rates.

23. A reasonable rate for interest during construction for the purpose of this proceeding only is 7.5 percent.

24. CTCC's computation of working capital erroneously includes funds provided by ratepayer. The staff's estimates of working cash plus materials and supplies are reasonable and will be adopted.

25. An estimate of $129,770,000 for intrastate rate base based on the staff's estimate revised for an 8.61 percent return for affiliated transactions for the 1972 test year is reasonable and will be adopted.

E. Depreciation

26. CTCC uses liberalized depreciation with flow-through for tax purposes.

27. CTCC does not maintain memorandum records showing depreciation expenses with the related depreciation reserve by accounts, on the straight-line remaining life basis.

28. The depreciation rates set forth in Table 14-C of Exhibit No. 49 for the years 1971 and 1972 (except Station Connections for 1972) are reasonable and will be adopted.

29. The depreciation expense of $7,412,000 is reasonable and will be adopted for 1972.

F. Rate Spread

30. The reasonableness of intrastate toll rates and the settlement procedures of Pacific and other telephone utilities is presently being considered by the Commission in Application No. 53666 and in the associated Case No. 9504.

31. The evidence on suburban mileage charges indicates that no change in the level of these charges is warranted.

32. The proposed rates contained in Exhibit No. 95 providing for rate averaging with limited increases is reasonable and is adopted herein to produce no change in exchange revenue.

G. Directory Advertising Rates

33. Directory Advertising rates were increased on an interim basis in Decision No. 80214. It is reasonable that Decision No. 80214 be made permanent.

34. The second ordering paragraph in Decision No. 80214 is ambiguous.

H. Service

35. The staff recommendations with respect to service are reasonable.

I. Accounting Practices

36. The staff recommendations with respect to accounting practices are reasonable.

We conclude that CTCC's request for rate increases should be denied and that CTCC should do such acts as are herein ordered, that Decision No. 80214 should be modified and reaffirmed, and that submission of Case No. 9296 should be set aside for further consideration of current earnings, settlements, and rate spread.

O R D E R

IT IS ORDERED that:

1. Application No. 52859 of the Continental Telephone Company of California for authority to increase its revenues for telephone services is denied.

2. In future rate proceedings Continental Telephone Company of California shall justify its investment in aircraft and the concomitant operating costs by showing the benefits accruing to the California ratepayer from the ownership or leasing of such aircraft. Applicant shall also maintain adequate records of aircraft usage and operating costs by individual aircraft, including flight logs and the affiliate to be charged with the associated expenses and flight hours.

3. Tax savings resulting from deferred federal income taxes associated with intercompany profits shall be applied as a reduction to the recorded cost of plant, beginning January 1, 1973.

4. CTCC shall establish and maintain memorandum records showing depreciation expenses, with the related depreciation reserve by account and sub-account, on the straight-line remaining life basis, beginning January 1, 1971, except Station Connections, Account No. 232, shall be treated as set forth in Ordering Paragraph 6.

5. CTCC shall submit annually to this Commission for its approval, by May 1 of each year, a copy of the records required by Ordering Paragraph 4 above along with its annual reviews of the straight-line remaining life depreciation rates, commencing with the year 1974.

6. CTCC shall use the depreciation rates set forth in Table 14-C of Exhibit No. 49 in this proceeding for the years 1971 and 1972, except that 8.50 percent shall be used for Station Connections, Account No. 232, for the year 1972. For the year 1973, and each year thereafter, the annual depreciation rate and the resultant accrual for Station Connections, Account No. 232, shall be calculated in a manner such that the annual net charge to the reserve will maintain the reserve balance in this account at, or near, zero.

7. Decision No. 80214 is hereby reaffirmed except that the second ordering paragraph in Decision No. 80214 is hereby amended to read as follows:

> Applicant is authorized to file with this Commission from time to time, in conformity with the provisions of General Order No. 96-A, revisions to the tariff schedules filed pursuant to paragraph 1 of this order in order to reflect changes in the rate group classification for any of its directories caused by changes in the number of stations in the exchanges included in such directories and upon issuance of Commission authorization to make any such revision effective coincident with the issuance of directory or directories involved subsequent to the Commission authorization.

8. For the year 1975, each central office serving area shall meet utility objectives for customer trouble reports per 100 stations as set forth in Table 1 of Exhibit No. 3 in this proceeding, in at least 10 months out of 12, or in at least 9 months provided no two failures are in consecutive months. CTCC shall report those offices failing to meet the above requirements annually by March 1 of the following year until 1975. For the year 1975, CTCC shall, in addition, report the reasons why such reported central offices failed to meet the requirements.

