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ORIGINAL

Decision No. 84662

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of CONTINENTAL TELEPHONE COMPANY OF CALIFORNIA, a California corporation, for authority to increase its rates for telephone service.

Application No. 55376
(Filed December 12, 1974)

Orrick, Herrington, Rowley & Sutcliffe, by James F. Crafts, Jr., and Robert J. Gloistein, Attorneys at Law, for Continental Telephone Company of California, applicant.
Scott LeFaver, for the City of Gilroy; Fred Wilken, for the People of Sanger; and Jerry Fuchs, for Gilroy Dispatch; protestants.
William L. Knecht and William H. Edwards, Attorneys at Law, and Ralph O. Hubbard, for the California Farm Bureau Federation; Neal C. Hasbrook, for the California Independent Telephone Association; and Brundage, Beason, Reed, Pappy & Hacley, by Jeff Pesses, Attorney at Law, for the International Brotherhood of Electrical Engineers; interested parties.
Lionel B. Wilson, Attorney at Law, Kenneth Chew, and George A. Amaroli, for the Commission staff.

INTERIM OPINION

Interim Relief

Applicant seeks interim rate relief comprising of increased exchange rates ($3.6 million) and a toll surcharge ($2.009[1/] million), pending final disposition of this application. The proposed toll surcharge would amount to 9.44 percent and would apply to all intrastate message toll revenue billed by applicant.

1/ During hearings a company witness sponsored a request for a toll surcharge to produce $2.280 million.

Applicant claims that an increase in this specific dollar amount is required to meet the interest coverage[2/] requirements in its bond indentures. Unless these coverage requirements are met, it would be a breach of applicant's obligations to existing lenders if it were to issue any additional secured debt.

Most of applicant's revenue comes from toll charges. Applicant claims that the intrastate message toll settlement ratio has been dropping and predicts that it will be further reduced in the near-term future.

The interest on applicant's most recent issue of $25 million of bonds (issued in January 1975)[3/] exhausted its available coverage. Without additional revenue, it will not be able to refinance $10 million of bonds maturing July 1, 1975. The applicant also needs $4 million to continue a service improvement program requiring capital expenditures. It therefore claims an urgent need to issue $14 million in new debt early in 1976.[4/] It asserts that the inability to do so at present rates constitutes a financial emergency justifying interim relief.

2/ As is common with utility indentures, those applying to applicant's bonds provide that it may not incur additional funded debt unless its income during any 12 consecutive months ending within 90 days of issuance of new securities is at least 200 percent of the total new annual interest obligation.

3/ Authorized by Decision No. 83809 in Application No. 55302.

4/ Applicant has obtained short-term credit to cover the gap between July 1 and the issuance of new securities.

The petition for interim relief estimated that present rates would produce a 1.90 coverage ratio during the 12 months ending December 31, 1975; the proposed rates will assertedly increase the coverage ratio to 2.3 percent and, according to the application, will produce a rate of return of 7.66 percent on a test year 1975 rate base, assuming that interim relief was made effective on April 1, 1975.

This petition is part of a general rate increase application. In support of the proposal for general relief, applicant claims that higher revenues are needed to meet the increasing costs of financing by debt and preferred stocks.[5] Applicant also points to rising costs for other commodities it consumes in providing service. (The issues in the general rate proceeding are now set for hearing this summer and early fall.)

The application notes applicant's election to use accelerated depreciation for federal income tax purposes and to pass tax savings through to subscribers, which assertedly imposes special difficulties on applicant in meeting the interest coverage requirement, contained in its bond indentures. Therefore, applicant requests permission to change to normalization as part of the requested general rate relief.

Applicant points out that its service improvement plans require it to sell more than $10 million of bonds annually. Applicant claims that, giving effect to its imbedded cost of debt, it will require a return on common equity of 14-1/2 percent in order to assuredly be able to successfully attract capital. The resulting overall rate of return on all

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5/ For example, the $25 million of bonds issued in January 1975 carried a 10 percent interest rate. In contrast, its existing long-term debt costs an average 6.19 percent.

investment would be 10.3 percent. The total amount of the proposed general increase is approximately $10.5 million from local service and related charges plus $5 million in increased intrastate toll revenues.

