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Decision No. 84938

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of The Pacific Telephone and Telegraph Company, a corporation, for telephone service rate increases to cover increased costs in providing telephone service.

Application No. 55492
(Filed February 13, 1975)

ORDER DENYING MOTION TO SET PUBLIC HEARINGS

On August 1, 1975, applicant The Pacific Telephone and Telegraph Company (Pacific) filed a "Motion To Set Public Hearings". The grounds for this motion, in summary, are as follows:

1. The application has awaited processing by the Commission for several months.

2. Since the application requests an increase in annual revenues of $131.2 million to cover increased costs, a major item being wage increases and associated costs which take effect on August 3, 1975, Pacific will start suffering "irreparable harm" after that date. In this connection, the motion mentions several financial problems experienced by the applicant: Pacific's bond rating has dropped from AAA to AA and "may" drop further to A; Pacific's actual rate of return has dropped below the 8.85 percent authorized to 7.71 percent for the twelve months ending May 31, 1975; and that according to the motion without additional rate relief earnings will continue to decline so that for the twelve months ending June 30, 1976, Pacific's adjusted results, based on present rates, would yield a rate of return of 6.83 percent (based upon data in Pacific's Application No. 55492, Exhibit D).

Pacific points out that Application No. 55214 (discussed hereafter) is still pending, which also has a negative effect on earnings.

Pacific asserts that it has already curtailed its construction program, and that further reductions are not advisable. The debt ratio of the company, according to the motion, is now over 50 percent and earnings improvement is necessary in order to attract additional equity capital.

Economic Considerations

We believe the motion should be denied because the procedural history of Application No. 55214 and Application No. 55492 demonstrates that the motion has no merit, but before discussing this history, the allegations concerning Pacific's economic condition should be studied in proper perspective.

Regarding Pacific's bond rating and debt ratio, these problems cannot be isolated from economic reality and traced simply to inadequate or delayed rate relief. During the last few years, inflationary pressures and unfavorable business trends have caused difficulties for all utilities in marketing bonds and stocks (and the same conditions have had similar effects to a lesser degree, regarding industrial investments). It has been particularly difficult for any investor-owned business, utility or otherwise, to sell common stock at prices reasonably close to book value, and this has caused a general tendency to finance more frequently by the use of bonds.

All this is not to say that the Commission should become jaded in its attitude toward Pacific's problems, but simply to point out that Pacific's situation can hardly be traced to regulatory delays in California; the general state of the economy must be considered. Regulation does not guarantee that, in spite of economic conditions, a utility will realize its assigned rate of return. (General Telephone Company, (1969) 69 CPUC 601; Citizens Utilities Company, (1971) 72 CUPC 181.)

We also deem it important to examine the various rate of return figures quoted by Pacific in its petition on a basis other than that which adjusts them by the use of various provisions of tax laws and previous decisions of this Commission[1/] which allow Pacific to compute its taxes for ratemaking purposes on other than an as-paid basis. Whereas other major utilities (other than General Telephone Company of California, Citizens Utilities Company of California, and Sierra Pacific Power Company) flow through to the ratepayer the benefits of tax reduction provisions such as liberalized depreciation, including asset depreciation range system (ADR), and investment tax credit, Pacific has been permitted to do otherwise (see footnote 1) in order to retain capital for expansion and improvement of the system. Such retained capital, since the issuance of Decision No. 83162 (footnote 1) as reported on a ratemaking basis to the Commission, amounted to $110.3 million for the twelve months ended December 31, 1974 and for the twelve months ended May 31, 1975 to $132.5 million (these amounts are noncumulative). These funds must be considered when measuring any difficulties experienced by Pacific in obtaining capital to finance expansion and modernization of the system.

Calculating Pacific's results of operation since the beginning of 1974 on both a normalized basis and a flow through basis shows the following differences:

1/ See the discussion of the history of the Commission's decisions in this regard, and an analysis of the Commission's current method of determining accelerated tax depreciation in Pacific Tel. & Tel. Company (1974), _____ CPUC _____, Decision No. 83162, Application No. 53587 et al., (mimeo. pp.55-63).

THE PACIFIC TELEPHONE & TELEGRAPH COMPANY

Rate of Return Analysis
Flow Through vs. Normalization

	RATE OF RETURN	
	Normalized1/ Basis	Full Flow2/ Through Basis
I. 12 Months Ended December 31, 1974		
As Reported	7.22%	9.33%
Decision No. 83162 (Company Basis)	7.28	9.19
Decision No. 83162 (Company Basis) with Rates Annualized	8.36	10.23
II. 12 Months Ended May 31, 1975		
As Reported	7.34	9.75
Decision No. 83162 (Company Basis)	7.34	9.55
Decision No. 83162 (Company Basis) with Rates Annualized	7.71	9.90

(1) Decision No. 83162 did not adopt normalization for California State Corporation Franchise Tax.

