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Decision No. 85287

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 offset increased wage, salary and associated expenses.	Application No. 55214 (Filed September 30, 1974; amended December 13, 1974)
Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, inter-company settlements, contracts, service, and facilities of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.	Case No. 9832 (Filed November 26, 1974)

(Appearances are listed in Appendix A.)

O P I N I O N

In this application The Pacific Telephone and Telegraph Company (Pacific) originally sought rate relief totaling $83.8 million, but on December 13, 1974, Pacific filed a substantial amendment requesting total relief of $97.9 million.

No changes are proposed in basic monthly exchange service rates. Increases are proposed for service connection charges, moving charges, certain changes of customer's sets, and in-place connection charges. There are also proposed revisions of charges for line extension and service connection facilities in suburban areas, and certain increases and changes in intrastate message toll service, discussed at greater length below.

The requested $97.9 million rate relief represents a 4.2 percent increase in total local and toll intrastate revenue. The chart below, taken from Pacific's Exhibit 2, shows a breakdown of the $97.9 million by major rate components and the percentage increase of each component:

The Pacific Telephone and Telegraph Company
Application No. 55214
Rate Relief Requested by Major Categories

Category	Dollar Increase (Millions)	Percent Increase
Service Connection, Move and Change and In-Place Charges, Installation Charges, and Line Extension Charges	$29.0	26.3%
Message Toll Telephone Service	51.2	6.2
Residence Extensions	9.1	25.0
Touch-Tone Calling Service	1.2	5.7
Private Branch Exchange Service	7.4	8.6

This decision awards relief in the amount of $65.2 million based on a 12-month test period ending June 30, 1975. Calculation of the additional revenue necessary is set forth in Finding 2; the results of operation and the effect of the adopted rate spread are set forth in Appendix B, page 1, which shows the adopted total company amounts and the resulting adopted amounts for intrastate results of operation.

Preliminary Matters

Although the caption of this application suggests this is an offset proceeding, this is not a proper description of it since it involves a new test period and therefore new analyses of results of operations for that period. A rate increase application is not an offset proceeding simply because no increase in rate of return is sought. (Pacific Tel. and Tel. Co. (1975) ____ CPUC ______, Application No. 55492, Decision No. 84938 dated September 30, 1975.)

Because of the scope of the relief requested, the Commission initiated Case No. 9832, an investigation of Pacific's rates, service and facilities, etc. on November 26, 1974 and consolidated it with this application. Several independent telephone company respondents in this case[1/] filed a written motion requesting us to amend the Order Instituting Investigation so that it would exclude any issue relating to modification of the toll settlement agreements between Pacific and the independent companies.

The examiner correctly denied this motion. The independent telephone companies are properly before the Commission on this issue, in a proceeding designed to investigate rates generally. (See discussion, Pacific Tel. & Tel. Co. v PUC (1965) 62 Cal 2d 634, 675; 44 Cal Rptr 1, 401 P 2d 353.) The fact that the various petitioners may have to expend sums to protect their interests is not an unusual occurrence for a company which is part of a regulated industry. The Commission must fulfill its obligations to set reasonable rates, including joint rates under Public Utilities Code Sections 728, 766, 1705, and other pertinent provisions of law.

Another preliminary consideration is the petition of the staff for an examiner's proposed report, opposed by Pacific. The staff wishes such a proposed report because of the complex issues (raised by the staff) concerning tax treatment, discussed elsewhere in this opinion. Pacific points out, among other things, that examiners' proposed reports have generally not been employed in rate relief matters, even when they are complex, and that the tax treatment issues were treated exhaustively in Decision No. 83162 dated July 23, 1974 (Applications Nos. 53587 and 51774), and therefore such issues, however involved they may be, are hardly novel.

1/ Calaveras Telephone Co., Dorris Telephone Co., Ducor Telephone Co., Evans Telephone Co., Happy Valley Telephone Co., Hornitos Telephone Co., Livingston Telephone Co. of California, Mariposa County Telephone Co., The Ponderosa Telephone Co., Sierra Telephone Co., The Siskiyou Telephone Co., and The Volcano Telephone Co.

We agree with Pacific's arguments. We have afforded Pacific as expeditious a schedule as possible, considering the issues raised, the parties involved, and our own workload. Pacific's amended application, with proper supporting documents, was filed on December 13, 1974, and we began hearings before Commissioner Holmes and/or Examiner Meaney which were held on various dates through June 6, 1975 in San Francisco, Los Angeles, San Diego, Fresno, and Sacramento. Closing briefs were due July 21. We should now proceed directly to our final decision, without consuming the time required to issue a proposed report. The motion will be denied.

Rate of Return

Pacific's rate of return of 8.85 percent was established in Decision No. 83162. In this proceeding, Pacific seeks no change in this return. The staff did not specifically advocate a lower return, but in its opening brief it invited the Commission's attention to the fact that the Commission, in Decision No. 83162, considered the prime rate "of prime importance" (mimeo. p. 19) and that, on June 9, 1975, we took official notice that the prime rate had dropped to 6-3/4 percent. In its brief the staff said that it supported any other party advocating a lower rate of return. No other party made a specific recommendation of a figure below 8.85 percent.

The rate of return cannot be altered based on this record. The prime rate fluctuates constantly. As of mid-September it had risen to a range of 7-3/4 percent to 8 percent. Were we to continually adjust rates of return based on the changes in the prime rate, or because of any other one factor, we would fail in our duty to weigh the many considerations we have consistently found important in determining rate of return, and would cause interminable confusion and extra expense to the utilities (and to the ratepayers) with constantly fluctuating rates.

What annual rate of return will constitute just compensation depends upon many circumstances. (General Telephone Company (1969) 69 CPUC 601; Pacific Gas and Electric Company (1971) 71 CPUC 724.) Any party wishing to adjust a rate of return should make a complete showing on this issue. No such showing was made here. However, in view of the Supreme Court's opinion in City of Los Angeles v PUC (December 12, 1975, S.F. No. 23215) ___ Cal 3d ___, we will, in supplementary hearings, take further testimony on whether rate of return should be adjusted vis-a-vis the issue of determining the method of calculating Pacific's tax liability for ratemaking purposes (see discussion infra).

Operating Revenues

The company's operating revenue forecast is essentially based upon a month-by-month review, and includes historical monthly data from past years (Exh. 20, Part II, Section B). Economic and telephone volume forecasts for future periods include many estimates of general economic factors, such as a "deterioration in the short-term outlook for the California economy" (Exh. 20, Part II, Section C, page 1) caused by the high inflationary rate and various restrictive economic measures designed to control it. The company arrived at a revenue estimate for the test year of $3.13 billion.2/

The staff's revenue estimate exceeds Pacific's by $35.4 million, or 1.1 percent. The staff is critical of the company's method of estimating on the basis that it is a "short view" which will not necessarily be indicative of future conditions.

The staff developed its estimate using 12-month moving totals up to the effective date of Decision No. 83162 (August 12, 1974). The staff then added the annualized net effect of revenues authorized in Decision No. 83162. The staff also trended revenue per average company station.

The company argues that the staff's method fails to consider the falloff in growth of business activity, which occurred from

2/ Estimates are rounded in the discussion section of this opinion for convenience only. When an estimate is adopted, the actual and not the rounded figure is adopted. Estimates are for the total company unless otherwise indicated.

August 1974, and that recorded data after August 1974 (not used by the staff although it was available) demonstrates this falloff. Pacific also points out that the staff witness conceded the later data showed a slowdown in business growth. Pacific points out that the staff witness testified that later data demonstrated a falloff of 61,000 company stations (compared to the number used to make the staff's original estimate).

We adopt Pacific's revenue estimate for this proceeding. We consider that it better reflects the short-run business downturn. Past history of Pacific's estimates demonstrates that the methods used by Pacific have proved accurate, when compared with recorded figures. Effects of increased directory advertising rates, effective January 1, 1975, and the timing of local calls, which will start in selected areas in the second quarter of 1976, are insignificant for this test period. These items will be analyzed in future proceedings.

Interstate Toll Revenue Estimates

Interstate toll settlement revenues are administered by the Long Lines Department of American Telephone & Telegraph Company (AT&T). Each AT&T operating company is reimbursed for its expenses and taxes and receives a return associated with its interstate investment.

The difference between staff's and company's estimates for the amount of such revenues results from (1) different estimates for Pacific's expenses, discussed elsewhere, (2) application of different AT&T rates of return in making the calculation, and (3) different separations factors.

The staff applies an 8.75 percent pro forma interstate rate of return to the Bell system on the basis that AT&T was granted an 8.74 percent interim rate of return by the Federal Communications Commission, as of March 9, 1975.

Pacific employed what it believed to be an effective rate of return of 8.38 percent.

Since we are adopting Pacific's revenue estimate, we will use Pacific's 8.38 percent estimate. We believe it is more representative for the test period.

Maintenance Expense

Maintenance expense is the largest operating expense item for Pacific, and the amount which should be found reasonable was heavily contested because of the difference between the company's estimate ($688 million) and the staff's estimate ($669 million).

Pacific's estimate was based primarily on a budget view for a 12-month period. Pacific's witness on this subject, Mr. Joses, stated that he used 12-month periods ending with June 30 of each year, to be consistent with the test period, in order to compare the 12-month budget view with recent trends. Pacific's test year estimate includes what it claims to be deferred maintenance, caused, according to Pacific, by its recent financial condition. This causes an increase of over 10 percent from the 1974 to 1975 company budget (Exh. 31, Table 8-C). The company witness stated that the charts he developed in a rebuttal exhibit (Exh. 62) demonstrate that Pacific's estimate is closer to the long-term trend than the staff's.

The staff is highly critical of Pacific's development of the estimate for this item, basically because in a "budget" estimate, long-term trends are given insufficient weight. The staff points out that since management has control of maintenance expenses, management decisions can influence short-range trend lines, to the advantage of the company in any given test period. The staff argues that while Pacific claims an increase in maintenance estimates due to deferred maintenance problems, Mr. Joses, on cross-examination, stated that there was no reason why an overall upward trend in total maintenance expense should be any steeper in the future than it was in the past.

The staff further points to the fact that maintenance per company station is not increasing as fast as formerly (there is a flatter upward trend since the beginning of 1974) and that this is due, among other things, to the fact that total maintenance hours are decreasing (Exh. 93). Therefore, argues the staff, a wage increase should not influence maintenance expense trends as sharply as in the past.

The company criticizes the staff's estimate on the basis that it makes mechanical use of trending theories (based, primarily on 12-month moving totals), and that the staff, in using a line-of-sight technique on an extremely small graph to develop a trend, could only produce the crudest information. Pacific also asserts that the staff, in plotting moving totals from December 1973 to December 1974 selected a period during which maintenance expense increased at a slower rate than would be indicated by a similar plot beginning in 1971.

We adopt the company's figure. We agree that the staff's trending period extended over a period when the increase in maintenance costs was relatively slow, and also that the staff's estimate inadequately considers short-range problems of deferred maintenance. Pacific's estimate is to a certain extent more consistent with known trends over the last four years, and as we mentioned in our immediate preceding decision regarding Pacific's rates (Decision No. 83162, mimeo. p. 22): "Our continuing concern with adequacy of service causes us to be somewhat more generous in regard to maintenance expense."

Traffic Expense

The staff estimated traffic expense as $8,049,000 less than the company, before adjustment for 7-1/2-hour operator shifts. The staff used recorded data through December 1974, and developed its trend on the basis of 12-month moving totals.

The company considers the wage increase granted to be too large to be included in such trending, and is particularly critical of the staff's failure to annualize the $2,128,000 increase in operator expense for the test period, resulting from shortening of operator tours from 8 to 7-1/2 hours.

The staff points to several factors which have an offsetting effect: installation of traffic service position (TSP) equipment which will improve operator productivity; the eligibility of an additional 1/7 of calls each year for processing with TSP equipment; a gradual decrease in the proportion of operator-handled calls; and Pacific's advertising campaign to reduce needless directory assistance calls.

We agree with the company's estimate. The offsetting factors mentioned by the staff have a gradual, long-range effect, while the wage increase's impact is immediate and substantial. The rates set in this proceeding are not likely to be in effect long enough for the company to feel any substantial relief from the productivity gains cited by the staff.

Commercial and Marketing Expense Generally (Advertising)

Since Pacific, for this proceeding, adopted the advertising disallowance from the last proceeding, there was very little difference between Pacific's estimate and the staff's. The staff trended recorded commercial expense, and made a separate trend per average company station, then adopted the average of these two estimates. This estimate, with the adjustments we will discuss below, is reasonable.

Direct Distance Dialing Campaign

During the proceeding it became clear that the $1,965,000 budgeted for a campaign to stimulate direct distance dialing will benefit Pacific 50 percent and AT&T's Long Lines Department by 50 percent. Under this circumstance, California intrastate ratepayers should pay no more than their fair share of such a campaign. We will make an additional intrastate disallowance of $683,820 for this campaign, reflecting the difference between Pacific's intrastate allocation for this item and the amount necessary to allow no more than 50 percent of the total for intrastate ratemaking.

"Design Line" Promotional Expense

"Design Line" is Pacific's trademark for various telephone shells, which Pacific purchases from Western Electric and other suppliers (Western Electric supplies Pacific with all the shells, including those manufactured by independent companies). Pacific, in this offering, breaks with its own established precedent and offers these shells for sale. By contrast, General Telephone of California, at least at this time, supplies decorator shells to its customers for a monthly fee. Company witnesses were examined carefully concerning this approach.

