

Decision 84 05 056

MAY 16 1984

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Lois Jane Gillham et al.,

Complainants,

vs

The Ponderosa Telephone Company,

Defendant.

Case 83-06-14
(Filed June 28, 1983)

In the Matter of the Application of
PONDEROSA TELEPHONE CO. to increase
certain intrastate rates and charges
applicable to telephone service
furnished within the State of
California.

Application 83-08-39
(Filed August 15, 1983)

Lois J. Gillham, for herself and other
complainants in Case 83-06-14.
Pelavin, Norberg, Harlick and Beck, by
William R. Haerle and Jeffrey F. Beck,
Attorneys at Law, for The Ponderosa
Telephone Company, applicant and
defendant.
Patrick Gileau, Attorney at Law, and
John P. McCarroll, for the Commission
staff.

SECOND INTERIM OPINIONI. INTRODUCTIONSummary

This decision awards Ponderosa Telephone Company
(Ponderosa) total intrastate rate relief of \$930,000. Interim "Phase
One" rates are established principally on a surcharge basis. Final
rate design issues, including whether optional call measured service
(OCMS) should be established, are deferred to supplementary
hearings. Total Phase One rate relief, including relief granted in

the previous interim decision, equals \$571,000 or approximately a 22% Phase One total (about 9% in addition to the interim increase.)

Background

In the interim decision, we described the company as follows:

"Ponderosa is an independent telephone company serving approximately 4,600 customers in Madera and Fresno Counties, in an area of widely varying terrain between the City of Fresno and Yosemite National Park. Its principal place of business is in O'Neals, Madera County.

"Ponderosa is a closely held family corporation. All the stock of the corporation at the time of the filing of the 1982 annual report was held by four persons. R. F. Bigelow, one of them, died in 1983 and his shares are in the estate. Another principal stockholder, Mrs. E. L. Silkwood, serves as President. Preston Ewing, who is not a stockholder, is the company's General Manager."

Prior to the interim decision, the company's most recent authorized rate of return (4%) was by way of a 1958 advice letter.

History of Proceeding

Our interim decision described the history of Case (C.) 83-06-14 and Application (A.) 83-08-39 as follows:

"On June 28, 1983, Lois J. Gillham and several hundred subscribers of the Auberry exchange filed C.83-06-14, complaining of excessive telephone bills and requesting OCMS on the basis that the nearest full service community is Fresno, and present available service makes every call to Fresno a toll call. The complaint also requests itemization of OCMS calls.

"On August 15, 1983, Ponderosa filed Application (A.) 83-08-13, seeking general rate relief, including an increase in rate of return.

"The case and application were consolidated, and hearings on the complainants' evidence and on Ponderosa's request for interim relief were held in Fresno before Administrative Law Judge (ALJ)

Meaney in the afternocn and evening of November 30 and the morning and afternoon of December 1, 1983. Several customers testified at length on the OCMS issue, and about 40 persons attended the November 30 hearing.

"The question of interim relief was submitted at the conclusion of the hearings. Complainant Gillham requested in her closing argument that OCMS be ordered as soon as possible pending full rate design studies."

The interim decision found that the issue raised in Gillham v Ponderosa of whether OCMS should be instituted was a question of rate design and should be deferred to the final decision. The interim increase was placed into effect primarily by a billing surcharge but also by unbundling instrument charges, and associated changes, as follows:

Increase from unbundling single-line instruments	\$ 70,000
Increase from multielement service charges	12,000
Shift of some of push-button service revenue to supplemental equipment tariff	<u>(2,000)</u>
Subtotal	80,000
Revenue requirement to be placed in billing surcharge	<u>295,000</u>
Total	\$375,000

Decision (D.) 84-03-016 found interim relief necessary in order to stem operating losses estimated, without rate relief, of about \$300,000 for 1984.

We then held further hearings on final rate relief, rate design, and service issues before Administrative Law Judge (ALJ) Meaney in San Francisco on March 19, 20, and 21, 1984. Upon the suggestion of the ALJ the parties agreed to submit the proceeding on oral argument rather than briefs, and argument took place on March 22.