9. For the year 1975, each toll office shall achieve CTCC's objective of 90 percent of toll calls requiring operator assistance shall be answered within 10 seconds in at least 10 months out of 12, or in at least 9 months out of 12 provided no two failures are in consecutive months. CTCC shall report those offices failing to meet the above requirements annually by March 1 of the following year until 1975. For the year 1975, the utility shall, in addition, report the reasons why such reported toll offices failed to meet the requirements.

10. CTCC shall record charges from its affiliated service company in Account 674 as required by the Uniform System of Accounts for Class "A" Telephone Companies as prescribed by this Commission.

11. CTCC shall conduct periodic (yearly) studies of administrative and general expenses relating to plant construction as a basis for capitalizing such costs.

12. CTCC shall capitalize interest during construction after the effective date of this order, at a rate of 7.5 percent per year. Such interest rate shall not be changed prior to notification to the Commission of a contemplated change.

13. Beginning 60 days after the effective date of this order applicant shall file 12 monthly reports of its recorded "12-months-ended" intrastate operations on two bases, one without regulatory adjustments and one including the regulatory adjustment adopted herein.

14. Within 180 days after the effective date of this decision, applicant shall file in conjunction with the Commission's staff, a report describing its then current affiliated relationships, transactions, and accounting therefor. Applicant shall annually file a supplemental report setting forth the then current status of these matters.

15. Applicant is authorized to file revised rates, that produce no change in overall exchange revenue, as set forth in Appendix A attached hereto, in conformance with General Order No. 96-A after the effective date of this order, and to make such rates effective upon five days' notice to the public.

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

Dated at San Francisco, California, this 25th day of SEPTEMBER, 1973.

Vernon L. Sturgeon
President

William Symons Jr.

Commissioners

APPENDIX A
Page 1 of 5

Authorized Exchange Rates
Continental Telephone Company of California

SCHEDULE NO. A-1: INDIVIDUAL AND PARTY-LINE SERVICE, BUSINESS AND RESIDENCE SERVICE

Exchanges with Local Service Only	Rate Per Month				
	Business		Residence		
	Individual Line	2-Party Line	Individual Line	2-Party Line	4-Party Line
	$8.60	$7.40	$4.30	$3.50	$2.90

Alderpoint a/
Alpine
Benton
Boron
Bridgeport
California City
Coleville
El Mirage
Fellows
Hayfork a/
Independence
Leggett a/
Lucerne Valley
Mad River b/, c/
Maricopa
Newberry
Orleans b/, c/
Randsburg
Running Springs
San Joaquin
Summit Valley
Taft BRA
Tranquility
Trinity Center b/, c/
Trona
Walker
Wrightwood

APPENDIX A

SCHEDULE NO. A-1 (Continued)

Exchanges with Local Service Only	Rate Per Month				
	Business		Residence		
	Individual Line	2-Party Line	Individual Line	2-Party Line	4-Party Line
Adelanto:					
Zone 1	$ 8.60	$ -	$ 4.30	$ 3.50	$ 2.90
Zone 2	10.10	-	5.80	4.50	3.60
Zone 3	11.60	-	7.30	-	4.30
Alpaugh	7.50	6.25	4.30	-	2.90
Apple Valley:					
Zone 1	8.60	-	4.30	3.50	2.90
Zone 2	10.10	-	5.80	4.50	3.60
Zone 3	11.60	-	7.30	-	4.30
Buttonwillow	8.50	-	4.05	-	2.90
Corcoran	7.50	6.25	4.30	-	2.90
Covelo	8.25	7.00	4.30	-	2.90
Cuyama	8.25	7.00	4.30	-	2.90
Dos Palos	7.50	6.25	4.25	-	2.90
Farmington	5.75	5.25	4.00	3.50	2.90
Hesperia:					
Zone 1	8.60	-	4.30	3.50	2.90
Zone 2	10.10	-	5.80	4.50	3.60
Zone 3	11.60	-	7.30	-	4.30
Laytonville	8.25	7.00	4.30	-	2.90
Linden	8.25	7.00	4.30	-	2.90
Lost Hills:					
Zone 1	8.60	-	4.30	-	-
Zone 2	10.10	-	5.80	-	-
Zone 3	11.60	-	6.75	-	-
Manteca	8.50	7.15	4.30	3.50	2.90
McKittrich	8.00	6.60	4.05	3.35	2.85
Ripon	8.50	7.30	4.30	3.50	2.90
Snelling	6.00	5.15	4.30	3.50	2.90
Victorville:					
Zone 1	8.60	-	4.30	3.50	2.90
Zone 2	10.10	-	5.80	4.50	3.60
Zone 3	11.60	-	7.30	-	4.30
Weaverville	7.75	6.50	4.30	3.50	2.90