The staff does not recommend that Pacific be ordered to switch to a monthly charge system, nor did the other participants, but there were various recommendations concerning the rate treatment to be afforded Pacific's expenses for this program. Also, a large volume of mail was received from the public, primarily voicing the fear that all ratepayers would be made to pay for the extra costs of the program.

Pacific's position is that it intends the Design Line equipment expense to be borne entirely by the purchasers of the decorator shells, and showed that the prices of the shells themselves would, because of the price levels,[3/] pay for 100 percent of the cost to Pacific, plus a profit margin, and ratepayers not wishing to purchase such equipment would not subsidize the program. Pacific's witness, Mr. Joses, stressed the need for "innovative marketing" to meet competition, and expressed the opinion that the program would ultimately be profitable enough to lessen the revenue requirement to be covered by basic exchange rates.

It would be premature of us to decide at this time that Pacific should emulate General Telephone and adopt a monthly charge system for its decorator telephone shells, but we will scrutinize the program closely and require reports to assure that there is no continuing subsidy of the program from other revenues.

The most serious problem which we must consider relating to the Design Line program is the promotional start-up costs. Pacific projected a net loss associated with Design Line of $71,000 for the test year, but further projected a net profit of $161,203 by December 1975. Because of the test-year loss, Toward Utility Rate Normalization (TURN) recommended disallowance of the entire program, and the staff recommended that at least the promotional expense of the program be disallowed.

The problem with the staff's presentation on this subject (Exh. 96) is that, as the city of Los Angeles points out, it is a "heads I win, tails you lose" proposition. While the revenues would be taken into account for ratemaking purposes, expenses would be excluded. Such a recommendation is inequitable. Los Angeles points

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3/ Prices range from a one time charge of $59.95 to $99.95, while the average cost per set is $39.15, according to Pacific.

out that in any start-up of a new program, costs will be higher in the first year and profit will not necessarily be shown (and, we might add, revenue will be lower while the public is introduced to the new product or service). Therefore, we agree with Los Angeles that whatever adjustment is made to Design Line should take these factors into account. Nor can we, as an alternative, ignore the program and disallow it entirely, for if indeed it is profitable, then the revenues are excluded from ratemaking.

We conclude that the adjustment should be in the amount which will treat some reasonable portion of the promotional expense as a start-up cost, in the same category as an investment, which should be borne by the stockholders. Any determination of this amount must be judgmental, since it is unknown at this time what an "ordinary" advertising budget for this program will be. We believe it is reasonable to disallow 50 percent of the test-year estimate (based on the staff's estimate of $770,750) for ratemaking purposes. This is not the establishment of a firm rule that 50 percent of such advertising costs should necessarily be so treated in future years. As explained, we deal here with start-up costs.

An equally important problem is monitoring this new program. We must examine Pacific's estimates to see if they include all expenses which should be attributed to Design Line. From a review of the staff's Exhibits 96 and 97, we are convinced that Pacific has failed to charge certain expenses to Design Line which should be laid at its doorstep. The staff projects continuing net deficits to the program through the end of 1975 because it attributes to it:

(1) Additional contact time necessary for customer representatives to handle Design Line transactions.

(2) Incremental cost difference between the electromechanical working parts of a standard ("Model 500") phone and the parts of a rotary Design Line phone.

(3) Instrument change loss - the loss to the company each time it replaces a standard or extension phone with a Design Line instrument. (The company estimates an instrument change cost of $28 for each residential subscriber and $36 for each business subscriber; the tariff is only $12.)

(4) A 10 percent contingency fund for unknown expenses in connection with the program. The subjects encompassed in this contingency are outlined in Exhibit 96 and include such items as inflationary factors; installation of telephone jacks on the customer's premises (required for Design Line phones); "interelasticity" - viz., the effect Design Line may have on other similar products such as Princess and Trimline phones; extra maintenance and management costs; installment financing costs; and costs of administering a warranty program.

The staff accepted the company's revenue estimates.

The proposed increase in the change of instrument charge (to $15 for residential subscribers and $18 for business subscribers) would only reduce the cumulative December 1975 deficit to $834,183, by staff's estimating methods.

The staff also notes that, in case of nonpayment, the company will not attempt recovery of the Design Line working parts (the non-Design Line sets are reclaimed). The staff did not evaluate the economic effect of the nonrecovery.

In an inflationary period, when every effort should be made to hold down cost increases to ratepayers, we should assure ratepayers who wish no more than standard equipment that they are not paying indirect costs of furnishing deluxe or nonessential items, whether they are offered by way of monthly charge or on a purchase basis. While we do not accept the staff's view that all promotional expense should be disallowed, we do agree with the staff that the costs attributed to the Design Line program in Exhibits 96 and 97 are proper (including a 10 percent contingency for the items set forth in Exhibit 96) and believe that Pacific should be required to file reports with the Commission which will help us evaluate the financial success or failure of the program, on a basis which will, with reasonable accuracy, include the indirect costs of the program. In making these reports, the company need not agree with every staff's assumption in determining revenues and expenses (for example, the company need not agree that 10 percent is the proper amount for contingency), but, we will expect Pacific to estimate as best as possible such factors as additional contact time, cost difference between standard and Design Line rotary mechanisms, and the contingency factors listed in Exhibit 96. Such reports should contain enough detailed information so that the staff may make its own analysis and draw its own conclusions.

We further determine that, regardless of the merit of keeping installation costs low for standard telephones, a change-of-instrument charge for a deluxe item should fully reflect the cost of the service. Since by the company's own estimates, a change of instrument costs $28 for each residential subscriber and $36 for each business subscriber, we will establish change-of-instrument charges associated with replacing a standard telephone with a Design Line model, or with replacing one Design Line model with another which will more nearly reflect the cost of service (this will not apply to the replacement of a Design Line phone with a standard instrument since it would be unfair to burden a new subscriber who moves into a location with a Design Line phone, and who does not want it, to have to pay a higher-than-standard installation charge to return to a regular telephone).

We will also require Pacific to attempt recovery of the instruments for nonpayment. We do not require any extraordinary measures but simply that Pacific take the same steps to recover at least the working parts of the phone that it would take regarding a standard telephone.

Lifeline Advertising

In Decision No. 83162 we ordered Pacific to make the public aware of "Lifeline" rates. The material concerning such advertising which was submitted during this proceeding clearly shows that Pacific's response to our order has been inadequate.

As contrasted to Pacific's considerable television and radio outlays for other campaigns such as for the reduction of information calls and for promotion of various classes of business services, Pacific's advertising for Lifeline was confined to certain weekly newspapers, on the ground that these papers circulate in low-income neighborhoods and therefore are effective in reaching those for whom Lifeline was intended.

Pacific's total reliance on these weekly newspapers is misplaced. There is no showing that a majority of persons in such neighborhoods read these papers, and in any event, distribution of this particular type of paper is not always a measure of readership. Additionally, the advertisements themselves are hardly typical in interest and ingenuity to those Pacific creates for markets in which it is more actively interested.

We have often been critical of Pacific's advertising budget and have ordered reductions. In this proceeding, for example, we have not hesitated to say that certain costs of advertising associated with direct distance dialing and Design Line should be disallowed. Now, however, we specifically authorize the amount of $150,000, to be included in setting rates for the test year, to be spent during calendar year 1976 for Lifeline advertising in areas where Lifeline is offered. While we are not against the use of a bill insert in the appropriate areas, since the cost of a bill insert is comparatively modest, we wish the great majority of this amount to be devoted to TV, radio, and general circulation (daily) newspapers, since one of the prime objectives is to reach those without phones who would not, of course, receive bill inserts.

Not all persons of modest means live in identifiable low-income neighborhoods. It is common knowledge that there is a mass audience available through TV, radio, and daily newspapers which is not reached through specialty advertising[4/] and Pacific should make at

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4/ Pacific itself has often maintained, for example, that it cannot conduct effective advertising campaigns solely by bill inserts and, certainly, for many services, this is true. Pacific presented adequate evidence to show the revenue-producing effects of some of its recent major campaigns. For this reason we disagree with the staff's comment (opening brief, p. 27) that we should generally call into question the efficiency and necessity of Pacific's major media campaigns. While we will always scrutinize carefully the extent of such campaigns, and their revenue-producing effectiveness, we are hardly prepared to tell Pacific that it is foreclosed from mass advertising. It is inconsistent of the staff to argue, on the one hand, that it is generally questionable for Pacific to engage in multi-media advertising, while arguing, on the other hand, that Pacific has failed in its public duty regarding Lifeline service because it has spent no money on such advertising for Lifeline (staff's opening brief, p. 60).

least some minimally adequate usage of such media to reach this audience. Since the availability of Lifeline service is restricted to four metropolitan areas (San Francisco Bay area, Los Angeles, Orange County, and San Diego), with eight other areas to be added in five years pursuant to our order in Decision No. 83162, there is no problem in locating the general areas to be reached.

We expect Pacific, in making use of the amount allowed, to employ the same ingenuity and imagination in preparing TV, radio, or newspaper copy for this subject that it would use regarding other campaigns, and considering the size of the budget. We hardly expect that Pacific should wish to spend the amount of money selling a service with a low return, such as Lifeline, that it would spend on a campaign for a class of service which might produce considerable revenues, and we have selected the amount to be devoted to Lifeline with this in mind. Nevertheless, as a matter of public service, we are firmly convinced that Pacific should devote at least some funds to mass media advertising of Lifeline.

We are not expressing an opinion that the exact level of expenses we have set for calendar year 1976 need necessarily be maintained in future years, but at the same time, we think that as Lifeline is introduced into new areas over the next five years pursuant to our previous order, there should be at least a brief, minimum mass media campaign in each area announcing its availability, plus at least one bill insert in such areas.

Operating Rents

Pacific recently made another departure from its normal operating policy, and leased its new regional headquarters at 1010 Wilshire Boulevard, Los Angeles, at an annual net cost of

\$1.5 million.5/ Pacific also leased a smaller regional building in Buena Park for \$300,000 per year.

Before proceeding to discuss the difference between the staff and the company regarding how these leases should affect trending of operating rents, we wish to dispose of the inference in the staff's brief that some sort of policy disallowance should be made. While, in an 11-page analysis (Exh. 66), there is a one-page mention of "corporate identity", various alternatives in the Los Angeles downtown area were investigated and this choice proved the least expensive available building. The company also considered modernization of its present regional office, and found this to be the most expensive alternative. The various choices are summarized in Exhibit 66, page 5, as follows:

5/ The total annual expenses are actually: rent, \$1,847,600; taxes and operating costs, \$737,000; less parking income, \$96,000; total, \$2,488,600. From this is subtracted the total present operating expenses of Pacific's present location, 740 South Olive Street, which amount to \$1,325,200 for the test year, since there is an interim period of overlapping leases, and \$1.1 million thereafter (Exh. 66, p. 8).

Plan	Location	Annual Cost	Remarks
1	Modernize 740 S. Olive St.	$3.50M	Cost reflects code requirements and air conditioning.
2	Security Pacific Plaza	3.18M(1)	Space not available on contiguous floors.
3	United California Bank	2.86M(1)	Good quality space. Other tenants.
4	Broadway Plaza	2.52M(1)	Good quality space. Other tenants.
5	1010 Wilshire	2.49M(2)	Good quality space. Sole occupant.

(1) Costs are based on offers received in January 1974 for a 10-year term subject to renegotiation. Included is cost of maintaining present garage operation and leasing suitable street level space elsewhere for employment or public offices.

(2) Cost based on current offer with a 30-year term.

Pacific's witness took the position that the reference to corporate identity had to do primarily with selecting a convenient and attractive location in order to attract high-caliber employees.[6/] The age and condition of Pacific's present building, according to the company, had presented a problem in this regard.

While we do not intend in this proceeding to make any policy adjustment, we agree with the staff that, at some point, continual dependence on long-term leasing may have undesirable long-term effects on expenses, and we should closely scrutinize it. The company has

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6/ Exhibit 66 does not bear out this contention since the sentence referred to (Exh. 66, p. 7) reads:

> "Prominent location with unique and beautiful exterior will provide an excellent corporate identity."

announced plans to lease space for a Northern Regional Headquarters in San Francisco (to be occupied beyond the test year). The company's rationale for increasing dependence on long-term leases for major buildings is that its study shows that if the current cost of debt is 8 percent or less there is an advantage to owning such facilities. While interest rates are expected to remain relatively high for the indefinite future, Pacific cannot necessarily assume (nor can we) that they will indefinitely be at the level of 9 percent or above (as it was at the time the decision was made). Further, although Pacific pays millions to AT&T under its license contract, and although AT&T, in 1971, asked that the operating companies consult before leasing large buildings (Exh. 82), Pacific failed to heed this request before making its decision.

And although we agree that the selection of the 1010 Wilshire location appears proper in this particular case, Pacific should remember that factors of corporate identity and aesthetics should play a minimal role in selecting buildings, as compared to the importance which might justifiably be placed on such considerations by a company operating in a fully competitive area. We are of the opinion that prominence of location may be considered only to the extent that it helps attract a quality work force by (1) providing an adequately attractive environment and (2) eliminating transportation problems for employees, in an era of increased reliance on public transportation.

For the above reasons, we intend to scrutinize leases for large buildings, and the selection of sites for all buildings, leased or otherwise, carefully. We expect Pacific to investigate not only "downtown" locations, but other sites out of high-rent or high-cost-of-purchase areas, which may still be reasonably convenient for the purpose intended. The entire study for Pacific's new Los Angeles building (Exh. 66) appears to have considered locations in downtown Los Angeles only. We will not consider such a restricted analysis satisfactory in the future.