II. RESULTS OF OPERATION

General Development

The application¹ requested rate relief in two steps, the interim relief being included in the first step. The intrastate pro forma results of operation (Table 5-2 to the application) proposes a step one rate of return of 8.71% and a step two return of 10.26%, which converts on the company's pro forma basis to an increase of operating revenues as follows:

Present rates	\$3,378,278
Step one	\$4,401,803
Step two	\$4,749,278

After the staff completed its investigation Ponderosa acceded to some staff adjustments, principally in rate of return, which reduced the total rate relief requested by Ponderosa from \$1.37 million to \$1.07 million. Staff also made certain adjustments to its original results of operation after further investigation of company estimates. These adjustments are covered in detail in the following discussions.

Rate of Return

At the start of this proceeding, the most significant issue in dollars was rate of return. Staff acknowledged that the 4% rate of return, set in 1958, was too low even to cover Ponderosa's weighted cost of debt of 5.3%, and that a rate of return increase is necessary because growth in toll revenues has not kept up with growth in expenses due to reduction of the "toll pot" through competition in the long-distance market.

¹ During the hearings in Fresno, Ponderosa made a few corrections to the text and tables of the application which did not increase the overall rate relief request. These appear in Exhibit 11, a corrected copy of the application.

In the interim decision staff recommended, and we adopted, a 9% interim return. The principal issue at the interim stage was what staff rate of return witness Terry Mowrey termed "Ponderosa's extremely highly leveraged capital structure, comprised of over 90% relatively low-cost debt and preferred stock which warrants an equity return higher than that which would be considered reasonable for a typical telephone utility." However, the staff witness's calculations convinced him that Ponderosa's request of 10.26% for final relief would produce an unreasonably high return on common equity of 38.40%.

A. H. Pelavin, one of the attorneys for Ponderosa, testified that he and his law firm had established the unusual capital structure (6,606 shares of common stock and 79,272 shares of preferred stock) for estate planning purposes, as was pointed out to the Commission in the various applications authorizing this sort of stock issuance.² We summarized his testimony in our interim decision as follows:

"Low-dividend paying preferred stock causes substantial reduction of the book value of the common stock. By allowing older-generation family members to retain only preferred stock, with its fixed redemption value, the value is fixed for estate tax purposes as well (i.e., growth of estate tax liability is eliminated).

"According to Pelavin, the preferred stock does not constitute, in its dividend rate, a reflection of the cost of capital. It is not, he said, what the market would have caused to be the dividend rate on such an issue of stock.

"When the 6% preferred stock was authorized in 1974, (see footnote 3), in round figures Ponderosa had total assets of \$3,800,000, with a debt of \$2,700,000 and the debt, according to Pelavin's testimony, was subject to increase

² Ponderosa Tel. Co., A.55269, D.83736 (October 28, 1974); Siskiyou Tel. Co., A.54755, D.82720 (March 27, 1974); Volcano Tel. Co., A.57383, D.87678 (August 9, 1977). See Exhs. 13-18.

because of growth. The small companies, he said, were 'normally running between 70% and 95% debt under REA financing.' (Tr. 179.) The result is, according to the witness, a disadvantage which he termed 'inverse leverage' because when the company is in a loss position there is only a very small stock 'buffer' and any loss unduly impacts the company. (See, generally, Tr. pp. 172-186.)"

Upon further investigation, staff witness Mowrey accepted Ponderosa's claim that for this type of closely held corporation, the preferred stock should be considered as part of common equity. He testified (Exh. 28, pp. 3-4):

"Decision 83736 dated November 19, 1974 authorized Ponderosa to issue \$792,720 of preferred stock. This was accomplished by transferring a like amount of unappropriated retained earnings to the preferred stock account. The purpose of this transaction was to insure family control of the company while avoiding the possibility of a forced sale to pay estate taxes in the event of a death in the family.

"The capital structure which formed the basis for my interim recommendation separated the preferred stock from the remaining equity capital in accordance with matching capital ratios and costs with plant investment. A review of the facts surrounding Ponderosa's preferred stock indicates that these monies are in fact common equity capital, held by the applicant's owners, and therefore should be recognized as such in arriving at the appropriate capital structure for rate of return purposes."