Applicant seeks authority for establishing uniform rates[6] throughout California. On a uniform basis, the basic individual residence rate sought would be $8.60 per month, with a uniform single party business rate of $19.75 per month. Consideration of this proposal will also be deferred until hearings on the general rate case have been concluded.

Hearings were held on the petition only on March 24, 25, and 26, 1975 in San Francisco before Examiner Gilman with Commissioner Sturgeon participating on March 24, 1975.

Statements were received from persons representing the Farm Bureau, customers in Sanger, City of Gilroy, the Gilroy Dispatch, the International Brotherhood of Electrical Workers, and the Linden-Peters, the Gilroy and the Farmington Chambers of Commerce.

Issues raised included a challenge to the Commission's jurisdiction to eliminate or modify the discount rates now available to applicant's employees. There was considerable concern about delays and difficulties in obtaining Extended Area Service, or other devices to cut toll costs between areas which are joined by a community of interests. There was one protest to the applicant's plans for uniform rates. Further, there were numerous complaints that the company's proposals were inflationary and particularly disadvantageous to the elderly living on fixed incomes. It was noted that the company had no life-line rates.

6/ Its present rate structure exhibits wide variations for similar services between various segments of applicant's service area. These variations are the result of applicant's formation from several small independent companies, each having their own rate structure.

Motion for Stay

The representative of the Sanger customers claimed not to have received sufficient notice until the mailed notice of March 13, 1975. He claimed that a group of concerned citizens was in the process of being organized and of contacting volunteers to participate in analyzing and evaluating alternative means of challenging the company's case. He contended that the group was also collecting funds to pay one or more expert witnesses and counsel; a resume of one of the prospective witnesses was offered as an exhibit. He sought further days of hearing in the latter part of April, which would delay submission of the petition for interim relief.

The presiding officer denied the motion subject, however, to the condition that the movant was to have time after submission of the petition for interim relief in which to challenge the propriety and amount of any interim relief given and to seek a refund and further that the interim increase was to be considered as being subject to refund.

The advantage of hindsight indicates that a better course of action might have been to grant the motion to delay hearings. This is not because of improper notice of hearing, which may be as short as five days (Rule 52), but because the additional hearings would probably not have delayed this decision.

It would have been proper for applicant to have complied with the time requirements of Rule 24, pertaining to notice of filing a rate increase application. However, because of the injury to applicant's customers that could result from deteriorating service unless some means of acquiring new capital is obtained by the beginning of next year, as discussed more fully later in this decision, we waive the requirement for mailed notice within 45 days of filing.[7]

7/ Rule 87. "Construction and Amendment. These rules shall be liberally construed to secure just, speedy, and inexpensive determination of the issues presented. In special cases and for good cause shown, the Commission may permit deviations from the rules. Rules may be amended at any time by the Commission."

Applicant and its counsel are admonished to adhere to the Commission's Rules of Practice and Procedure in the future.

We affirm the action of the presiding officer in denying the motion of the Sanger customers. In so doing we place applicant and the customers on notice that the rate increases authorized herein are interim in nature and subject to refund should later evidence reveal that they were not required to obtain additional financing. The customers may raise any issue in the subsequent hearings in this application that they could have brought before us in the March hearings.

<u>The Testimony</u>

Applicant called its treasurer who explained applicant's recent financing history and future objectives. He testified that the company's most recent transaction was in January of this year when it issued $25 million in bonds. Four-fifths of this sum was used to pay existing debt and the remainder was budgeted for construction.

He described the company's need for $14 million in additional financing early in 1976. Of this sum $10 million will be required to replace short-term loans and the remainder, for additional construction commitments.

He claimed that a reasonable and conservative projection of the company's 1975 earnings, if measured as required by the trust indenture, would yield only a 1.92 percent coverage ratio, assuming that the new bonds are sold at 10 percent interest.

He contended that interim rates should be set at a level which would predictably produce a 2.3 coverage ratio. He claimed that an offering at or near 2.0, while possible under the indentures, might in fact be unsaleable at any tolerable interest rate. He indicated that a coverage ratio at or near 2.0 might possibly cause a further derating of applicant's bonds, and indicated that the present rating (Baa) was close to the lower limits of marketability.