Turning to the economic analysis of operating rents for the test year, the staff took the position that the account was suitable for trending and used recorded data from 1970. On an annualized basis, the staff included in its estimate $2 million over 1974 recorded costs for operating rents. The staff is of the opinion that its trending encompasses both the new Los Angeles and Buena Park leases.

The company's position is that the staff witness, in failing to give particular consideration to these two buildings, failed to recognize these specific lease costs as outside the trend.

We agree with the company that the staff's trend fails to take into account the Los Angeles lease adequately (although the Buena Park lease appears to be included within the trend). Attribution of over $1 million to the normal trend would leave too small an amount to reflect other leasing cost increases throughout the State. However, a figure of $1.5 million includes, as we stated above, $400,000 of overlapping leases which occur in 1975 only. Therefore, the staff's estimate should be increased by $1.1 million, not $1.5 million.

General Office Salary and Expense

The staff's estimate is $1,880,000 less than Pacific's, with most of the difference traceable to engineering salaries (both the company's and the staff's estimates exclude $167,000 for legislative advocacy). As with traffic expense, the company argues that the increase in engineering salaries was not included in staff trending, and the staff disagrees.

We again believe that the staff's trending fails to give adequate weight to the short-range impact of the salary increases, especially considering the length of time the rates we set here are likely to be in effect, considering current economic conditions. The company's estimate is adopted.

Western Electric Adjustment

Based upon methods approved in previous decisions, the staff prepared a study updating previous information to reflect rate base and expense adjustments for Pacific's California purchases from Western Electric Company (Exh. 32). The net rate base adjustment is $49,627,000, and the net total expense adjustment is $3,033,000.

Pacific did not contest this adjustment for this particular proceeding, and there is only a minor difference between Pacific's calculation and the staff's ($169,000 for expenses and $1,503,000 for rate base).

The staff had available later data in calculating these adjustments and, accordingly, the staff's adjustments are adopted.

General Service and License Expense (AT&T License Contract)

Pacific and all other Bell subsidiaries have a license contract with AT&T for providing certain services such as basic research, engineering advice and assistance, and other aid in areas such as accounting, law, financing, and other areas where, in the opinion of AT&T, these services can be performed more economically than if they were handled by each operating company. In Pacific Telephone and Telegraph Co. (1971) 72 CPUC 327 (339), we said:

> "Historically, the Commission has rejected the percentage-of-revenue basis of payment to AT&T when determining reasonable expenses for the purpose of setting rates for Pacific. Although over a period of years the percentage basis might result in average charges that are reasonable, the end result in a particular year at a particular level of rates may not be reasonable. For example, a ten-percent increase in Pacific's telephone rates would result in a ten-percent increase in payments to AT&T for exactly the same services. In lieu of the percentage allocation basis, the Commission generally has based its prior decisions on a determination of actual costs to AT&T for the services rendered to Pacific."

Pacific has paid as much as 2-1/2 percent of its gross annual revenue to AT&T under the contract, although recent payments have been 1 percent. Then during the test year, AT&T changed its method of assessing the operating companies, except for Bell of Canada, to an allocated share of total costs. The Canadian company continued on a percentage basis.

The staff's estimate is based on trends which take into account past experience, incorporating the rate of cost increases over the last few years. We agree that this is a reasonable approach, and adopt the staff's estimate.

Apparently, Pacific believes that the staff made a separate adjustment or disallowance for Bell of Canada. This is not the case; the staff simply included Bell of Canada within the trend, and on a trended cost basis, regardless of the fact that Bell of Canada continued to pay on a percentage basis (it is noted that Bell of Canada has now terminated its license contract arrangement with AT&T; therefore, the problem of a separate method of payment will not be present in the future).

Lien Date Adjustment

As the company's opening brief (pp. 55-56) points out, based upon the California State Board of Equalization's assessment of Pacific's property, the staff and Pacific reached agreement on the fact that the net effect was to increase Pacific's federal income taxes during the test year by $1,648,000 and the California corporation franchise tax by $362,000. These changes are adopted.

Net-to-Gross Multiplier

The net-to-gross multiplier is a factor used to compute the gross revenues necessary to increase net revenues by one dollar. For computation of the California corporation franchise tax (CCFT) component of the multiplier, the staff used an incremental tax rate, as it has done in the past, rather than an effective tax rate. Pacific disagrees with this approach, pointing out that the staff otherwise used an effective tax rate in calculating the amount of CCFT for the test period, and that an incremental rate "erroneously assumes that a change in total Bell system unitary income for CCFT purposes, and thus in Pacific's CCFT, will come about only by a change in California revenues" (Pacific's opening brief, p. 34). Pacific points out that many rate increases, totaling $914 million have been granted to Bell system companies, and many rate increases are pending.

Pacific does not present us with a change of circumstance by showing us that many rate increase cases are either pending or have recently resulted in rate relief throughout the Bell system. This has always been the case in recent years. We used an incremental rate in the previous proceeding when economic circumstances were similar, and such a rate was used by Pacific in past cases. We do not believe that we should change to an effective tax rate based on this record. The staff's calculation is adopted.

Expenses Connected With Divestiture Litigation

The United States Department of Justice has commenced a divestiture suit against AT&T which, if successful, would require AT&T to divest itself of Western Electric and Bell Laboratories. (It is unclear whether the Justice Department actively seeks an order requiring divestiture of the operating companies.)

The staff wishes us to place Pacific on notice that since the defense of this litigation can only benefit AT&T's stockholders, any amounts charged to Pacific by AT&T should be disallowed.

Whether preservation of the existing corporate structure of AT&T would also benefit the ratepayers is certainly controversial. On this record, we are not prepared to make a final decision that there are no benefits at all to the ratepayer, but in order that we may carefully consider this problem in the future, we will order Pacific to be prepared, in forthcoming rate cases, to furnish for the record the amounts actually spent, the amounts projected to be spent in connection with this suit, and how the operating companies are charged for the expense (i.e., whether it is included in license contract payments or billed separately). Of course, we will wish information on any sums spent directly by Pacific on this litigation, including Pacific's best estimate of the financial value of the time involved in defending the suit.

Management Salaries

The staff claims that Pacific was imprudent in accepting a recommendation by its personnel department in mid-1974 which granted an 8.3 percent salary increase to management (nonunion) personnel. The staff argues that a more responsible course, in view of the economic situation, would at least have been deferral of the increase, and that, even without the new wage scale, Pacific's own survey showed that its management group was paid about average among the forty corporations surveyed.

Pacific states that the increase was in line with that granted to union employees and was necessary to prevent undue compaction or even overlapping salary levels, resulting in situations in which some nonmanagement personnel would earn more than their supervisors. Pacific also argues that its survey shows the raise was in line with general trends.

We do not believe an across-the-board disallowance is warranted. An 8.3 percent management salary increase is not out of line to maintain reasonable levels and attract personnel to management positions in an era of unusual inflationary pressures.[7/]

This does not mean, however, that we will always consider it necessary or proper for a utility to match, dollar-for-dollar, a union-contract-wage increase with a management salary boost. And, regarding Pacific's "compaction" argument, we note that it certainly does not apply to top-level executive salaries, which we will continue to scrutinize closely.[8/]

7/ The Federal Reserve Bulletin for September 1975 (page A-53) shows that for the period from January 1973 through July 1975, the Consumer Price Index compiled by the Bureau of Labor Statistics rose 19.2%, and the wholesale price index for the period January 1973 through August 1975 rose 42.0%.

8/ We note our statement in the recent Pacific Gas and Electric Company decision (D.84902) that salary amounts in excess of $100,000 will not be recognized for ratemaking purposes. This rule applies to Pacific, which has two salaries over $100,000, the total overage being $105,000. No separate adjustment is necessary in this proceeding for this amount because the size of Pacific's rate base means that the adjustment would be too small to affect rates. We will continue to scrutinize the effect of such salaries.

Computation of Wages by Subaccount

Since Pacific has stated that increased wage costs, more than any other factor, prompted this application, the staff proposes that the company be ordered to file monthly reports of wages by subaccount.

Pacific replies that it has never analyzed wages on this basis and to do so would require costly changes in company accounting procedures.

We disapprove this request. Such detail is not required by the Uniform System of Accounts, and furthermore, it is difficult to see how it would be of value, at least if the staff's normal estimating and trending practices are followed in future applications. The staff has traditionally developed its trends and estimates by account number, with each account containing all expenses, including wages, associated with it.

Depreciation Expense

After making its own calculations and analyzing those of Pacific, the staff adopted Pacific's estimate of depreciation expense, except for a minor variation in the adjustment for common utility plant, which amounts to a difference of only $4,000 (Exh. 31, Table 14-A). The adjusted depreciation expense figure of $421,914,000 (the staff's estimate) is adopted.

Miscellaneous Operating Expenses

In addition to operating rents and general service and licenses (both of which are discussed elsewhere), Chapter 11-B in the staff's Exhibit 31 contains an analysis of certain other accounts which do not require lengthy discussion.

The staff's analysis of insurance accounts included certain premium increases occurring in late 1974, which were not covered by Pacific's estimates. Likewise, the staff's estimate of the accidents and damages account includes actual 1974 experience. The staff's estimates exceed the Pacific's by a total of $192,000. These estimates are adopted.

For relief and pensions, the staff's estimate is 2.2 percent or $4,768,000 lower than Pacific's due to (1) an adjustment to reflect lower accruable payroll commensurate with differences on estimates for expense items that include payroll and (2) the staff's evaluation which attributed a higher percentage of payroll to capitalized expenditures. Since our adopted results are in line with Pacific's as to payroll items, we will adopt Pacific's estimate.

Tax Estimates

This discussion concerns differences in taxes other than those which result from different estimates of revenue and expenses.

Ad Valorem Taxes. The staff's estimate is 2.1 percent lower than Pacific's. The staff used the 1974-1975 fiscal year billings which became available in December 1974. The staff's estimate is adopted.

Payroll Taxes. The staff's estimate for this account is 1.8 percent lower than the company's, resulting from different trending by the staff for accounts including payroll expense. Again, since our adopted results for payroll accounts are basically those of Pacific, we adopt the company's estimate for this account.

Separations

In this section we deal with issues relating to apportionment of total company investment, revenues, and expenses between interstate and intrastate operations.

Plant in Service. The largest difference between company and staff calculations concerns separating telephone plant in service, which is the largest component of rate base. Pacific used a factor of 0.2097 while the staff employed 0.2138. The resulting difference in dollars for the test year is $33,777,000.

The staff witness testified that he developed his factor using recorded data from 1972 through 1974, and applied least squares trending methods to it. He also developed a visual, or graphic, estimate which he stated checked with the estimate that resulted from the mathematical analysis.

Pacific is critical of this result on the basis of recent recorded data and the fact that each of several other estimating methods yield a lower factor. Pacific introduced Exhibits 42, 43, and 44, each of which contain least squares projections based on recorded data for different periods. On cross-examination, the staff witness, Mr. Evans, stated (Tr. 1222):

> "My analysis of Exhibits 42, 43, and 44 is that these are three exhibits that show least square projections that yield an interstate factor in the range of .2121 to .2126."

We believe the company's proposed factor is too low, but that it has shown that the staff's factor is too high. While it will probably eventually reach the staff's suggested level, we cannot assume under current economic conditions that we are setting rates for a few years into the future. On the other hand, the company relied in part on a minutes-of-use study, the details of which the company witness was not familiar with, and Exhibit 79, graphs prepared by Pacific to justify its development, shows on its face that its projections are not typical of recent recorded results.

We adopt the lower end of the range calculated by the staff witness from Exhibits 42, 43, and 44 (0.2121) as an appropriate factor for the period that the rates found reasonable here are likely to be in effect.

<u>Other Factors</u>. The staff's separations factors for other factors were based on use of later recorded data and analyzed with regard to long-term trends. Pacific did not contest the staff's figure during the hearings or on brief. The staff's estimates are adopted.

Rate Base

In reaching a determination of rate base, we consider telephone plant in service (with the Western Electric Adjustment, discussed elsewhere), property held for future telephone use, materials and supplies, and working cash. From the total derived from this analysis we deduct the depreciation reserve, the deferred tax reserve,[9/] and other adjustments. The staff's estimate of rate base is $6,324,120,000, which is $24 million or 0.4 percent less than Pacific's estimate.

Telephone Plant in Service. Differences between the staff's and the company's estimates result from (1) different estimates of the test period construction budget, and (2) the factor employed to calculate the amount of this budget that will be added to the rate base as plant during the test period. The staff's estimate is 2.5 percent higher than Pacific's.

We adopt the staff's estimate. It is based on the December 1974 construction budget while Pacific employed the August 1974 budget adjusted to reflect several additional months of data. The staff's factor of 47.2 percent is also reasonable. It was developed from more than one year of past experience of the weighted average additions to net plant, whereas Pacific determined its factor from an analysis of test-year data only.

Working Cash Allowance. The small difference between Pacific's and the staff's estimates is due to staff use of 1974 study data not available to Pacific when it made its study. The staff's estimate is reasonable and is adopted.

9/ In this section, we determine the deferred tax reserve based on the method we found reasonable in Decision No. 83162. Discussion of alternate methods of ratemaking treatment of the deferred tax reserve is discussed infra.

Other Rate Base Factors. There are minor differences in estimates of materials and supplies, and property held for future telephone use. We have analyzed the staff's method of computing these items (Exh. 30, p. 7-LGA; Exh. 31, Tables 13-B and 15-B) and conclude that the staff's estimates should be adopted.