(2) As computed by staff with company provided data.

Employing a "flow through" basis for ratemaking purposes would, of course, eliminate the concept of special funds available to Pacific for capital investment, but, based on the rates in effect for the above mentioned periods, Pacific's rates of return would have been about two percent higher. Pacific's allegations of financial hardship must be viewed in this perspective.

History of the Application

We turn now to the history of this present application and that of Application No. 55214. As will be seen, these applications must be considered together in judging whether Pacific's claims of undue delay are valid. It is clear from a review of these applications that Pacific, by filing two rate increase applications close together, created a situation which was bound to result in delay in processing the second of the two applications (55492), especially since both applications, in their original form, did not include the customary exhibits.

Preliminarily, any comparison in the way this Commission is able to process a true "offset" case and the proceedings we are concerned with here is irrelevant. A rate increase application should not be characterized as an offset matter simply because no increase in rate of return is sought. A true offset proceeding is one in which rate relief is sought to cover a few specifically identifiable cost increases, and in which such increases can be measured against a recent recorded period or a recent test period already adopted by the Commission for the utility. Such an application can be processed with dispatch because a new test year and a new results of operations study need not be considered.[2/] Neither Application No. 55214 nor Application No. 55492 fall into this category, since both applications involve estimated results for new test periods.

2/ While it has been customary in such proceedings to allow the staff and interested parties to introduce evidence regarding specifically identifiable economies and productivity gains in order to avoid setting rates which would result in an excessive return, we have not allowed offset cases to evolve into full-fledged general rate increase proceedings by way of exploring any and all cost increases against any and all possible economies, since to do so means to require an entirely new results of operation study for a new test period.

Application No. 55214, requesting rate relief of $83.8 million, was first filed on September 30, 1974 and a prehearing conference was held on December 2, 1974 even though Pacific filed a major amendment, as well as its exhibits to the application, on December 13, 1974. Hearings were held in various locations from February through June 1975. Final briefs were due on July 21, 1975. This schedule was reasonable considering the scope of the issues involved.

Application No. 55492 requests rate relief for a 1976 test year amounting to $131.2 million. It was filed on February 13, 1975, exactly two months after Pacific filed its major amendment and its exhibits to Application No. 55214. For practical purposes the December 13 date must be regarded as the date from which we could begin processing Application No. 55214. It is, of course, impossible to process a rate increase application such as Application No. 55214 in two months. Pacific does not argue that we should have been able to do this, but rather takes the position that we should start hearings on Application No. 55492 before issuing our decision in Application No. 55214. In order to examine this contention, we must consider the completeness of Application No. 55492 as originally filed, and whether the amendment filed in April cured any defects in it.

Twelve days after Application No. 55492 was filed, the staff moved to dismiss it on the ground that it failed to comply with Commission Rule 23(g) and because of alleged uncertainty and prematurity of the application.

Pacific then filed, on April 17, 1975, an amendment to the application, which incorporated certain prepared testimony of various witnesses, including testimony and accompanying exhibits which, at least in form, furnished for the record a more complete report of operations for the test period.

The staff filed a supplement to its motion to dismiss on April 21, 1975, taking the position that the newly-filed material did not save the application from any of its defects. Pacific responded by asserting that the application is fully supported by the exhibits and testimony filed with the amendment, and that the amendment rendered moot any problems relating to Rule 23(g). Pacific further argued that whatever rates are established in presently pending Application No. 55214, the relief requested in Application No. 55492 will be necessary, and that therefore Application No. 55492 is not premature.

The Original Application

Because of Pacific's assertions regarding how Rule 23(g) should be interpreted, we believe that it is essential to discuss briefly these arguments against the application in its original form, before considering the amendment.

Rule 23 of the Commission's rules concerns applications for rate increases. Subsections (a) through (k) specify in detail the material to be included in the application or filed with it. This rule is designed to require that the original filing contain the facts and financial data which will permit the Commission to begin analyzing it.[3/] Section (g) of this rule reads:

3/ We have not required all of the exhibit data for a "true" offset case that is necessary for a general rate proceeding, but as explained above, this application is by no means an offset matter.

"(g) Applicant's exhibits must accompany the application and applicant shall state the date it will be ready to proceed with its showing."

The staff took the position, regarding the original application, that Pacific did not file its exhibits as required by the subsection; Pacific disagreed, interpreting this subsection to require nothing more than the filing, concurrently with the application, of what is required by the other subsections of the rule.

We agree with the staff that Pacific's original filing failed to comply with Rule 23(g), and that such noncompliance was a substantial defect.