He sponsored an exhibit intended to show that even if the proposed interim increase were granted in full, applicant would not achieve the rate of return on equity last found *reasonable*[8/] by this Commission. According to the witness this rate was 12.42 percent. The rate of return on equity and debt combined would be 9.22 percent if his proposal were adopted.

He emphasized the need for accelerated consideration of the request for interim relief. This arises because the applicant assertedly needs to obtain a fixed amount of additional revenue prior to December 31, 1975 if it is to issue the $14 million worth of bonds in early 1976; therefore, any delay in the effective date of relief will increase the amount of additional rates necessary to obtain the desired coverage.

In response to a staff challenge, he explained why the company decided to issue only $25 million of bonds in January instead of $35 million predictably required. This decision was assertedly compelled by the unpredictable state of the market at that time. The company's best judgment was that $25 million was the maximum saleable at reasonable rates. Applicant was concerned that if the full amount were offered, the market might require interest high enough to create issues under the California usury law, or under the interest coverage requirement. He conceded, however, that the $25 million issues sold quickly at 10 percent with a seven-year term, and that they might have been able to dispose of more at comparable terms.

8/ This characterization of Decision No. 81896 in Applications Nos. 52805 and 52859 is inaccurate. That decision found that existing rates yielded 8.61 percent on overall, and 12.42 percent on equity. It did not, however, find either of those rates of return reasonable; rather the application was denied since those rates were well within the range sought by the company. The staff had recommended an overall rate of return between 7.70 percent and 8.0 percent, producing an equity return between 10.00 and 10.80 percent.

He indicated that the sale of equity might be considered a feasible alternative to debt financing. He claimed, however, that applicant's parent corporation (Continental Telephone Corporation or CTC) was already considered over-leveraged by the financial community and that a recent sale of equity by it yielded substantially less than book value. The parent corporation owns 99.6 percent of applicant's shares; its present debt-equity ratio is 70/30. It has long-term plans to increase equity to 35 percent. Applicant's long-term objective for itself is a 50/50 debt-equity ratio.

Applicant had at one time considered cutting expenses by requiring its employees to work only four days per week. This plan was abandoned, however, in favor of other cost-saving techniques which are expected to reduce costs by $4.8 million. Some of these savings will be accomplished by postponing construction projects and some, by deferring maintenance. The company overspent its 1974 construction budget by $3 million, which is being offset by a $3 million reduction in 1975 expenditures.

The applicant called an assistant vice-president of Continental Telephone Service Corporation (an affiliate) to testify and sponsor exhibits concerning applicant's proposed rate spread and tariffs, which were designed to obtain an additional $3.6 million from local exchange service and $2.28 million from toll; assuming a May 1 effective date, the toll increase would take the form of a 10.71 percent surcharge on all intrastate message toll revenue billed by applicant. He indicated that the company's original toll forecasts for 1975 were optimistic and that recorded revenues for late 1974 and early 1975 were substantially less than predicted.

The staff's finance and accounting witness confirmed that 70.5 percent of applicant's intrastate revenue and 50 percent of its total revenue is derived from toll service. He indicated that, based on the staff engineer's projection of revenue, the staff had concluded that the coverage ratio at existing rates on December 31, 1975 would be 2.02. The projected 2.02 estimate is based on an assumed 10 percent interest rate; if the interest rate is significantly higher the coverage would be correspondingly less and might well be below the legal minimum. In his opinion, a figure so close to the minimum coverage requirements would not provide a satisfactory basis for financing. He urged as a matter of policy that the company should have an adequate cushion above the minimum indenture requirements. Further, he urged that a course of action intended to keep California utilities in a sound financial condition would enable them to obtain capital at the lowest possible cost and at the most advantageous terms. He asserted that a 2.18 coverage ratio was the minimum necessary to give the company flexibility in financing.

He noted that the existing rates were designed to produce a rate of return of 8.61 percent, with ratemaking adjustments equivalent to .20 percent. For the purposes of determining whether the interim increase would yield excessive returns, he advocated using an 8.41 percent rate of return on a recorded basis.