Depreciation Reserve. There is also only a minor difference (less than 1 percent) between the staff's and the company's estimates of depreciation reserve. The staff points out that Pacific has in the past underestimated retirements of plant. The staff's figure is adopted.

Deferred Tax Reserve. This amounts to the difference between income taxes paid using accelerated depreciation and income taxes calculated using book depreciation under the normalization treatment of income taxes used by the company. Based upon this treatment (staff disagreement with the use of this method being discussed elsewhere) there is no difference between the company's and the staff's calculations. The estimate for the test period is $319,739,000.10/

Staff's Proposed Treatment of Interest on Plant Under Construction

The staff previously proposed a working cash adjustment to rate base (with which Pacific disagreed) to recognize the lag in the payment of bills after the time material is received from Western Electric Company. This adjustment was adopted in Case No. 7409. The staff's position was that amounts related to plant under construction should be included in the working cash adjustment because Pacific was accruing interest during construction and therefore would earn on those amounts.

10/ It should be emphasized that this reserve is subtracted from rate base, and thus has the effect of a downward adjustment on rates for the test year. Hence our discussion, infra, on methods of "annual adjustment" concerns future periods only. There already being the necessary "adjustment" for the deferred tax reserve included in test year rate calculations for this proceeding.

In this proceeding, the staff argued that Pacific should not include interest on unpaid contractor's bills in the rate base. At the same time, however, based upon its previously adopted recommendation, it still included amounts related to plant under construction in the working cash adjustment, and for the same reason the company argues (opening brief, p. 49):

> "The evidence shows that the Staff's proposed treatment of interest would decrease the rate base by \$1,968,149 (see Tr. 2563, 2659), but that the corresponding increase in the rate base from the removal from the working cash adjustment of amounts related to plant under construction would be in excess of \$3,500,000 (see Tr. 2603, 2617-18). The Staff's proposed treatment of interest is inconsistent with the working cash adjustment, and would -- together with the corresponding change in that adjustment -- result in an increase (not a decrease) in the rate base. For these reasons the proposed interest adjustment to rate base should be rejected."

We agree with Pacific and will not adopt the staff's proposed treatment.

Use of Proceeds from the Sale of Notes

Exhibit 69 is a letter dated November 15, 1974 sent to the Commission pursuant to previous Commission authorization relieving Pacific of its responsibility to report on the disposition of funds from the sale of notes under General Order No. 24-B, and allowing it to furnish the Commission with the information by letter.

The exhibit states that some of such funds were used "for general corporate purpose", which would be a violation of Public Utilities Code Section 817. The examiner ordered the Finance and Accounts Division to investigate the matter. The result of the investigation was to show that the letter was misleading; however, the Finance and Accounts Division's exhibit on the subject (No. 114) recommends that in the future, the depreciation reserve balance should be part of the calculations in the amount reported to reimburse the treasury for unreimbursed capital expenditures. The staff witness indicated that this is the practice followed by other major utilities.

We agree with the staff recommendation as better practice, to assure the Commission that the intent of Section 817(h) is carried out, but believe that, in addition, the company's letter format of reporting the disposition of funds has proved unsatisfactory. The company, having been relieved of its duty to file a full report under General Order No. 24-B (as is the case with most other major utilities, due to numerous financing transactions) should at least furnish us with enough information to eliminate the confusion caused by Exhibit 69. We will order Pacific to make such reports in the future in substantial accordance with the format in Appendix D to this decision. The reports may continue to be in letter form.

Proposed NARUC Separations Plan

The city of Los Angeles and TURN both advocate that the separations plan adopted by the National Association of Regulatory Utility Commissioners (NARUC) should be adopted. This plan allocates more of the revenue requirement to interstate traffic and less to intrastate. The staff did not advocate the adoption of the NARUC plan on this record, although under examination, the staff witness testified that in his personal opinion, the NARUC plan was a more reasonable basis of allocation than the so-called Ozark plan.

The Ozark plan is consistent with the separations method adopted by the Federal Communications Commission (FCC). Pacific points out that present use of the NARUC separations plan, without such a plan first being adopted by the FCC, would leave a gap in the revenue requirement since our unilateral adoption of it would disallow $94 million of intrastate revenue requirements without any corresponding increase having been adopted by the FCC for interstate revenues.

The city of Los Angeles and also TURN support the present adoption of the NARUC plan.

Central to the question is not only ratemaking theory, but whether the Commission may adopt a plan without working a confiscation of Pacific's property. It is clear that we are not bound generally to every determination of the FCC (Pacific Tel. and Tel. v PUC (1965) 62 Cal 2d 634, 655-656). However, Pacific argues that in that case no confiscation of property was involved since the Commission was not bound to depreciation rates prescribed by the FCC, and since Pacific would recover the value of its property over its allowable life-span, all that was involved was the rate of capital recovery in its jurisdiction.

Los Angeles points out, in response, that historically state commissions have adopted plans consistent with the FCC not because the FCC plan was required but because the FCC plan was usually the most reasonable before the state commission. Therefore, the argument runs, if in fact there is a more reasonable plan, there is no bar to adopting it. In New Hampshire, the New Hampshire Commission adopted its own plan and was challenged by a Bell affiliate before the New Hamsphire Supreme Court. The court upheld the Commission's right to adopt, for intrastate purposes, a separation plan different than that used by the FCC. (New England Tel. & Tel. Co. v State of New Hamsphire, ____ NH _____, 97 A 2d 213, 99 PUR NS 111 (1953).)

We will not resolve this question on this record because we feel that we do not have sufficient input from General Telephone Company, Continental Telephone Company, and the other independent telephone companies on the effect of the adoption of this plan on these companies. The only exhibit offered on the subject was the staff's exhibit, and we think the record needs more development before we take such a major step. We note that the FCC has had the question of revision of interstate/intrastate separations before it in one form or another for several years.

We will defer all questions concerning this problem including the legal arguments regarding its adoption to Pacific's Application No. 55492 now pending. The brevity of our discussion here should not be a measure of this issue's importance. We expect Pacific, the staff, other telephone companies, and any interested parties concerned with this issue in Application No. 55492 to be ready to present legal and economic issues to the Commission which will help us resolve this problem. Certainly (and without here indicating that we have decided the legal issues), we will state that it is our opinion that we do not have to wait indefinitely for the FCC's action before disposing of the various issues presented regarding adoption of the NARUC plan, or any other plan.

Service Complaints

Pacific has always maintained a high standard of service and this record presented us with no general or widespread service considerations. However, certain specific problems merit discussion.

Public Payment Agencies. Arthur S. Hecht and the Sunset-Parkside Educational Action Committee (SPEAK) introduced evidence to show that Pacific's policy was to minimize, if not eliminate, the number of public payment agencies such as bank branches, drugstores, etc., available to pay telephone bills.

SPEAK's position is that at least a minimum of such agencies should be maintained in low-income neighborhoods in order that persons of limited means can pay their bills without paying postage, and also because persons who have mobility problems may find it easier to pay their bills at a bank branch, a drugstore, or some other location which they normally patronize, rather than taking a separate trip to the nearest mailbox or post office branch. Exhibit 53 contains over 500 signatures which SPEAK obtained asking Pacific to establish more public payment agencies in various locations throughout San Francisco.

SPEAK points out that Pacific Gas and Electric Company maintains 31 offices which can be used for this purpose scattered throughout the city while Pacific maintains five offices, three of which are within several blocks from each other (the latter being in Chinatown or close to the financial district).

Pacific's position is that the costs of maintaining these stations have risen to the point where it is unfair any longer to burden all subscribers with these additional costs. Pacific terminated its arrangement with some banks because of increasing costs thus reducing the amount of stations available. The statewide cost in 1974 for a public agency was almost 20 cents per payment according to Pacific's evidence while it would cost the subscriber only 10 cents to mail a payment and Pacific 3.2 cents to process payments mailed directly to it.

Pacific points out that at least one bank now offers senior citizens free checking accounts and claims that if a person has mobility problems it would be just as difficult for him to get to a public payment agency as to a mailbox.

The staff and SPEAK point out that costs vary widely and that Pacific has not made much of an investigation to determine whether public payment stations could be operated on a more reasonable basis. While the fee to Wells Fargo Bank for handling payments is now 35 cents per bill, the Bank of California charges only 7 cents for performing the service in Berkeley, and the hardware store in Newark handles the payment for 9 cents. SPEAK suggests several alternatives which Pacific apparently has not considered, such as making use of agencies now employed by Pacific Gas and Electric Company and the San Francisco Water Department and studying the possibility using certain public agencies such as senior citizens' housing areas and food stamp distribution centers. SPEAK's ultimate objective is a system of public payment agencies which would be comparable in convenience (although not necessarily in number) to the agencies utilized by Pacific in 1972.

We believe that there are problems with making an order as sweeping as SPEAK proposes. We agree with Pacific's argument that times have changed and that the normal method of payment is now the use of a check. As was pointed out, free checking accounts are now available for senior citizens. A further problem is identifying the particular neighborhoods or locations which would continue to be convenient for such persons. In an era where more and more people of all ages live in the suburbs, it is increasingly difficult to pinpoint specific locations where senior citizens live in high numbers. As we pointed out elsewhere in this opinion in connection with Lifeline advertising, we cannot assume that all persons of modest means necessarily live in identifiable low-income neighborhoods.

We do agree, however, that Pacific appears to have made an inadequate survey of the problem to determine whether public payment agencies can be maintained in proper locations at a reduced cost. We will order Pacific to investigate in San Francisco and other appropriate urban areas to determine whether public payment agencies may be maintained or established on a low-cost basis in areas convenient to the urban poor, and to report more fully on this problem in Application No. 55492. Such investigation should include the possibility of use of different types of stores or agencies than have been considered previously, since the cost from one type of establishment to the other, according to Pacific's own evidence, varied so highly. While we will not ask Pacific to seek formal abandonment of payment agencies, we will require Pacific to report on an annual basis the establishment and disestablishment, or the change in location, of such agencies. This report will be available to the public.

Telephone Installations for Mobile Homes. A public witness in San Diego, who is the manager of a trailer park, stated that under Pacific's tariffs, the owner of a trailer is charged $25 for a connection fee, $25 as a deposit, and, in addition, $25 for a mobile connector. Such people may only need the telephone for three months and, at the same time, he said they must pay considerably more than a person in an ordinary house.

According to the witness' information, the situation regarding the mobile connector is indefinite, with some of the installers requiring the connector and others not.

Pacific responded (Exhibit 109) that it is about to adopt a new practice which would provide for the use of newly developed jacks, plugs, and cords for installation of this kind of service, which would be specially built for nonpermanent service. Regarding this new program, it was unclear whether any parts which would be attached to the customer's vehicle would be left with the customer at the conclusion of the installation, and, if so, whether such parts would be sold to the customer rather than furnished on a monthly charge.

We are convinced that Pacific is taking its own steps to straighten this matter out; therefore, we need enter no order on the subject other than to require that Pacific's study on this problem be available for the record in Application No. 55492. It is important to remember that when a customer of this sort wishes to leave he would be able, under Pacific's new program, to disconnect the jack and depart. Therefore, we believe that Pacific should explore, in its study, the alternative of selling whatever equipment is to be placed aboard a boat or in a trailer under its new program.

Ratemaking Treatment of the Deferred Tax Reserve

In Decision No. 83162 dated July 23, 1974 we adopted test-year normalization for Pacific. In City of Los Angeles v PUC (December 12, 1975, S.F. No. 23215) ___ Cal 3d ___, the Supreme Court reversed this determination because it found error in our opinion that the "annual adjustment" method was unavailable to us because of due process and statutory problems. The final paragraph of the Court's opinion states in part:

> "The Commission, on remand of this matter for further proceedings consistent with this opinion, shall expeditiously determine what position it will adopt with respect to the tax expense issue (See City and County of San Francisco v Public Utilities Com., supra, 6 Cal. 3d 119, 130-131.) Having ascertained this position, be it annual adjustment or some other alternative, including the possibility of a commensurate adjustment in the rate of return, the commission shall provide for refunds, if appropriate, to the ratepayers of the difference between such a rate and the tariff reviewed herein."

The Court found no other error (slip opinion, p. 46) and specifically made no ruling upon our interpretations of the relevant federal tax statutes and associated Treasury regulations, or the constitutionality of such laws or regulations. Nor did the Court pass judgment on the continued availability of what we referred to in our previous opinion as "pro forma normalization", or determine that we must, or should, ultimately adopt any particular federal tax treatment in determining Pacific's revenue requirement. (See the Court's Footnotes 42 and 43, slip opinion, pp. 45-46.)

In this proceeding, the staff again has recommended various alternatives to test-year normalization. The evidence on this issue was, of course, submitted before the Supreme Court's latest opinion.

As the staff points out, the subject of accelerated depreciation, and the ratemaking treatment of its use, has been a subject the Commission has dealt with for at least 15 years (cf. Rate Fixing Treatment for Accelerated Amortization (1960) 57 CPUC 598). The particular subject matter we are concerned with here had its genesis in Pacific Telephone & Telegraph Co. (1970) 71 CPUC 590, when we determined that Pacific was entitled to employ accelerated depreciation with normalization[11/] in fixing rates. This determination was the subject of the California Supreme Court's opinion in City and County of San Francisco v PUC (1971) 6 Cal 3d 119, 98 Cal Rptr 286, 490 P 2d 798, which annulled our order on the basis that we erred

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11/ The terms "flow-through", "normalization", and other associated terms are defined, and discussed conceptually, in Decision No. 83162, p. 55 et seq.; see especially p. 67.

in refusing to consider the merits of adhering to the 1968 method of determining Pacific's tax liability for ratemaking purposes (that is, the method we approved prior to the passage of the (federal) Tax Reform Act of 1969). It should be emphasized that the Court did not impose on us a duty to consider the 1968 method (flow-through) exclusively. The Court stated:

> "For failure to consider lawful alternatives in calculation of federal income tax expense, the decision of the commission must be annulled. . . . Upon further consideration the commission should consider whether to adhere to the 1968 method of determining federal income tax expense and whether to adopt the accelerated depreciation and normalization method adopted by the decision before us. . . . The commission may also consider alternative approaches which strike a balance between these two extremes.
>
> "...although the method open to the nontelephone utilities is not open to Pacific, the commission is not compelled to adopt one of the two extremes set forth above but may adopt a compromise striking a proper balance between the interests of the ratepayers and Pacific in the light of current federal income tax statutes." (6 C 3d at 130.)