The staff witness's 9% recommendation also results from later information on the embedded cost of debt. Mowry's final recommendation included in the capital structure a 1984 embedded cost of debt of 6.31% compared to a 6.11% projection for 1983. Thus, Mowrey's final recommendation of a 9% return on rate base is predicated on the following capital structure for 1984:

<u>Component</u>	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-Term Debt	84.00%	6.31%	5.30%
Common Equity	16.00	23.13	<u>3.70</u>
Total	100.00%		9.00%
After-tax coverage			1.70X

In arriving at the return on equity of 23.13%, Mowrey stated he was guided by standards set forth in U.S. Supreme Court decisions that:

1. The return to the equity holders be commensurate with returns on investments in other enterprises having similar risks.
2. The return be sufficient to enable the utility to attract capital at reasonable rates while ensuring confidence in the utility's financial integrity.
3. The return balance the interests of both the investors and ratepayers.

He pointed out that Ponderosa is not a typical utility in comparison to large California telephone companies in that it serves a rural area and its capital structure, comprised of 84% debt (mostly low-cost Rural Electrification Administration (REA) loans) means higher financial risk than a company leveraged at only 50%, due to the amount of interest expense which each dollar must support. For test year 1984, the annual interest expense is estimated at \$762,219. Mowrey pointed out that REA requires a borrowing telephone company to maintain an after-tax interest coverage of at least 1.5 times to access additional construction funds. His 9% recommendation allows 1.7 times coverage "which should protect the utility from modest earnings fluctuations while allowing it to continue to borrow from the REA to meet anticipated construction expenditures beyond the test year." (Exh. 28, pp. 5-6.) Regarding risk factors, Mowrey stated:

"Also, because of the amount of leverage employed by Ponderosa in its capital structure, a swing of

only 25 basis points in rate of return impacts the resulting equity return by over 150 basis points. This radical earnings variability warrants, in my opinion, an equity return higher than that would be considered reasonable for a 'typical' telephone company."

Lastly, Mowrey testified that, in his opinion, the high leverage is a benefit to Ponderosa's customers.

"The interest expense associated with Ponderosa's debt is deductible for income tax purposes and therefore the customers are not required to pay additional dollars to the utility to cover income tax expense on that portion of capital financed through debt issuances. The resulting gross revenue requirement is lower for the utility which finances its construction program with debt.

"In addition, even though my rate of return provides an equity return of 23.13%, the 9% cost of capital is obviously low in comparison to rates of returns which have been authorized for other telephone companies. For example, Citizens was recently authorized a 12.41% rate of return for its telephone operations. This return equated to a 14.10% return on equity based upon a capital structure comprised of only 30% debt and resulted in a higher cost of capital to its customers than does the return I am recommending. Therefore, I believe that my rate of return of 9% which provides an equity return to Ponderosa of 23.13% balances the interests of both the investors and its ratepayers. The investors are compensated for the high degree of financial risk while at the same time the customers pay a relatively low cost of capital." (Exh. 28, p. 7.)

Upon review of Mowrey's testimony, Ponderosa stated at the final hearings that to expedite the proceeding it would not present a separate final rate-of-return development and would accept the staff witness's recommendation, although it considered 9% to be at the low end of the reasonable range.

We agree with the staff witness's development and will authorize the 9% return on rate base. The unusual capital structure benefits both the owners and the customers. It is reasonable to include the preferred stock as part of the common equity for this type of closely held corporation. It is also essential to afford Ponderosa something more than bare minimum after-tax interest coverage to protect it from being shut out of obtaining additional low-cost loans due to relatively small fluctuations in net earnings. The special factors reviewed above make the recommended return on common equity reasonable in spite of the fact that it appears high when compared to larger, more normally leveraged utilities.

Revenues

Total revenues include four categories: local service, toll service, miscellaneous, and uncollectibles. Staff and Ponderosa agree on the development of miscellaneous revenues and uncollectibles. Differences between Ponderosa's and staff's estimates of toll service revenues are actually derivative from differences in estimates in test year operating expenses, telephone plant in service, depreciation, and rate base, since these factors are part of the settlement formula. The only direct revenue issue outstanding is the test year local service revenue estimate, resulting from divergent views of the growth factor which should be applied for the test year.