The first paragraph of Rule 23 recites that applications under the rule "...shall contain the following data, either in the body of the application or as exhibits annexed thereto or accompanying the application: . . ." (this clause is followed by the various subsections). Pacific's construction ignores the above-quoted clause, or, in the alternative, interprets Subsection (g) to add nothing to the rule. To construe Subsection (g) to require nothing but what is already called for elsewhere in Rule 23 is to engage in interpretative hocus-pocus.

"Exhibits" in Subsection (g) means the documentary material forming the direct showing of the applicant. While we have not so rigidly and strictly interpreted this subsection that no supplementary direct evidence may be offered before or at the hearings,[4/] we have always required that at least a detailed report of operations for the test year, and a substantial amount of the direct exhibits be furnished in compliance with Subsection (g).

This interpretation has been standard practice, and can hardly be thought to take Pacific by surprise. Pacific's prior rate increase filings (with the exception of Application No. 55214) indicate substantial initial compliance, as do the most recent filings by General Telephone Company (Application No. 55383 filed December 16, 1974) and Continental Telephone Company (Application No. 55376 filed December 12, 1974). The most cursory comparison of the documents filed with the last two mentioned applications, as against what was originally filed by Pacific herein, shows that Pacific's application in its original form was substantially defective.

The Amendment to the Application

When the amendment to the application was filed, we were of the opinion that it cured at least the substantial formal defects of the original application, and that, therefore, nothing would be gained by dismissal, since Pacific could simply re-file at a later date. Therefore, instead of granting the staff's dismissal motion, we communicated to Pacific in a letter dated May 7, 1975 addressed to Mr. Gordon L. Hough, Pacific's president, that we considered the application "untimely" and explained that such applications aggravate our workload problems. We therefore informed Pacific that our attention must first be given to applications for rate relief for

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4/ For example, we have not required prepared testimony to be furnished with the application, although this is frequently done.

earlier periods of time (that is, earlier than for a test year ending June 30, 1976). However, we are convinced that it would have been within our discretion to order the application dismissed because of serious questions of uncertainty and prematurity which were not resolved by the amendment. Page 3 of the original application states:

> "The rate increases requested herein are Pacific's best estimate of what is needed to afford it the opportunity to realize the return authorized in Decision No. 83162. If subsequent conditions merit a material modification of this estimate, Pacific will modify its application accordingly."

The staff urged that this statement makes the application uncertain and places the staff in the position of being unable to process or evaluate it.

Since amendments are permitted, the mere recital that an amendment might be necessary does not turn an otherwise proper application into one which is defective; however, this recital must be judged in the context of surrounding circumstances.

As mentioned, Application No. 55214, filed September 30, 1974, is now submitted. It is a reasonable assumption that the original failure to comply with Rule 23(g) and the statement in the application concerning the possibility of amendment is traceable largely to the fact that Pacific cannot estimate its 1975-1976 results with certainty without knowing what relief will be awarded in Application No. 55214.

Pacific has attempted to anticipate this problem in Exhibit D attached to the original application by estimating a revenue effect of Application No. 55214, but even with such calculations, the problem remains. In its response to the staff's supplement to the

motion to dismiss, Pacific pointed out that Application No. 55492 is not dependent on Application No. 55214; that it assumes the Commission will grant full relief in Application No. 55214; and that it does not attempt to cover any of the revenue requirements which Pacific seeks to establish in Application No. 55214. Pacific argued:

> "Whatever the rates (and resulting revenues) established in Application No. 55214, Pacific will require the full amount of rate relief requested in Application No. 55492 to cover the additional revenue requirements which are reflected therein and which are not included in Application No. 55214 or any other Pacific application. Regardless of the action the Commission takes in Application No. 55214, the Commission should promptly process Application No. 55492 and grant the relief therein requested."

This statement overlooks realities. Pacific continues to seek to earn the 8.85 percent rate of return found reasonable in Decision No. 83162 (dated July 23, 1974), and if the Commission does not in fact award 100 percent of the relief requested in Application No. 55214, Pacific will have to make a major amendment to Application No. 55492 with higher proposed rates, and probably a new rate spread, in order to achieve its goal (or, in the alternative, Pacific could elect to file yet another application). An amendment of this kind would make the analysis done by the staff and by interested parties prior to the amendment a waste of time. Such analysis must therefore be delayed until the revenue effect of Application No. 55214 is known. Even a prehearing conference is of no value since one of its objectives is to set dates for exchange of further exhibits and prepared testimony and to allow parties to make initial data requests. Neither the staff nor any interested party would be able to determine what data it wished with the application in its present shape. This, in turn, would lead to uncertainty regarding when, or even whether, hearing dates should be set.