As a consequence of the Court's opinion, we gave exhaustive consideration to various methods of determining Pacific's tax levels for ratemaking purposes in Decision No. 83162, and to associated arguments concerning the actual tax consequences to Pacific flowing from the adoption of one method or another.

We first considered various methods of accounting for tax depreciation. We devoted more than 19 days of hearing to the issue of accelerated depreciation. We reviewed in detail the history of federal tax provisions concerning this subject, especially Section 441 of the Tax Reform Act of 1969, which provided that utilities such as Pacific which had been straight-line depreciation taxpayers prior to August 30, 1969 would not be allowed to take accelerated depreciation unless normalization was used to reflect operating results in the company's regulated books of account and for establishing the company's cost of service for ratemaking purposes. (Pacific did not elect to take accelerated depreciation prior to August 30, 1969, but did so afterwards.)

At the hearing in the applications and cases culminating in Decision No. 83162, we considered five methods of accounting for depreciation:

(1) Straight line,
(2) Accelerated depreciation with (test year) normalization,
(3) Accelerated depreciation with flow-through,
(4) Accelerated depreciation, with what we termed in that proceeding "normalization on a pro forma basis", and
(5) The automatic adjustment clause.

The descriptions and methods of computation relating to these various methods are discussed in detail in Decision No. 83162.

Regarding the use of straight-line depreciation, no party, either in the previous proceeding or in this one, advocates it.

We summarized our opinion regarding the use of accelerated depreciation with flow-through as follows (Decision No. 83162, mimeo. pp. 59-61):

> "In our opinion we are precluded, as a practical matter, from imputing accelerated depreciation with flow-through to Pacific. Although the tax statutes seem to be very carefully drawn to avoid limiting the Commission's power, our interpretation of the applicable statutes is that if we were to impute flow-through to Pacific, the United States Treasury would assess taxes against Pacific on the basis of straight-line depreciation. Such a result would be a financial disaster to Pacific and would cause a substantial deterioration of service within a few years.
>
> "Section 167(l) of the Internal Revenue Code, as amended by Section 441 of the Tax Reform Act of 1969, makes it clear that Pacific cannot elect accelerated depreciation for tax purposes if flow-through is used to establish the Company's 'cost of service for ratemaking purposes' (I.R.C. 1954, §167(l)(3)(G)(i)). As to post-1969 property, i.e., property which became public utility property after December 31, 1969, Pacific may elect accelerated depreciation only if a normalization method of accounting is used. The phrase 'normalization method of accounting' is defined in subsection (3)(G) of Section 167(l).
>
> '(G) NORMALIZATION METHOD OF ACCOUNTING - In order to use a normalization method of accounting with respect to any public utility property -
>
> '(i) the taxpayer must use the same method of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, and

'(ii) if, to compute its allowance for depreciation under this section, it uses a method of depreciation other than the method it used for the purposes described in clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from the use of such different methods of depreciation.'

"In FPC v Memphis Light, Gas & Water Div. (1973) 411 US 458, 36 L ed 2d 426, the United States Supreme Court explained the options available to regulated utilities following the Tax Reform Act of 1969:

'With respect to post-1969 property, a utility may use (1) straight-line depreciation, (2) accelerated depreciation with normalization, or (3) accelerated depreciation with flow-through if the utility used flow-through prior to August, 1969 (§ 167(l)(2)). In addition, under § 167(l)(4)(A), a utility may elect to abandon accelerated depreciation with flow-through with respect to post-1969 expansion property.' (411 US 463, emphasis added.)

"Pacific did not, prior to August 1969, elect accelerated depreciation with flow-through, and if Pacific's rates are established on that basis, it will lose its eligibility to use accelerated depreciation (Memphis Light, Gas & Water Div. v Federal Power Com'n (DC Cir 1972) 432 F 2d 853, 857). The California Supreme Court in its decision annulling Decision No. 77984 recognized that flow-through is no longer available to Pacific (City and County of San Francisco v PUC (1971) 6 C 3d 119, 124-125). The Court concluded that 'the option to switch to accelerated depreciation and flow-through has been terminated', and that 'the method open to the nontelephone utilities is not open to Pacific' (6 C 3d 119, 130)."

We then turned to an extensive legal and regulatory analysis of what we termed in that proceeding as "pro forma normalization", which we now believe is more aptly termed "extended normalization", since "pro forma" suggests that the method is some mere formality and not an actual means of normalization. This procedure, by either name, determines an estimate of time until the next rate case (i.e., the amount of time that the rates are likely to be in effect) and then uses the amount of the deferred tax reserve at the middle of the period as an approximate weighted average of the reserve over that period (in the previous proceeding, the Commission chose a three-year period, and in our present proceeding, the examiner followed this precedent and suggested the development of any extended type of normalization be based on a three-year span).

Our analysis led us to the conclusion that regarding tax treatment (and as Pacific argued), the creation of a hypothetical reserve for ratemaking purposes using a larger deferred tax reserve amount (the "normalized" amount) than would be present in the test period does not comply with the requirements of Internal Revenue Code Section 167(l) (quoted above, p. 46) and would jeopardize Pacific's eligibility for the use of accelerated depreciation.

We then went further with our analysis in view of the fact (which is not contested) that a consequence of the use of accelerated depreciation with normalization by Pacific:

> "...is to create a rapidly growing reserve for deferred taxes that is totally out of consonance with the roughly harmonious relationship between revenues, expenses, and rate base. . . . This rapidly growing reserve is, in our opinion, an extraordinary item which, if not handled properly, will create a windfall for Pacific to the detriment of the ratepayers. The tax statute has created a regulatory problem with which the Commission must deal." (Decision No. 83162, mimeo. p. 63.)

On this basis we analyzed staff's concepts of extended (or, as they were termed "pro forma") normalization periods, and the arguments connected with the issue. The problem is most fully discussed in Decision No. 83162 (mimeo. pp. 63-72) and need not be repeated here, except to state our conclusions, which were as follows (mimeo. p. 72):

> "Notwithstanding this discussion we are not making this extraordinary item adjustment for federal taxes. We have read the relevant tax statutes and the explanatory Treasury Regulations published June 7, 1974 (39 F.R. 20194, et seq.), plus the briefs submitted July 3, 1974. Our conclusions are: (1) from a tax viewpoint, treating the extraordinary item adjustment as part of the deferred tax reserve, the adjustment is improper; (2) from a regulatory viewpoint, as a ratemaking adjustment for an extraordinary item, the adjustment is proper, and (3) the Treasury Department is most likely to look at this matter from a tax viewpoint. If we make the adjustment and if the Department does what we expect them to do, they will disallow the accelerated depreciation treatment entirely, compute Pacific's taxes on a straight-line basis, and assess back taxes and penalties of more than $57 million for 1973. The Commission does not want this $57 million to flow to Washington; we want it in California where it will be used to provide service to the public. Further, a $57 million outflow will affect Pacific's current service, as well as its ability to finance, to maintain its credit, and to assure confidence in its financial integrity. These risks outweigh the $23 million gross revenue saving to the ratepayers that our adjustment would cause."

We then held, on the same basis, that job development investment credit (JDIC) should be computed "in the same manner as the treatment accorded accelerated depreciation". (Mimeo. p. 73.)

Lastly, we stated that in compliance with the Supreme Court's decision, state income taxes should be computed on a flow-through basis, citing City of Los Angeles v PUC, supra, pp. 338-342.

We have presented this full summary of our analysis and conclusions concerning methods other than the "automatic adjustment clause" because, obviously, neither the Supreme Court's direction to us to "consider lawful alternatives"[12/] in the calculation of federal income tax expense, nor anything in its recent opinion in City of Los Angeles v PUC, supra, encompasses a mandate to us to relitigate, based upon the same facts, the same alternatives we have previously considered on the merits, over and over again in each successive rate application. Neither the staff nor any other party argues that this is our duty.

We will of course accept our responsibility to comply with the opinion of the Court regarding the automatic adjustment clause, and we will additionally analyze the record of our current proceeding to see if there are any new alternatives proposed which we should study.

The staff's opening brief (p. 67) argues that Pacific's rates should be set on some other basis than test-year normalization, and recommends, in order of preference:

(1) Flow-through.

(2) Three-year normalization.

(3) "Year-to-year adjustment".

The staff's arguments regarding flow-through are the same as those in Application No. 53587; in fact, the staff's brief supports this position entirely from exhibit material in that application.

The staff's position on the use of an extended normalization period of three years again raises no new or novel issues not covered by the staff's arguments in Application No. 53587, and not dealt with by us in Decision No. 83162. We have analyzed the staff's arguments presented here on congressional intent and the wording of various

12/ City and County of San Francisco v PUC, supra, 6 Cal 3d at p. 130.

IRS regulations, but this leads us back to the determination we made in Decision No. 83162 (mimeo. p. 72) that the Treasury Department would most likely look at any three-year normalization period from a tax viewpoint. We went on to say:

> "If we make the adjustment and if the [Treasury] Department does what we expect them to do, they will disallow the accelerated depreciation treatment entirely, compute Pacific's taxes on a straight-line basis, and assess back taxes and penalties of more than $57 million for 1973. The Commission does not want this $57 million to flow to Washington; we want it in California where it will be used to provide service to the public. Further, a $57 million outflow will affect Pacific's current service, as well as its ability to finance, to maintain its credit, and to assure confidence in its financial integrity. These risks outweigh the $23 million gross revenue saving to the ratepayers that our adjustment would cause."

The "Year-to-Year Adjustment"

In Decision No. 83540, which modified Decision No. 83162, we disposed of a staff method called the "automatic adjustment clause"[13/] because its automatic feature which would have reduced rates without a hearing was, in our opinion, violative of statutory requirements. This determination resulted in the Court's recent annulment in City of Los Angeles v PUC, supra.

In this proceeding the staff proposes a variation of this proposed method which would eliminate the automatic feature. This "year-to-year adjustment" would operate so that on January 1 of every year the effect of the growth of the deferred tax reserve in that year would be reflected in a change of the revenue requirement. This method, in the staff's opinion, is prospective ratemaking because the January 1 change would be effective for the forthcoming year. The staff witness proposed

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13/ The mechanics of the method are described in detail in Exhibit 104 in Applications Nos. 53587 and 51774, of which the Commission took official notice in this proceeding.

that the tax reserve estimate for the forthcoming year could be tied to the October view of the company so that a hearing could be held and a decision issued on the adjustment prior to the end of the year.

The staff witness stated that while the extended adjustment is more administratively convenient (and while he would still recommend flow-through, if allowable by the IRS), "I think the year-to-year treatment is the most accurate, because it makes use of the most recent data in each year's adjustment".14/

The staff cites other advantages for this proposed method.

First, the year-to-year adjustment would operate irrespective of Pacific's authorized rate of return, thereby, in the staff's opinion, equitably insuring that extraordinary tax savings would be passed on to California ratepayers (which does not occur under current methods unless Pacific's monthly reports show that Pacific actually exceeds its authorized rate of return). As mentioned, the growth of the deferred tax reserve is out of proportion when compared to the normal growth of revenue, expenses, and rate base. For a normalization company like Pacific, the rate base does not grow as fast as normally because the deferred tax reserve displaces investment which would come from the shareholders for a straight-line or flow-through company (this is true regardless of whether the reserve is held or used to build physical plant since any plant built with tax reserves is not added to rate base, the contribution for it not having come from the shareholders).

Second, the staff claims that the year-to-year adjustment does not burden the staff with "policing" the deferred tax reserve, as is required under Decision No. 83540 which adopted a procedure for

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14/ The year-to-year adjustment is another form of the automatic adjustment (see footnote 24, City of Los Angeles v PUC, supra, pp. 17-18).

Pacific to file monthly reports which the staff would monitor to insure that Pacific does not exceed its rate of return. (We question this claimed advantage since it may or may not be less work to run an annual rate proceeding which this proposed method would require.)

Third, according to the staff, the year-to-year adjustment would not violate any IRS regulation so as to render Pacific ineligible for accelerated depreciation. The staff points out that a utility such as Pacific can use accelerated depreciation for property acquired after 1969 under Internal Revenue Code Section 167(l)(2) provided the reasonable allowance was computed under a normalization method of accounting (see staff's opening brief, p. 94a). The staff then cites the following IRS regulation (39 Fed. Reg. 20201, adopted June 6, 1974) clarifying what would not be considered normalization:

> "(6) Exclusion of normalization reserve from rate base. (i) Notwithstanding the provisions of subparagraph (1) of this paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under section 167 (l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's tax expense in computing cost of service in such ratemaking." (Emphasis added.)

The staff's point is that since this regulation means that deferred taxes can be excluded from rate base for the "period used" (i.e., a test year) in ratemaking, the year-to-year adjustment method is not in conflict with IRS regulations, because the adjustment is applied, prospectively, one year at a time, to a test year, for purposes of the adjustment.