He challenged the company to explain why it had not issued $35 million of debt in January instead of $25 million. He also indicated that the applicant should explain why it was committed to the issuance of debt rather than equity even though it was nearly at the limits of its capacity to market debt securities. He also noted that the staff's projections as well as the company's were based on pessimistic forecasts provided by Pacific Telephone and Telegraph Company.

At one point the witness stated that he believed that applicant had not made an adequate showing of financial emergency to justify interim relief. However, he subsequently stated that there was a financial emergency, but not as serious as represented by the company.

The staff's engineering witness claimed that the company's forecasts were unduly gloomy. He presented an estimate that the applicant's return on intrastate operations would be 1.8 percent higher than applicant's estimate. He predicted that the company's overall return on all intrastate business at present rates would be 7.96 percent. He also challenged the applicant's estimates of intrastate toll settlements as unrealistically low. According to his projections, the company would need only an extra $1,645,000 to achieve a revenue of $88,935,030. This revenue would give the applicant a rate of return of 8.40 percent on its own estimated rate base and provide the 2.18 times coverage recommended by the finance witness (assuming a 10 percent interest rate on the new securities).

He recommended that any interim rate relief be granted subject to certain protective conditions. First he noted the possibility that Application No. 55214[9/] might be finally decided within the life span of an interim increase herein. Substantial rate relief in that proceeding would produce additional toll settlement revenue for applicant. For example, if Pacific were to be granted 75 percent of its requested increase, applicant's annual revenues would increase by $1.498 million. Assertedly the surcharge could, in that event, be reduced to 1.0039, without adverse effect on the projected coverage.

9/ App. of The Pacific Telephone & Telegraph Company to Offset Wage, Salary and Associated Expenses.

He recommended that any interim increase granted be terminated on the effective date of any final order herein. Finally, he recommended that, if applicant's unadjusted intrastate rate of return exceeds that last authorized, the multiplier should be adjusted downward.

Discussion

The Commission recognizes that a general rate case on a major utility is a time-consuming process. In order to prevent regulatory lag from inflicting unnecessary injuries, the Commission has authority to grant interim rate relief at an early stage in such a proceeding, based on a showing that failure to grant relief would create a financial emergency (City of Los Angeles v P.U.C. (1972) 7 Cal 3d 331). The relief is based on tentative estimates rather than the fully developed studies characteristic of the final decision in a general rate case. Because of the tentative nature of the findings characteristic of such a procedure, the rate of return is often substantially less than that allowed in a general case. Refund provisions are often imposed. As a result, an interim increase is limited to that amount necessary to meet the emergency. There must be a showing that the increase will not produce an excessive return to stockholders.

Applicant claims that its return will fall to such a low level that it will not be able to obtain conventional bond financing, without rate relief; there has been no real challenge to that claim or any demonstration that there is another more favorable form of financing available. Even if it were in the public interest to compel applicant to abandon the construction needed[10] for improved service and to meet applicant's obligation

10/We note that inflation has already compelled applicant to postpone substantial amounts needed for construction and maintenance.

to new customers, this would not eliminate the need for financing. Inability to issue bonds is a sufficient basis for financial interim relief.

We note, however, that the staff has not yet completed its analysis of feasible alternatives (Scenic Hudson etc. v F.P.C. (1965, 2nd Cir.) 354 Fed 2d 608 cert. den. 384 US 941) to applicant's financing plans. The staff's concern over the company's plans to utilize only debt financing may be a legitimate one. The company asserts that debt financing is necessarily the least expensive method; nevertheless, using another viewpoint, it would appear that this may be a very expensive form of financing for the consumers. In order to obtain the use of $14 million (assuming seven years maturity and 10 percent interest) the customers will have to pay $9.8 million in interest to the lenders; in addition, they would also have to pay at least an additional $1.657 million to achieve the desired coverage ratio. Under these conditions the customers would be no better off than with an alternative form of financing at 11.74 percent annual interest.

While the final election between alternative modes of financing can be postponed, the question of the need for interim rate relief cannot.

At the very least, we must ensure that bond financing is available as an option on December 31st of this year. To preserve this option, additional revenues must be provided now. The revenues should be sufficiently in excess of the minimum 2.00 times interest coverage to provide a cushion for unexpected eventualities and to ensure marketability of the bond issues. The 2.18 coverage recommended by the staff would be sufficient for this purpose.