Company's original estimate for local service revenues was \$27,450 less than staff's because it estimated zero growth, while staff's test year growth estimation (main stations) was 4.5%.

Ponderosa's witness Barker testified that he revised Ponderosa's estimated growth of telephone main stations to 3% for the test year based on the 3% main station growth for 1981-82 and 1982-83. He discounted the 8.8% growth from 1980 to 1981 because this was the year in which Ponderosa installed new digital central office

equipment and started an intensive effort to rid itself of a large amount of back orders. By 1981 back orders had been reduced to a normal number, and have remained roughly constant since then, he said.

Staff witness Karen Miller, who developed the staff rate design, employed a 4.5% growth factor. This was based on an assumed 5% growth in Fresno County and 4% in Madera County, averaging to 4.5% since the service territory is divided roughly in half by the county line. She developed the growth rates from information on population growth furnished by the Fresno County planning staff and the State Department of Finance. The population growth estimates were, in turn, based upon building permits granted by county planning departments.

The company witness criticized this development because it included approximately 1,000 workers for a hydroelectric project, most of whom would leave and reduce the growth. Miller said most of them live in camps outside the service territory and she had subtracted the 1,000 before calculating growth.

There was also an issue of whether the "Sierra North Area" of Fresno County, for which Fresno furnished Miller with population growth estimates, coincided with Ponderosa's Fresno County service area. Exhibit 35, a map of the Sierra North Area, shows it to encompass Ponderosa's Fresno County exchanges, and some additional, largely unpopulated areas. (Compare Exh. 35 with Exh. 37, a map of the exchange areas.)

Barker testified that based on information obtained just prior to the hearings, his 3% information is verified. He sponsored Exhibit 26, a letter from the County of Fresno Planning Department, with actual census counts from 1980 to 1983 for Fresno North showing growth of 2.91%.

In testimony and on argument, staff maintains that Ponderosa's 3% growth factor is low because it encompasses a

recessionary period. Company considers the staff witness's information on how many temporary hydroelectric workers do or do not live in Ponderosa's territory to be vague, and questions whether her adjustment was performed correctly.³

In our opinion, Ponderosa's 3% growth in main stations for the last two years is the best single indicator of test year growth, especially since it is corroborated by the census development in Exhibit 26. Some weight should be assigned to other factors, such as the slight improvement in the economy which may continue through 1984-1985 and the fact that County estimates for building starts are in the 4% to 5% range. We will adopt an estimate of test year growth at 3.5%.

One additional note on this subject is that Ponderosa and the staff agreed at the end of the hearings that growth rates should not apply to mileage rates and joint users rates, since there is no anticipated growth for those schedules.

Depreciation - Central Office Equipment

The largest single dollar difference between Ponderosa and the staff is caused by differences of opinion in establishing depreciation lives. Ponderosa recommends 12 years for central office equipment and seven years for station apparatus (customer premises equipment), while the staff proposes 18 years for central office equipment and 10 years for station apparatus.

Company witness Barker testified that unlike larger companies, Ponderosa cannot relocate obsolescent central office

³ Miller said she removed 1,000 from the totals for each year. Assuming the workers live outside the territory, excluding them entirely would be a correct adjustment. If some of them live within the territory (the Auberry and Tollhouse exchanges, as the company contends), then simply deleting 1,000 from all years rather than revising the trend line would not account for the expected outward movement.

equipment among its exchanges, and that there is no market beyond salvage value for it.

In 1981, (see "back order" discussion on the issue of growth) Ponderosa spent approximately \$600,000 per office⁴ acquiring electronic equipment to replace its electromechanical (step-by-step) central office system. This not only enabled the company to reduce back orders but allowed the introduction of custom-calling features which add to revenues. The witness conceded that digital equipment is relatively low-maintenance and that even the higher maintenance step-by-step apparatus could actually last 18 to 20 years, but his point was not that solid-state equipment would wear out faster but rather that with rapid changes in electronics, it would become obsolete faster. He pointed out that central office solid-state equipment is essentially a computer, and businesses write off computers in five years. He noted that analog common control equipment, introduced in 1970, was considered obsolete by 1975 (because of the introduction of solid-state equipment) and has not been manufactured for several years. Ponderosa's Shaver Lake central office is so equipped, and the company plans on replacing it in the near future.