Pacific responds to the staff's argument regarding the tax regulation by pointing out that it makes clear that a taxpayer does not use a normalization method of accounting if the amount of the reserve for deferred taxes under Section 167(l):

> "...which is excluded from the base to which the taxpayer's rate of return is applied...exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's tax expense in computing cost of service in such ratemaking."

Under the staff's proposal, the rate base would be reduced (i.e., it would reflect a larger deferred tax reserve, which, as we explained, is subtracted from total plant before arriving at rate base) while at the same time the tax expense for the coming year would still be based on the test year. This leads Pacific to the conclusion that, therefore, there would not be one "period used" as required by the regulation, thus rendering Pacific ineligible for accelerated depreciation.

We now have two similar annual adjustment methods we must consider together ("automatic" and "year-to-year") to determine whether either of them should be adopted. We also, as a result of the Court's opinion in City of Los Angeles v PUC, supra, have the question of whether any downward adjustment in Pacific's assigned rate of return should be made in order to offset the continued use of test-year normalization. These interwoven questions are best considered at supplementary hearings, which we will set expeditiously by further order.

Because these questions remain outstanding we will set rates based upon the test-year calculations we have found reasonable (on a test year ending June 30, 1975), subject to refund to provide for an annual adjustment of the out-of-test-year normalization reserve, if adopted, or, in the alternative, any adjustment in rate of return we may make, if we elect to continue test-year normalization for Pacific and determine that because of such election, a downward adjustment in rate of return is warranted.

We are aware that the Supreme Court's order is not yet final, but since this present application has been pending for some time, we should issue a decision. Should there be any changes in the Supreme Court's order resulting from any challenge to it, we will be able to deal with such changes at the supplementary hearings herein, or by further order. Since the public is adequately protected by refund provisions, we are making the order herein effective the date hereof.

Job Development Investment Credit (JDIC)
And Investment Credit (IC)

The tax treatment of JDIC and IC must be consistent with Pacific's election of ratable flow-through of March 9, 1972 under Internal Revenue Code Section 46(f)(2) (formerly Section 46(e)(2)). Since the same problems present themselves regarding these two items that are present with the deferred tax reserve, their treatment will also be considered in our supplementary hearings.

One point concerning these tax credits may be finally disposed of here, and this is the staff contention that Pacific is in error in computing these tax credits, for ratemaking purposes, on a weighted basis for the tax year.

Pacific's position is that the statutes governing IC make it clear that the credit is not available to Pacific if its "cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a <u>ratable portion</u> of the credit allowance..." (26 USC § 46 (f)(2)(A)), and that the "ratable portion" is determined by reference to "the period of time used in computing depreciation expense for the purposes of reflecting operating results in the taxpayer's <u>regulated</u> books of account..." (26 USC § 46(f)(6)); (emphasis added).

Pacific's argument confuses amortization and depreciation. While depreciation is weighted during a test year because plant is added at different times, the tax credit accrues at one point in time, that is, at the end of the calendar period used for the tax year, and the computation is made when the tax return is filed for that tax year. This means that no matter when during the year the plant is put into service, the full tax credit applies. As the staff states (opening brief, p. 99):

> "Since the tax credit will fully accrue to Pacific's advantage on all plant put in service anytime during the test year, it is wholly incorrect to weigh the accrual."

Approaching the problem from the viewpoint of the language in the aforementioned tax statutes, this means that the "ratable portion", under our system of ratemaking, is determined using the end-of-year amount for IC. Any other construction is unreasonable as not reflecting the "ratable portion", and we are not obliged to anticipate possible unreasonable or illogical interpretations by taxing authorities, or to set rates in order to save and hold harmless Pacific from such possible constructions. We adopt the staff's method of calculation (Exh. 76, Table A, revised).

Regarding JDIC and IC, in order that we can better assess Pacific's current earnings on a continuing basis, we will order Pacific to include in its monthly reports under Ordering Paragraph 3 of Decision No. 83540 the current amount of JDIC and IC available to Pacific, on an end-of-reporting-period basis.

California State Income Tax

The treatment we most recently afforded this item was explained in Decision No. 83162 (mimeo. p. 74) as follows:

> "In compliance with the Supreme Court's decision, state income taxes shall be computed on a flow-through basis. (City of Los Angeles v PUC (1972) 7 Cal 3d 331, 338-342.) Further, the reasons for an extraordinary item adjustment are equally applicable to state tax flow-through, and no tax statute prohibits this procedure. Therefore, we shall compute state tax expense using a projected three-year average flow-through for the years 1974-1975-1976. (See Note 11 to Table I in Appendix B.) This three-year adjustment is appropriate to Pacific's results of operations because Pacific has so recently begun to compute its tax depreciation on an accelerated basis as contrasted to other classes of utilities which have been utilizing accelerated depreciation for more than a decade."

No party argues that we should change this procedure at this time. Therefore, the state tax expense for this proceeding shall be computed using a projected three-year average flow-through for 1975-1976-1977.

Rate Design

As pointed out by Pacific, rate design is not a major issue. Most of the rate design differences between the staff and Pacific result from the differing estimates of revenue requirements. There are, however, several conceptual problems, particularly concerning message toll service, which require discussion.

Intrastate Message Toll Rates. The staff did not dispute that if revenues are to be increased, a reasonable percentage of the increase should be placed into higher toll revenues, but there was serious disagreement between staff and company methods of arriving at any increase. Pacific wishes to institute, for customer-dialed calls, a low-cost one-minute minimum toll period for daytime hours only (8:00 a.m. to 5:00 p.m.), followed by a higher-cost three-minute period. The staff would take an additional step regarding such calls and have a one-minute minimum applied 24 hours a day.

The staff argues that such an interstate schedule became effective March 9, 1975 and that, if a similar schedule is not adopted for customer-dialed message toll service in California, the minimum call for many intrastate points will be much higher than that for many out-of-state calls.

Pacific responds by stating that its usage studies show that a one-minute call does not meet the needs of most persons. These studies (explained in general but not introduced as documents) show that a much higher percentage of evening and night calls are residence-generated rather than from business locations, and that while the average duration of a business call during the day is four minutes, the average duration of a call during outside the daytime period is seven minutes. Pacific claims that its market research indicates that residential callers prefer longer initial periods (the exact phraseology of the questions and the format of the survey were not presented as exhibits).[15/]

We agree with the staff that a one-minute period for customer-dialed intrastate toll calls should apply for 24 hours. Since the FCC has allowed a one-minute period to go into effect for 24 hours on an interstate basis, retention of a minimum three-minute period for toll calls within the State will aggravate already-existing problems involved in keeping intrastate message toll service competitive with the same service for out-of-state calls. One of the most frequent complaints which we receive from members of the public is that message toll calls to points outside of California are, under certain circumstances, less expensive than those for shorter distances within the State. As we explained elsewhere, much of this problem may be due to separations issues which we intend to investigate in Application No. 55492, but meanwhile, it will hardly do to exacerbate the problem by continuing with a minimum three-minute call in the evening when it is possible to design a proper rate schedule with a lower one-minute period.

While some residential users prefer longer calls in the evening, certainly there is a place for an inexpensive one-minute call for those who can make use of it. The staff's basic rate design plan for message toll service is adopted, but at rate levels higher than originally suggested by the staff, in order to produce a

15/ There is no indication (in spite of Pacific' license contract payments) that Pacific attempted to make any use of whatever research AT&T may have completed before adopting its one-minute plan.

reasonable proportion of the total revenue requirement we have found reasonable. The adopted message toll rates are designed to produce a test-year revenue of $37.3 million. The following table illustrates a sampling of message toll calls at the existing and the adopted rates:

San Francisco to:	Present	Authorized		
	One, Two, or Three Minute	One Min.	Two Min.	Three Min.
	Direct Dialed (8 A.M. to 5 P.M.)			
Eureka	$ .95	$.51	$ .83	$1.15
Fresno	.80	.45	.71	.97
Los Angeles	1.15	.59	.98	1.37
Sacramento	.55	.34	.53	.72
San Diego	1.30	.64	1.07	1.50
	Direct Dialed (11 P.M. to 8 A.M.)			
Eureka	.45	.20	.33	.46
Fresno	.45	.20	.33	.46
Los Angeles	.49	.21	.35	.49
Sacramento	.40	.19	.31	.43
San Diego	.49	.21	.35	.49

<u>Conversion of 6 MMU Rates to Toll</u>. Six multi-message unit (MMU) tariffs presently exist, along with 3, 4, and 5 MMU, in the San Francisco and Los Angeles extended areas. The staff recommends elimination of the 6 MMU rates at this time.

The city of Los Angeles and TURN oppose the elimination of these tariffs on the grounds that to take this action unduly impacts the telephone users in the areas mentioned, particularly, the residential customers.

We believe that opposition to elimination of the 6 MMU schedule stems in part from a misunderstanding of the effect of its cancellation. These MMU tariffs date back to the 1930's, before more complex dialing and billing equipment was available, and when at the same time it was essential to eliminate what became an increasingly monumental task: the operator handling of toll calls in metropolitan areas. A simple system of charging multi-message units was invented for these areas. While the calls were placed automatically, meters were attached to each line and read at the central office each month. The information was then transferred to the bill. Now, although there is no longer any such equipment in use, the MMU tariffs remain.

Actually, assuming no toll increase and at present rates (that is, 5¢ per message unit) a call for the same distance is the same cost under either system. If, for example, a 6 MMU call is placed, the charge is 6 MU's (30¢) for the first three minutes, then overtime at 2 MU's (10¢) per minute. If a regular toll call is placed for the same distance, the charge is 30 cents for three minutes and 10 cents each additional minute. Thus, <u>assuming no toll increase</u>, the effect on the consumer of the elimination of MMU tariffs is zero.

The staff's rate design exhibit (No. 34) shows projected increases in the revenues due to the elimination of 6 MMU rates but this is due to new higher toll schedules. Thus, for example, in Exhibit 34, page 5, the table shows elimination of gross billing of $60.5 million MMU revenue and an offsetting increase of $63.2 million in toll revenue.

It is true that the Los Angeles and San Francisco areas are more profitable to Pacific because, as is the case with any utility, the cost to serve a densely populated area is lower. Even considering this, however, it is not reasonable to maintain MMU tariffs indefinitely at the same levels while gradually increasing toll rates. Under such circumstances, MMU rates become increasingly preferential. Nor is there any point, considering that separate MMU equipment is no longer actually used, to deal with the problem by maintaining MMU tariffs in effect and granting increases in the tariffs to maintain approximate parity with toll.

The only reason we cannot eliminate all MMU tariffs at once is that the impact on intercompany settlements is too pronounced, but we affirm our determination, expressed in Decision No. 83162, to cancel all MMU rates as soon as it is reasonable to do so. Here, the staff's recommendation to eliminate the 6 MMU schedules is a reasonably prudent step in this direction, and is adopted.

Directory Assistance Calls. The staff urges that as soon as possible, some system of charges for directory assistance calls be established. According to staff witness Macario, "Studies have shown that as many as 80 percent of the customers make three or less calls per month to directory assistance and that the remaining 20 percent make more than 80 percent of the total calls."

While we take no position on the imposition of such charges at this time, we note that Pacific's advertising campaigns to alleviate growing use of directory assistance for local numbers have been only partially successful. There are many problems of fairness to consider in imposing such a plan. For example (as a public witness in Sacramento mentioned) blind persons should be excluded from such charges if possible. Also, with a growing percentage of unlisted numbers, what is a reasonable method of allowing persons a minimum number of "free" directory assistance calls for local numbers? Lastly, should requests for emergency numbers (police, fire, ambulance) be excluded from any charge plan?

We will order Pacific to submit a directory assistance charge plan for the record in Application No. 55492, preferably in coordination with the staff.

Private Branch Exchange (PBX), Centrex, Telephone Answering Service, and Private Lines. Pacific proposed increases in charges to PBX rates and a restructuring of the Dial Series 100 and 300 PBX services which, according to Pacific's witness Sullivan, would bring these services closer to their indicated costs. Scott-Buttner Communications Company, an interested party, supports these changes as being more nearly representative of true costs.

The staff recommends adoption of the proposed tariffs, except for the rates for a piece of trial equipment called the NA-409, because Pacific has not developed adequate cost information regarding it.

We will approve Pacific's proposed PBX rates, except for the NA-409, and order Pacific to file a study within 90 days of the date of this order, which may be used as a basis for considering NA-409 rates in Pacific's pending Application No. 55492.

Regarding Centrex, Scott-Buttner questions whether the rates are compensatory, and staff witness Macario recommends that for Centrex and telephone answering services, Pacific be ordered to file cost studies and compensatory rates with the Commission within six months (staff witness Evans' exhibit on separated results of operations shows a 3.61 percent return on these items). We will order Pacific to file such studies for the record in Application No. 55492, along with the cost studies on toll private lines recommended by the staff (opening brief, p. 108). Toll private line is estimated to produce earnings of about 3 percent. The study should produce the information necessary to determine the cause of this problem.

Supersedure Revision. Under supersedure, a subscriber in effect takes over existing telephone service. This usually occurs when a business changes ownership. According to staff witness Macario:

> "The present procedures require the incoming customer on a supersedure to sign what amounts to a 'blank check' for the charges incurred by the outgoing subscriber. This requirement has resulted in numerous cases of customer irritation and dissatisfaction. The staff's proposal will eliminate this problem. The cost of $4.6 million for this item shown in Table 1 will be offset by an estimated $1.1 million of connection charges for supersedures. This latter amount is included within the revenue effects of the staff proposed connection charges."