Because of the ability of applicant to seek further interim relief should there be any major unanticipated loss of revenue, we will accept the more optimistic revenue projection proposed by the staff. Based on this projection, applicant would need an additional $1,657,000 to increase its revenues to achieve a coverage ratio of 2.18 as of December 31, 1975.

The question remains whether this amount should be available to the company before January 1, 1976 or whether, as the staff suggests, it should be collected in smaller amounts over a year. The staff position has much merit. The rates the staff would allow (a 4.53 percent increase) will generate an 8.40 percent rate of return (on a recorded basis) in any future test period. That is almost precisely the rate of return[11/] the company was expected to earn as a result of Decision No. 81896, supra. The last authorized rate of return is the traditional criterion used for determining whether or not an interim or offset rate is excessive. However, the staff annualization proposal would defer the achievement of a 2.18 coverage ratio until after December 31, and would compel the company to postpone financing, possibly by as much as six months. The staff has not suggested any satisfactory way to circumvent or accommodate this difficulty.

In contrast, the company's proposal requires a greater increase in rates in order to achieve the desired coverage ratio by the end of this year. Using the staff's revenue estimates, an increase of this magnitude would produce an overall rate of return of 8.84 percent on an annual basis. This is higher than the rate of return expected to result from Decision No. 81896, supra.

11/ Decision No. 81896 found that the rates now in use would produce a rate of return of 8.61 percent after ratemaking adjustments. This would be the practical equivalent of an 8.41 percent recorded rate of return.

While the traditional test of an interim or offset rate is whether it exceeds the last authorized overall rate of return, we think it appropriate in this instance to note that the proposed 8.84 percent would be very comparable to the 8.85 percent recently authorized for both General and Pacific Telephone companies.[12/] It should be further noted that such an increase will not produce a rate of return on equity as high as the 12.42 percent which present rates were expected to produce.

For these reasons we will adopt the company's position on annualization in order to achieve the 2.18 coverage ratio on December 31, 1975. After January 1, 1976 applicant can maintain this 2.18 coverage ratio with an increase of only 4.53 percent, rather than 9.06 percent. Our order shall so provide.

The fact that part of the relief sought relates to coverage deficiencies occurring during the first part of 1975 might suggest that a retroactive ratemaking issue is present. The Supreme Court in the City of Los Angeles case, supra, expressed itself thus on the subject of retroactive ratemaking:

> "We were confronted with a similar question in Pacific Tel. & Tel. v. Public Util. Com., supra, 62 Cal. 2d 634, 649-656. In that case the commission determined that Pacific should reduce its rates by more than $40 million annually. The commission also ordered that Pacific refund to its customers amounts collected from its customers in excess of the new rates during the nearly two years while the rate investigation had been pending before the commission. The amount of the refund ordered was approximately $80 million. Although we affirmed the decision of the commission insofar as it reduced future rates, we annulled the portion of the decision which required the refund. We concluded after an extended review of the relevant statutes that the Legislature had given the commission power to establish rates prospectively and has not given it power

12/ App. of General Telephone Company (1974) Decision No. 83779, Application No. 53935; App. of Pacific Tel. & Tel. Co. (1974) Decision No. 83162, Application No. 53587.

to order refunds of amounts collected by a public utility pursuant to an approved order which has become final. [Emphasis added.]

"We pointed out that the fixing of a rate is prospective in its application and legislative in its character, that under section 728 of the Public Utilities Code, as well as other sections of the code, the commission is given power to prescribe rates prospectively only, and that the commission could not, even on grounds of unreasonableness, require refunds of charges fixed by formal finding which had become final. (62 Cal. 2d at pp. 650-655.) We recognized that there may be policy arguments for giving power to the commission to order refunds retroactively where rates are found to be unreasonable or to prevent unjust enrichment, but we concluded that such 'arguments should be addressed to the Legislature, from whence the commission's authority derives, rather than to this court.' (62 Cal. 2d at p. 655.) The Legislature has not changed any of the relevant statutory provisions. [Emphasis added.]