A review of Application No. 55492, even in its amended form, thus demonstrates that the problems of uncertainty and prematurity remain, since the data furnished with it are of no use unless an assumption is made that we will necessarily award Pacific 100 percent of the relief it requested in Application No. 55214.

In summary, Pacific had at least one reasonable alternative to the filing of two applications so close together. The company certainly was not unaware at the time it filed Application No. 55214 that it was faced with wage and salary problems. Only a slight delay in filing the first application would have allowed Pacific to file a properly prepared omnibus application which would have included the relief now sought in both applications. The Commission would have had the data to proceed promptly with this one application

Incomplete and premature filings bring upon the Commission and its staff undeserved criticism for regulatory lag. Early filing dates are obtained for applications which are not ready for hearing (regardless of recitals to the contrary) and which defy staff analysis without an excessive amount of data requests and prehearing discovery.

Applicants do not assist the Commission or themselves in reaching an early determination of any rate increase proceeding by obtaining an unusually early filing date. Pacific and other utilities similarly situated are admonished that we will scrutinize future applications for initial completeness and will regard premature filings with strong disfavor. When a utility finds it essential, in its opinion, to file an application for general rate relief while another such application is still pending, it should recite in the second application the particular facts and circumstances regarding why the filing must be made at such time rather than at the conclusion of the already pending application, and how such a filing will expedite the Commission's business.

Findings

1. Application No. 55492, in its original form, was substantially defective in that it failed to comply with Commission Rule 23(g).

2. Application No. 55492 remains uncertain and premature, in that the revenue effect of Application No. 55214 cannot be established at this time. Therefore, any prehearing conference or hearings, in Application No. 55492 must await the decision in Application No. 55214.

3. Pacific was afforded a reasonably expeditious schedule in processing Application No. 55214.

4. Uncertain and premature applications should be regarded with disfavor by the Commission.

Conclusion

Applicant's motion to set public hearings is unmeritorious.

IT IS ORDERED that applicant's motion to set public hearings is denied.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 30th day of SEPTEMBER, 1975.

I will file a dissent
William Symons Jr.
I will file a
dissent
Vernon L. Sturgeon

President

Commissioners

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COMMISSIONER WILLIAM SYMONS, JR., DISSENTING

COMMISSIONER VERNON L. STURGEON, DISSENTING

Regulatory lag is a chronic problem at this Commission. Our inability to act expeditiously upon applications for rate adjustments based on rising operating costs does real harm to the companies we regulate, weakens them, and ultimately works to the detriment of California utility customers.

In our opinion, we would be better served if we spent less time spinning elaborate defenses for not having processed the work of the Commission and more time eliminating the regulatory lag. Application 55214 had final briefs submitted July 21, 1975. We should apply our energies to writing that decision, rather than orders such as this one which do little to clear the log jam. Instead, the jam up is used as an excuse for "straight-arming" the utility company.

We should disabuse ourselves of the notion that the Commission is the center of the universe and that the planets and stars revolve about us. Changes in costs to the company accrue when they occur in the real world, not when this Commission reflects them. The size of the time lag between the two events does not go unnoticed by the investors of capital. We do not have the power of Joshua to raise our arms and stop the flow of time, anymore than the utilities have the power to reverse inflation. This being the case we, possessing the monopoly power to raise or lower rates, must be prompt and not dilatory. Browbeating the company and piously asserting that our regulatory lag had nothing to do with the downgrading of the utility's bond rating from AAA to AA is self-serving but does not get the job done.

Nor is it proper to soothe ourselves with thoughts that this company has been permitted to use normalized depreciation and that the attendant increase in cash flow exonerates us from responsive action on applicant's relief request. This Commission examined Congressional intent and determined that accelerated depreciation under U. S. income tax laws was available only with normalization. The Commission further determined that any device to frustrate the Congressional mandate, such as direct adjustments, was not allowed. But today's opinion suggests a back-door method of adjustment -- the gouge of regulatory lag. It is a strong temptation to some with a taste for vigilante action, but a circumvention of the fair return which has been adjudged proper for the company to earn. We note that the utilities rate of return has been adjusted for normalization, in Decision 83540 in Application 53587, et al, dated October 1, 1974, page 4:

> "Nor do we believe that the contention that we did not take into account the risk-reducing effect of normalization has merit. The impact of normalization upon risk, and hence upon rate of return, was taken into account in the Commission's deliberations and was one of the factors which caused us to reduce the equity return authorized for Pacific below that authorized for other California utilities of similar capital structure."

In light of the above discussion and the fact that the test year in Application 55492 began July 1, 1975, we believe decision in Application 55214 should be reached and Application 55492 be set for public hearings.

San Francisco,
California
September 30, 1975

WILLIAM SYMONS, JR.
Commissioner

VERNON L. STURGEON
Commissioner