The witness mentioned certain formal complaint cases such as Cases Nos. 9899 and 9770, now both dismissed, which involved supersedure disputes over amounts, in round figures, of $59,000 and $10,000, respectively.

The staff proposes that these procedures be changed and that instead, each customer be liable for his own charges and that the incoming customer pay the staff's proposed service order charge. The staff concedes that eliminating this procedure might result in a revenue loss to Pacific of $4.6 million, but this would be partially offset by $1.1 million in new revenues from the staff's proposed service connection charges.

We agree that our present supersedure tariffs are undesirable in that they result in situations in which an incoming customer objects that he was misled (the amount he has to pay is unstated on the form he signs to take over the existing service). We wish, however, to adopt connection charges which will more significantly offset possible losses from elimination of supersedure collections than under the staff's proposal. Our adopted service order charges are set forth in Appendix E (Schedule 28-T) and are estimated to produce new revenue of $2.4 million.

Service Connection and Move-and-Change Charges. It is undisputed that service connection charges and charges for moving or changing a telephone instrument do not meet current costs.[16/] Both the company and the staff propose increases which are not designed to recoup 100 percent of the actual costs, in order to maintain customer's accessibility to new telephones and reasonable availability of move and change services.

There is a strong divergence as to how to accomplish the revenue increases, however. The company's proposal would leave the basic tariff structure unchanged, and simply increase the charges (see Exhibit B to the application, p. 96 et seq.). For simple telephone residence and business service, the staff proposes a three-part change plan which would break the charges into "service order", "central office work", and "premises work" segments. Thus, while the company proposes an increase of from $24 to $35 for a simple telephone residential connection and an increase from $35 to $45 for simple telephone business service, the staff's plan is as follows (Exh. 34, p. 2):

16/ Pacific estimates that the simplest new service connection costs $47, exclusive of the work on the customer's premises. As mentioned in our Design Line discussion (p. 14) Pacific estimates that a change of instrument costs $36 for a business subscriber and $28 for a residential customer.

Proposed Charges, Simple Residence, And Business Service

	Residence	Business
Service Order		
Initial	$11.00	$18.00
Subsequent		
Premise Visit Required*	8.00	12.00
No Premise Visit Required	6.00	8.00
Central Office Work	4.00	6.00
Premises Work		
Inside Wiring	6.00	7.00
Telephone	4.00	5.00
* Minimum Total Charge	11.00	18.00

The staff argues that its plan recognizes the dramatic increase in telephone installation charges over the last several years, and that telephone subscribers are aware that, at present, an installation requiring moving a telephone and other premises work costs the same as the simplest service connection.

Pacific objects to a multi-part charge plan on the basis that the present plan is simpler, but more strongly on the ground that the staff's plan at the staff's proposed rates would yield insufficient additional revenue. The company points out that the total charges would equate to $25 for residence service and $36 for business service, or only a $1 increase for each.

We agree with the staff that the present tariffs are overly simple and do not give a customer who is willing to require the minimum work a chance to pay a minimum fee. Ten years ago, a residential customer could obtain telephone service for as little as $4, compared to the present $24. Even though increased connection charges still do not bear their full costs, something should be done to minimize increases for connections requiring a bare minimum of work. We recently recognized this problem in General Telephone Company (1974) ____ CPUC _____ (Decision No. 83779, Application No. 53935) and adopted a plan similar to that which the staff proposes here. We agree with Pacific, however, that the staff's suggested rates would provide inadequate rate relief for these charges, considering the actual cost of the service. The following table shows our adopted rate levels under the staff's plan:

Adopted Service Connection and Move-And-Change Charges
(Simple Residence and Business Services)

	Residence	Business
Service Order		
Initial	$12.00	$20.00
Subsequent		
Premise Visit Required*	10.00	14.00
No Premise Visit Required	6.00	10.00
Central Office Work	5.00	7.00
Premises Work		
Inside Wiring	7.00	8.00
Telephone	4.00	6.00
* Minimum Total Charge	12.00	20.00

(Note: The above table does not include certain installation and move-and-change charges associated with Design Line phones, and is not all-inclusive of service connection and move-and-change charges. Consult the appendix.)

<u>Line Extension Charges</u>. The staff does not dispute the company's contention that, considering present costs, line extension charges should be increased, but the staff and Pacific disagree on the method of changing the tariff.

Pacific would revise the method of determining the charge. Instead of continuing with a specific charge per one hundred feet of line extension in excess of the free footage allowance, Pacific's proposal reduces the free footage allowance from 2,460 feet to 1,000 feet. Then, charges for the extension of plant in excess of that allowance would be equal to 50 percent of the estimated cost of construction along public thoroughfares and 75 percent of the estimated cost of construction on private property (Exh. 8, p. 95; Exh. 21, p. 9).

The staff criticizes the plan as resulting in lack of uniformity and as tending to cause disputes, including formal complaints. The company counters by arguing that flat rates make no allowance for inflationary factors in a time of spiraling construction costs, and do not consider differences in circumstances.

Adequate recovery for line extensions has always been a problem. We accept Pacific's arguments concerning inflation and the fact that special circumstances cannot be properly considered under present methods, and will authorize the filing of Pacific's proposed tariff. If, however, it produces an excessive number of disputes, we may find it necessary at a future date to return to a tariff which will contain specific charges.

<u>Other Rate Changes</u>

As mentioned, differences in rates proposed by the company and the staff grow smaller as the different estimates of rate levels are narrowed. Other changes reflected in the adopted rates are not the subject of arguments in principle between the staff and the company, and do not require discussion. The levels for such rates are set to be consistent with the rates and tariffs we have discussed above.

Findings

1. The petition for a proposed report of the examiner should be denied.

2. Based upon adopted results of operations and on test-year normalization of federal taxes, the additional revenue necessary to produce a rate of return on rate base of 8.85 percent is as follows:

Rate of return authorized (D.83162)	8.85%
Rate of return at present rates	8.18%
Increase in rate of return required	0.67%
Adopted rate base	$4,946,611,000
Net revenue increase	$33,142,000
Net-to-gross multiplier	1.966
Gross revenue increase	$65,157,000
Settlement provision	$11,600,000
(The total settlement provision amount includes $6,700,000 for General Telephone Company, $3,200,000 for Continental Telephone Company, and $1,700,000 for other telephone companies.)	
Gross billing increase required	$76,757,000

3. The rate of return found reasonable in Decision No. 83162 should not be modified at this time, but should be the subject of supplementary hearings for the reasons set forth in the opinion.

4. Pacific's estimate of revenues for the test period is adopted.

5. The effective rate of return for the test period for American Telephone and Telegraph Company is 8.38 percent.

6. A reasonable estimate for maintenance expenses is $587,996,000.

7. A reasonable estimate for traffic expense is $262,344,000.

8. The amount of $683,820 should be disallowed from intrastate advertising expenses on the basis that this amount benefits the AT&T Long Lines Department rather than Pacific.

9. Fifty percent of the staff's test-year estimate of Design Line advertising should be disallowed as a start-up cost of this program.

10. Pacific should be required to file financial reports of its Design Line program as set forth in the order.

11. Change-of-instrument or move-and-change charges involving Design Line telephones should as nearly as possible reflect the actual cost of the service.

12. Pacific should attempt to recover Design Line instruments for nonpayment in the same manner that it now seeks recovery of ordinary telephones.

13. "Lifeline" advertising is inadequate. $150,000 should be authorized for the 1976 calendar year for such advertising, to be devoted to mass-media publicity, as discussed in the opinion.

14. A reasonable estimate for operating rents is the amount of $27,375,000.

15.a. Pacific's estimate for general office and salary expense is adopted.

b. The staff's estimates for the Western Electric adjustment and the AT&T license contract are adopted.

16. The staff's lien date adjustments are adopted.

17. The staff's calculation of the net-to-gross multiplier is adopted.

18. In forthcoming general rate increase applications, Pacific should indicate the amounts spent on the AT&T divestiture litigation, as discussed in the opinion.

19. The 8.3 percent management salary increase is not unreasonable under current economic conditions.

20. Pacific should not be ordered at this time to compile wage information per subaccount.

21. A reasonable estimate of depreciation expense is $421,914,000.

22. The staff's estimate of insurance accounts is adopted.

23. Pacific's estimate for relief and pensions is reasonable and is adopted.

24. The staff's estimate for ad valorem taxes is adopted.

25. Pacific's estimate for payroll taxes is reasonable.

26. A reasonable separations factor for telephone plant in service is 0.2121. The staff's separations factors for other accounts are reasonable and are adopted.

27. It is reasonable, for this proceeding, to adopt an adjusted total company rate base of $6,274,493,000.

28. The staff's proposed treatment of interest on plant under construction should not be adopted.

29. Pacific should be required to report the use of proceeds from the sale of notes by letter, substantially in the format set forth in Appendix C.

30. Pacific should be ordered to investigate in San Francisco and other appropriate urban areas to determine whether public payment agencies may be maintained at a reduced cost, as more fully discussed in the opinion and should be further ordered to report on an annual basis, the establishment, termination, or relocation of such agencies. The results of the investigation mentioned should be available for the record in Application No. 55492.

31. Pacific's study on mobile connectors should be made available in Application No. 55492.

32. It is reasonable to set rates for this proceeding based on test year normalization, subject to refund, and, at supplementary hearings, to consider whether any method of annual adjustment should be adopted, and whether any downward adjustment in rate of return should be made if test-year normalization without any annual adjustment is continued in effect.

33. The staff's computation of IC is correct and is adopted.

34. California state income taxes should continue to be computed on a 3-year average flow-through basis.

35. California intrastate message toll rates should be designed to provide for a one-minute minimum toll period.

36. Six MMU tariffs should be canceled.

37. Pacific should be required to submit a directory assistance charge plan in Application No. 55492.

38. Pacific's proposed increases to PBX rates and its proposed restructuring of the Dial Series 100 and 300 PBX services should be adopted, except for the NA-409 equipment. Pacific should be ordered to file, within 90 days, a cost study which may be used as a basis for considering NA-409 rates in Application No. 55492. Pacific should file similar studies within 90 days, regarding Centrex, telephone answering service, and toll private line operations.

39. Supersedure tariffs should be revised.

40. The staff's proposal to break service charges for simple residence and single business service into components is reasonable and is adopted.

41. Pacific's proposal for line extension charges is reasonable and is adopted.

Conclusion

The application should be granted to the extent set forth in the following order and in all other respects denied.

O R D E R

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company is authorized to file with this Commission, on or after the effective date of this order and in conformity with the provisions of General Order No. 96-A, revised tariff schedules with rates, charges, and conditions modified as set forth in Appendix D. The effective date of the revised tariff schedules shall be five days after the date of filing. The revised tariff schedules shall apply only to service rendered on or after the effective date of these tariffs.

2. The rates established by this order shall be subject to refund pending consideration of the Supreme Court's directive in City of Los Angeles v PUC (December 12, 1975, S.F. No. 23215) as it may pertain to this proceeding. Pacific shall maintain such books and records as are necessary to determine the difference between the rates established herein and any other rates, if any, which may be established by further order.

3. The issue of appropriate regulatory treatment of the deferred tax reserve in this proceeding shall be consolidated with the remand of Decisions Nos. 83162, 83540, 83778, and 83779, and heard on a common record with the same issue in those proceedings. Refunds, if appropriate, will thereafter be handled in one Commission order.

4. Financial reports on the Design Line program shall be filed with the Commission on a semiannual basis, consistent with the views expressed in the opinion section of this decision.

5. Pacific shall attempt to recover Design Line equipment for nonpayment on the same basis that it now attempts recovery of ordinary equipment for nonpayment.

6. Pacific shall expend the sum of $150,000 for Lifeline advertising during the calendar year of 1976, consistently with the views expressed in the opinion section of this decision.

7. Pacific is ordered in any rate increase application involving a new test period to report the amounts spent by itself or by American Telephone and Telegraph Company on divestiture litigation.

8. Pacific is ordered to report by letter the use of proceeds from the sale of notes, substantially in the format set forth in Appendix C.

9. Pacific shall investigate in San Francisco and other appropriate urban areas to determine whether public payment agencies may be maintained at a reduced cost. Such investigation shall be available for the record in Application No. 55492. Pacific shall report, on an annual basis, the establishment, termination, or relocation of such agencies.

wxy 10. ~~11~~. Pacific shall include, in its monthly reports required by Ordering Paragraph 3 of Decision No. 83540, the current amount of JDIC and IC available to it, on an end-of-reporting-period basis.

11. ~~12~~. Pacific's study on mobile connectors shall be made available in Application No. 55492.

12. ~~13~~. Pacific shall submit a directory assistance charge plan in Application No. 55492.

13. ~~14~~. Within ninety days of the effective date of this order, Pacific shall file cost studies concerning NA-409 equipment, Centrex, telephone answering service, and toll private line operations.

14. ~~15~~. The petition for a proposed report of the examiner is denied.

The effective date of this order is the date hereof.

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

will file a written
I dissent
Leonard Ross

I abstain
Robert Batinovich
Commissioner

President
William Symons Jr.
Vernon L. Sturgeon

Commissioners

APPENDIX A

LIST OF APPEARANCES

Applicant: Milton J. Morris, Attorney at Law, for The Pacific Telephone and Telegraph Company.