"We pointed out that the conclusion that the Legislature has not authorized retroactive rate making was supported by section 734 of the Public Utilities Code. (62 Cal. 2d at pp. 654-655.) That section provides that when a rate has been formally found reasonable by the commission, the commission shall not order the payment of reparation upon the ground of unreasonableness. Of course, the rates existing prior to the present proceeding have been found reasonable by a final commission decision. [Emphasis added.]

* * *

> "Although there may be substantial policy reasons to permit retroactive rate making, there are also substantial reasons to the contrary, and it is for the Legislature to determine whether California should abandon its policy against retroactive rate making." (7 Cal. 3d at 356-357.) (Emphasis added.)

However, we have concluded that this rate increase, though intended in part to meet a coverage deficiency which has already been in existence for several months, does not involve retroactive ratemaking.

First, the rates which applicant seeks to change have never been found just and reasonable for applicant since it acquired its component companies. (See footnote 6) supra. Secondly, the new rates we set are found not to allow the shareholders any more return than that intended to result from the now existing rates. The increases in rates are offset either by a revenue loss caused by decreasing patronage or by an increase in the cost of debt capital. The predicted revenue and cost changes would, standing alone, offset the rate increases authorized herein without reference to events occurring in the first months of 1975.

The company proposed that the rate spread be accomplished by a combination of toll surcharge plus an exchange rate increase. The reason for this was a feeling that one increase split in this manner would raise fewer objections from applicant's customers.

The staff, on the other hand, proposed a simple multiplier applicable to all of applicant's monthly charges on intrastate transactions.

We prefer the staff method. One of the principal objectives of interim or offset proceedings is an expeditious decision. That objective would be frustrated if we must consider alternate means of adjusting the conflicting interests of various classes of customers. Therefore, we have frequently selected a method of spreading offset or interim increases which makes the smallest differential between classes of subscribers.[13] The staff recommended multiplier satisfies that requirement.

This form of increase would also appear to be easy to administer particularly if mid-term modifications or refunds are necessary

Affiliated Relationships and Financing

Applicant's parent corporation, CTC, is the third largest independent telephone holding company in the United States. It has operating subsidiaries, such as applicant, in 41 other states, in Canada, and in five foreign countries. CTC also has manufacturing, service, and leasing subsidiaries which provide services and equipment to applicant.

The process, by which numerous isolated California telephone utilities were assembled into a larger organization and became the applicant system, was completed without formal consideration or approval by this Commission.

In Decision No. 81896, supra, we extensively considered applicant's affiliated relationships, concluding with the following discussion:

> "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.

13/ Cf. App. of P.G.&E. to Offset, etc. (1973) Decision No. 82137, Application No. 54127.

> A special burden must be borne by the applicant in a rate case to demonstrate conclusively not only 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."

Because 99.6 percent of applicant's stock is owned by CTC, every financing transaction is at least potentially an affiliated transaction. Therefore, it would appear that the financial relationships between applicant and its parent corporation ought to be scrutinized with extreme care. If they are found not to be beneficial to California consumer, there should be careful consideration of alternative courses of action within the Commission's jurisdiction.

This record tends to illustrate that the relationship does not operate to provide the California operating subsidiary with cheaper financing than it could have obtained as a separate entity. Rather, it appears that the subsidiary may have exhausted its borrowing capacity, at least in part, to provide cash to its parent corporation. For example, despite its difficulties in financing, applicant was able to pay $7.5 million[14/] in cash dividends to its stockholders in 1974.

While applicant has not yet had an opportunity to place these transactions into perspective with other details of the financial relationships between affiliates, it nevertheless appears that a thorough review is needed and that new concepts may have to be considered in passing on applicant's future requests for approval of securities issues. As indicated above, a staff alternatives analysis should be forthcoming with respect to applicant's next bond issues and should prove useful in accomplishing this review.

Findings

1. Applicant must obtain $14 million in capital early in 1976; $10 million will be used to refinance existing short-term loans, and $4 million is necessary to provide capital for continuation of applicant's service improvement program.

2. The consuming public will be injured if applicant is unable to issue bonds as one alternative means to raise this capital. Consideration of the need for additional revenues should not be postponed.

14/ The company values its common stock at $99,560,414 and as being 38.20 percent of its total capital.