APPENDIX A

SCHEDULE NO. A-1 (Continued)

Exchanges with Extended Service	Rate Per Month				
	Business		Residence		
	Individual Line	2-Party Line	Individual Line	2-Party Line	4-Party Line
	$8.60	$7.40	$4.30	$3.50	$2.90
Barstow					
Big Bear City					
Big Bear Lake					
Havasu Lake					
Hoopa a/					
Inyokern					
Lenwood c/					
Ridgecrest					
Willow Creek a/					
Yermo					

SCHEDULE NO. A-1 (Continued)

Exchanges with Extended Service	Rate Per Month: Business: Individual Line	Business: 2-Party Line	Residence: Individual Line	Residence: 2-Party Line	Residence: 4-Party Line
Big Pine	$11.10	$ 9.90	$ 5.15	$ 4.35	$ 3.75
Bishop	9.30	8.10	4.30	3.50	2.90
Blythe	8.95	7.60	4.30	-	2.90
California Hot Springs	8.25	7.00	4.70	-	3.60
Clements	8.25	7.00	4.30	-	2.90
Crowley Lake	9.95	8.55	4.90	4.10	3.50
Earp	10.00	7.50	4.85	4.05	3.45
Exeter	7.50	6.25	4.30	-	2.90
Garberville	7.75	6.65	4.50	3.65	3.05
Gilroy:					
Zone 1	8.50	7.40	4.30	3.50	2.90
Zone 2	9.50	-	5.40	-	3.70
Glennville	8.25	6.40	4.30	-	2.90
June Lake	9.20	8.00	4.50	3.70	3.10
Kernville	9.95	8.50	4.80	4.00	3.40
Knights Landing	7.00	6.25	4.55	3.75	3.15
Lake Isabella	11.15	8.95	4.80	4.00	-
Lee Vining	9.80	8.55	4.70	3.90	3.30
Lemon Cove	8.25	7.00	4.90	-	3.50
Lone Pine	9.05	7.85	4.30	3.50	2.90
Mammoth Lakes	8.85	7.65	4.75	3.95	3.35
McFarland	6.25	5.25	3.50	3.00	2.75
Olancha	9.95	-	5.65	4.85	-
Palo Verde	11.00	9.35	5.15	-	3.75
Parker Dam	9.35	7.50	4.55	3.75	3.15
Piercy	8.75	7.50	5.20	-	3.80
Pine Creek	11.10	9.90	5.15	4.30	-
Robbins	7.00	6.50	4.65	3.80	3.15
Sanger	7.25	6.25	4.00	3.85	3.25
Tivy Valley:					
Zone 1	7.25	-	4.00	3.50	-
Zone 2	8.00	-	4.75	4.00	-
Weldon:					
Zone 1	9.95	-	5.10	-	-
Zone 2	11.45	-	6.60	5.30	-
Zone 3	11.45d/	-	6.60d/	-	4.40
Whitethorn	8.75	-	5.20	-	-

NOTES:

Business extensions $1.75.
Residence extensions $1.00.
Present increments for SRA's shall be maintained.
a/ No 2-party residence line offered.
b/ No 2-party business line offered.
c/ No 4-party residence line offered.
d/ Plus mileage from Zone 2.

AUTHORIZED EXCHANGE RATES

Schedule A-5 - Local and Extended Suburban Service

Applicant is authorized to file the rates shown as "Proposed" for local and extended suburban service on pages 22 and 23 of Exhibit No. 95.

Schedules A-4, A-6, A-7, A-10, A-11, A-12, A-14, A-25, A-29, A-31, D-1, G-1, and L-1 - Other Nonrecurring

Applicant is authorized to file the rates listed under "staff" on page 12 of Exhibit No. 95 and as further detailed in associated sections in Exhibit No. 95.

Schedules A-15, Supplemental Equipment, and A-22, Special Billing Number

Applicant is authorized to file the rates proposed for these schedules in its application.

Schedule A-30 - Service Connection

Applicant is authorized to file the rates for this schedule contained in its application except that the service connection rate shall be $20 per line for business service and $12 per line for residence service.