Respondents: Dinkelspiel, Pelavin, Steefel and Levitt, by Lenard G. Weiss, Attorney at Law, for Dorris Telephone Co., Ducor Telephone Co., Evans Telephone Co., Foresthill Telephone Co., Livingston Telephone Co., The Ponderosa Telephone Co., and The Siskiyou Telephone Co.; and Delwyn C. William, for Continental Telephone Company of California.

Interested Parties: Administrator of General Services Administration by Max M. Misenar, Harold S. Trimmer, Jr., C. Paul Swift, and Maurice J. Street, Attorneys at Law, for General Services Administration; Independent Taxpayers Union of California; A. M. Hart and H. Ralph Snyder, Jr., Attorneys at Law, for General Telephone Company of California; Neal C. Hasbrook, for California Independent Telephone Association; Thomas M. O'Connor, City Attorney, and Robert R. Laughead, for the City and County of San Francisco; Joel Effron, for Scott Buttner Communications Inc.; Robert W. Russell and Manuel Kroman, for Department of Public Utilities Transportation, City of Los Angeles; Leonard L. Snaider, Attorney at Law, for Burt Pines, City Attorney, Los Angeles; William S. Shaffran, Attorney at Law, for John W. Witt, City Attorney, San Diego; Sylvia M. Siegel, Eugene P. Coyle, and George R. Gilmour, Attorney at Law, for Toward Utility Rate Normalization; Colonel Frank J. Dorsey, Attorney at Law, for Consumer Interests of the Executive Agencies of the United States; Philip Endliss, for the City of Gardena; Jean Daniels, for Alpha Gamma Omega Chapter of Alpha Kappa Alpha, Inc.; Arthur S. Hecht, for SPEAK (Sunset-Parkside Education and Action Committee); and Donald Scott and Michael Kennedy, for themselves.

Commission Staff: Ira R. Alderson, Jr., Attorney at Law, and James G. Shields.

APPENDIX B
Page 1 of 2

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY

Summary of Earnings
Twelve Months Ending June 30, 1975 Estimated

Item	Total Company Operations: Staff Est.	Total Company Operations: Utility Est.	Total Company Operations: Adopted	Intrastate: Adopted
	(Dollars in Thousands)			
Operating Revenues	$3,203,252	$3,163,815	$3,163,815	$2,487,666
Uncollectibles	35,236	31,150	31,150	24,712
Revenues after Unc.	3,168,016	3,132,665	3,132,665	2,462,954
Total Oper. Rev.	3,168,016	3,132,665	3,132,665	2,462,954
Operating Expenses				
Maintenance	668,865	687,996	687,996	530,032
Traffic	256,423	262,344	262,344	204,104
Commercial	261,451	260,877	261,216	221,346
Revenue Accounting	48,305	48,305	48,305	41,929
Bal. G&O Sal. and Exp.	127,912	129,953	129,953	101,987
Operating Rents	26,275	27,786	27,375	22,505
Gen. Service and Lic.	34,480	36,805	34,480	27,067
Relief and Pensions	221,569	226,337	226,337	177,629
Bal. Other Oper. Exp.	11,053	10,861	11,053	8,709
Subtotal	1,656,333	1,691,264	1,689,059	1,335,308
Depreciation & Amort.	421,914	421,918	421,914	337,067
Prop. & Other Taxes	173,224	176,875	173,224	136,483
Payroll Taxes	61,449	62,584	62,584	49,116
State Income Tax	33,912	29,378	27,316	19,913
Federal Income Tax	269,755	238,904	239,700	182,912
Affiliated Interest Adj.	-3,033	-2,864	-3,033	-2,419
Net Oper. Exp.	2,613,554	2,618,059	2,610,764	2,058,380
Net Oper. Revenues	554,462	514,606	521,901	404,574
Rate Base				
Account 100.1	8,274,146	8,304,898	8,274,146	6,519,200
Account 100.3	4,430	4,700	4,430	3,107
Materials & Supplies	37,920	38,700	37,920	30,658
Working Cash	94,629	92,752	94,629	74,804
Less: Depr. Resrv.	1,766,066	1,771,664	1,766,066	1,385,126
Less: Def. Tax Resrv.	319,739	319,953	319,739	255,663
Subtotal	6,325,320	6,349,433	6,325,320	4,986,980
Affiliated Interest Adj.	-49,627	-48,124	-49,627	-39,169
Pay TV Adjustment	-1,200	-1,200	-1,200	-1,200
Total Rate Base	6,274,493	6,300,109	6,274,493	4,946,611
Rate of Return	8.84%	8.17%	8.32%	8.18%

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY

Estimated Revenue Effect of Adopted Rate Spread

Item	Revenue Effect (Millions of Dollars)
Service Connection Charges	\$16.3 1/
Number Change Charge	- 2/
WATS Installation Charge	.1
Key Equipment Installation Charge	2.1
Miscellaneous Supplies and Equipment Installation Charge	.3
Line Extension Charge	-
PBX Rates and Charges	6.8
Touch-Tone Rates and Charges	1.2
Supersedure	(4.6) 3/
6 MMU Conversion to Toll	5.7
Message Toll	37.3
Total	65.2

1/ Includes "Design-Line" change charge.
2/ Included in 1 above.
3/ Offset by \$2,400,000 included in 1 above.

APPENDIX C

(Format for reporting disposition
of proceeds from sale of notes)

Proceeds from sales of security authorized by Decision No.__________	$ ________
Disposition of proceeds	
1. Repayment of short-term obligations	________
2. Retirement or refund of long-term indebtedness	________
3. Acquisition or construction of property	________
4. Reimbursement of treasury for unreimbursed capital expenditures	________
5. Other (explain)	________
Total disposition of proceeds	$ ________

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Rates - The Pacific Telephone and Telegraph Company.

Respondent's rates, charges, and conditions are changed as set forth in this appendix.

SCHEDULE CAL. P.U.C. NO. 6-T MESSAGE UNIT SERVICE

Schedule shall be so modified as to convert 6 message unit routes to message toll routes. Schedule Cal. P.U.C. No. 53-T shall be appropriately modified to accommodate this change.

SCHEDULE CAL. P.U.C. NO. 12-T - PRIVATE BRANCH EXCHANGE SERVICE

Schedule shall be modified as proposed in Exhibit No. 22, excluding the NA4-09 system, pages 79-84-C, of Exhibit No. 22 as recommended in Exhibit No. 34, page 2, "Private Branch Exchange Service." Present rates and charges shall be applicable to existing services until said services are converted at the company's operating convenience but no later than December 31, 1976 to the modified rates and charges authorized herein.

SCHEDULE CAL. P.U.C. NO. 22-T - KEY EQUIPMENT SERVICE

Schedule shall be modified as proposed in Exhibit No. 8, page 94.

SCHEDULE CAL. P.U.C. NO. 23-T - CHARGES FOR LINE EXTENSION AND SERVICE CONNECTION FACILITIES IN SUBURBAN AREAS

Schedule shall be modified as proposed in Exhibit No. 8, page 95.

SCHEDULE CAL. P.U.C. NO. 28-T - SERVICE CONNECTION CHARGES-MOVE AND CHANGE CHARGES-IN PLACE CONNECTION CHARGES

Simple Residence and Business Service (Excludes Key System, PBX, and Centrex Installations):

Service Order	Residence	Business
Initial	$12.00	$20.00
Subsequent		
Premise Visit Required *	10.00	14.00
No Premise Visit Required	6.00	10.00
Central Office Work	5.00	7.00
Premises Work		
Inside Wiring	7.00	8.00
Telephone	4.00	6.00
* Minimum Total Charge	12.00	20.00

Other Residence and Business Service:

Schedule shall be modified as proposed in Exhibit No. 8, pages 96-102.

No charge shall be applicable for change of address where no change of service or facilities is involved.

Charges for supersedure of service shall be the "Initial" service order charge per line and trunk superseded.

Charge for change to vacation rate service shall be the "Central Office Work" charge only.

Change of Instrument - "Design-Line"

	Charge Residence	Charge Business
Replacement of telephone set with a "Design-Line" set	\$25.00	\$30.00

Note: Total charge for change of instrument to "Design-Line" in addition to applicable charges in Schedule Cal. P.U.C. No. 32-T, Supplemental Equipment. Includes change of instrument work only, and not other services under this schedule.

SCHEDULE CAL. P.U.C. NO. 32-T - SUPPLEMENTAL EQUIPMENT

Schedule to be modified as proposed in Exhibit No. 8, pages 103-108.

SCHEDULE CAL. P.U.C. NO. 36-T, RULE 23 - PRIORITY OF ESTABLISHMENT AND SUPERSEDURE OF SERVICE

Schedule shall be modified as proposed in Exhibit No. 34, page 3.

SCHEDULE CAL. P.U.C. NO. 50-T - PRIVATE LINE SERVICES AND CHANNELS SUPPLEMENTAL EQUIPMENT

Schedule to be modified as proposed in Exhibit No. 8, pages 109-110.

SCHEDULE CAL. P.U.C. NO. 53-T - MESSAGE TOLL TELEPHONE SERVICE

	Initial Period						Each Additional Minute All Classes of Service		
	Station					Person			
	Dial			Coin	Operator				
Rate Mileage	1 Min. Day	1 Min. Evening	1 Min. Night	3 Min.-All Days-All Hours			Day	Evening	Night
0- 8	$0.11	$0.09	$0.07	$0.25	$0.65	$1.25	$0.07	$0.05	$0.04
9- 12	.11	.09	.07	.25	.65	1.25	.07	.05	.04
13- 16	.14	.12	.10	.30	.70	1.30	.08	.07	.06
17- 20	.17	.14	.13	.40	.77	1.37	.10	.09	.08
21- 25	.19	.16	.15	.45	.83	1.43	.12	.11	.10
26- 30	.22	.18	.17	.50	.88	1.48	.13	.12	.11
31- 40	.25	.21	.19	.55	.93	1.53	.14	.13	.12
41- 50	.28	.23	.19	.65	.98	1.58	.15	.14	.12
51- 70	.31	.25	.19	.80	1.05	1.65	.17	.15	.12
71- 90	.34	.27	.19	.95	1.12	1.72	.19	.16	.12
91-110	.37	.29	.19	1.05	1.19	1.79	.21	.18	.12
111-130	.40	.31	.19	1.10	1.24	1.84	.22	.20	.12
131-150	.43	.33	.20	1.15	1.31	1.91	.24	.21	.13
151-170	.45	.33	.20	1.20	1.37	1.97	.26	.21	.13
171-195	.47	.33	.20	1.25	1.43	2.03	.28	.21	.13
196-220	.49	.34	.20	1.30	1.49	2.09	.30	.23	.13
221-245	.51	.34	.20	1.35	1.55	2.15	.32	.23	.13
246-270	.53	.34	.20	1.40	1.61	2.21	.34	.23	.13
271-300	.55	.35	.21	1.45	1.65	2.25	.35	.24	.14
301-330	.57	.35	.21	1.50	1.71	2.31	.37	.24	.14
331-360	.59	.35	.21	1.55	1.77	2.37	.39	.24	.14
361-430	.61	.36	.21	1.60	1.83	2.43	.41	.26	.14
431-510	.64	.36	.21	1.65	1.90	2.50	.43	.26	.14
511-590	.66	.36	.21	1.70	1.96	2.56	.45	.26	.14
591-685	.67	.37	.21	1.75	2.01	2.61	.47	.28	.14
686-795	.67	.37	.21	1.75	2.01	2.61	.47	.28	.14
796-905	.67	.37	.21	1.75	2.01	2.61	.47	.28	.14

Notes:

1. Initial period for all directly dialed toll messages is 1 minute regardless of time of day message is placed.
2. Day, Evening, and Night classifications of "Additional Minute" charges are applicable to all classes of service.

<u>SCHEDULE CAL. P.U.C. NO. 83-T - SPECIAL ASSEMBLIES OF EQUIPMENT</u>

Schedule shall be modified as proposed in Exhibit No. 8, page 115.

<u>SCHEDULE CAL. P.U.C. NO. 128-T - WIDE AREA TELEPHONE SERVICE</u>

Schedule shall be modified as proposed in Exhibit No. 8, page 116.

<u>SCHEDULE CAL. P.U.C. NO. 132-T - TOUCHTONE CALLING SERVICE</u>

Schedule shall be modified as proposed in Exhibit No. 8, pages 117-120.

A. 55214 C. 9832 KB
D. 85287

DISSENTING OPINION OF COMMISSIONER ROSS

I cannot join in today's decision. Three facts are central to this case.

•Pacific Telephone collects $260 million annually from ratepayers as an allowance for "phantom taxes" -- taxes which Pacific does not currently owe, and which it may never have to pay.

•If this Commission tries to eliminate those phantom taxes from customers' rates, it runs straight into a federal tax law adopted at the urging of the Bell System. This law might penalize telephone ratepayers additional hundreds of millions of dollars in the event that the PUC attempts to protect customers from excessive rates.

•While benefitting from these 9-figure tax loopholes, Pacific is systematically reducing the service it provides customers. Pacific, in its Third Quarter Report to Shareholders (October 1975), announced an increase in earnings for the 12-month period ended August 31, 1975 from $1.54 to $1.76 per share. The report notes that "these earnings improvements were 'bought' in large part by cutbacks in expenditures which, if continued, will inevitably have an adverse effect on service."

I do not believe that a utility which receives $260 million in gross revenues ($130 million after taxes) from special tax benefits should have free rein to reduce service levels in order to "buy" an increase in earnings. Nor should the company receive a $65 million rate increase until this Commission complies with the State Supreme Court mandate to explore all means for reducing the $260 million phantom charge.

Leonard Ross
Leonard Ross
Commissioner

San Francisco, California
December 30, 1975