3. Applicant cannot issue bonds unless during the previous 12 months its pre-tax earnings are twice the amount needed to cover the total annual interest charges of proposed and existing bonds.

4. In order to ensure that applicant's bonds can be sold without excessive interest charges or other unfavorable terms, applicant's annual earnings should be at least 2.18 times the projected total interest cost. This additional .18 times coverage would also be necessary if the bonds must carry an interest rate greater than 10 percent, or if any of our projections are unduly optimistic.

5. Pre-tax earnings of 2.18 times the total annual interest charge for calendar 1975, assuming issuance of $14 million of additional bonds at 10 percent, is the equivalent of an annual recorded rate of return on equity and debt capital of 8.84 percent and a return on equity of less than 12.42 percent. These rates of return are not excessive.

6. A multiplier of 1.0906 or a 9.06 percent surcharge applied to all of applicant's intrastate billings at present will produce additional revenue of $1,657,000 by December 31, 1975 and 2.18 times the total interest charges, including a new issue of $14 million of 10 percent bonds. This would permit the sale of $14 million in 10 percent bonds in early 1976.

7. A rate spread device which consists of a multiplier for all of applicant's intrastate billings will be fair and equitable to all classes of consumers and can be adopted without taking extensive evidence as to its impact on various classes of consumers.

8. The findings herein are based in part on incompletely considered projections and estimates; the Commission should be free to order refunds in whole or in part.

9. It is not necessary to consider alternatives to applicant's financing plans at this stage in the proceeding.

10. Applicant's present rates are, for the future, unjust and unreasonable. Applicant's rates will be just and reasonable if applicant's monthly billings for all intrastate charges are multiplied by a factor of 1.0906, or have added a surcharge of 9.06 percent to applicant's rates through December 31, 1975. Effective January 1, 1976, the rates will be just and reasonable if the billing multiplier is reduced to a factor of 1.0453, or have added a surcharge of 4.53 percent to applicant's rates.

Conclusions

1. Interim rate increases are granted based on a showing of financial emergency. A utility which needs capital and cannot issue bonds at its present revenue levels is in a state of financial emergency, unless there is some other alternative feasible means of providing capital.

2. Before an interim rate increase can be given, there must be a showing that the increase will not produce an excessive rate of return. While in prior cases we have used the last authorized rate of return as a benchmark, this is not available under the unusual circumstances of this proceeding. We conclude that the rates authorized herein will not be excessive if they are limited to a level which will not increase the return on equity over that resulting from the last rate decision on applicant.

3. In order to minimize regulatory lag, interim rate relief should, insofar as possible, be spread rateably between classes of customers.

4. It is the responsibility of the staff to develop and analyze alternatives to the applicant's financial proposal (<u>Scenic Hudson, etc. v F.P.C.</u>).

5. No retroactive ratemaking is involved.

INTERIM ORDER

IT IS ORDERED that:

1. Continental Telephone Company of California, on or after the effective date hereof, is authorized to file in conformance with the requirements of General Order No. 96-A, the tariff schedule attached hereto as Appendix A, and to make said tariff effective for service rendered on and after the date of filing of said tariff. The charges billed under this tariff shall not be subject to settlement with connecting utilities.

2. The authority granted by Ordering Paragraph 1 shall expire on the effective date of a final order herein.

3. Applicant may be ordered to refund any or all of the increase authorized herein on a Commission finding:

(a) That the increase was not used or was not needed for issuance of bonds.

(b) That the increase produced a higher rate of return for any 12-month period ending after July 1, 1976, after ratemaking adjustments than 12.42 percent on equity or 8.41 percent on rate base.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 15th day of San Francisco, 1975.

President

Commissioners

Commissioner William Symons, Jr., being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

BILLING SURCHARGE

APPLICABILITY

Applicable to customers' intrastate billing for service rendered.

TERRITORY

Within the territory served.

RATES

	Percentage Rate
Intrastate billing surcharge effective through December 31, 1975	9.06%
Intrastate billing surcharge effective January 1, 1976 and until further order of the Commission	4.53%

SPECIAL CONDITION

The percentage rate applies to each customer's bill for intrastate services, exclusive of federal and local taxes.