Barker stated that when depreciation lives are too long, extraordinary writeoffs are sometimes necessary, and when they occur, there is upward pressure on rates because the company is writing off old equipment and depreciating new equipment at the same time. He testified that in his experience over the last several years as an accountant for several of California's small telephone companies, he has encountered this situation, which has resulted in the Commission staff being on the other side of the fence and criticizing a company for not having depreciated equipment more rapidly to avoid the writeoffs.

⁴ Total investment in such equipment over the last several years is about \$4.5 million, amounting to about one-third of the company's plant in service.

Barker testified that his depreciation study was performed in accordance with staff-established practices for small telephone utilities. He noted that the Internal Revenue Service recognizes a five-year life for central office equipment.

Staff originally estimated central office depreciation as 15 years but then increased the estimate to 18 years. At the hearings on interim rate relief in Fresno, McCarroll supported a 15-year life recommendation by pointing out the following: (Tr. 239-240):

1. While step-by-step equipment is obsolete, some companies still use it; General Telephone (General) has 60% of its lines served by step-by-step.
2. Electronic analog equipment, also obsolete, is still in use; General installed a 20,000-line analog office in Santa Monica last year, and will install another in Kenwood (900 lines). The latter of the installations is expected to be in use through the year 2000.
3. In recent decisions or agreements between companies and the staff, Continental Telephone was assigned a 20-year life for all digital switches, CP National 19 years, Volcano Telephone Company (Volcano) 15 years, and Dorris Telephone Company (Dorris) 15 years. For the current Pacific Bell rate increase proceeding, staff and company agreed on a 22-year life for electronic central office equipment.

Staff's Exhibit 29 (McCarroll), introduced at the San Francisco hearings on final rate relief, changed the recommendation to 18 years. The exhibit states (p. 14-5) that recent studies have produced the following adopted depreciation lives:

Pacific Bell	22 years (see above)
Roseville Tel. Co.	21
General Tel. Co.	25
Continental Tel. Co.	20
CP National	19

McCarroll expressed the opinion that digital equipment will likely outlast step-by-step and that the new equipment can accommodate growth for many years without approaching building space limitations. Staff considers Ponderosa's opinions on rapid technological obsolescence of solid-state equipment speculative and points out that Internal Revenue Service depreciation lives (five years for central office equipment) are set to encourage investment, and not necessarily because the depreciation lives are equal to actual useful lives.

We adopt the original staff recommendation of 15 years. We accept Ponderosa's argument that it cannot relocate obsolescent central office equipment like a larger company. Lives of 19 years or longer have been found reasonable for larger companies. Staff witness's testimony at the interim hearing notes our recent assignment of 15-year depreciation lives for central office equipment to Dorris and Volcano. These companies are nearer in size to Ponderosa than those to which we have assigned longer lives, and the difference recognizes the relative inability of these smaller companies to transfer older equipment from location to location. It may also be noted that in view of General's service problems, its use of a large amount of older equipment can hardly be appropriately cited as an example to be followed.

On the other hand, our duty is to the ratepayer as well as the utility, and as we stated in Citizens Utilities Co., D.83-10-092, October 19, 1983, A.82-09-52):

"While a public utility is entitled to a reasonable return on its investment (Bluefield Water Works v West Virginia Pub. Serv. Comm. (1923) 262 U.S. 679; Federal Power Comm. v Hope Natural Gas Co. (1944) 320 U.S. 591) the setting of rates 'involves a balancing of the investor and the consumer interests' (FPC v Hope Natural Gas Co., 320 U.S. 591, 603) and agencies to whom rate setting authority is given are free to make 'pragmatic adjustments which may be called

for by the particular circumstances.' (FPC v Natural Gas Pipeline Co. (1942) 315 U.S. 575, 586.) This Commission has traditionally considered a wide variety of factors in setting rates, including customers' acceptance of rates and usage patterns developed under existing rates, and no one factor is solely determinative of the result. (Pacific Tel. & Tel. Co. (1968) 69 CPUC 53.)"

In balancing ratepayer-utility interests on this issue, we recognize the ratepayer's desire for reasonably modern equipment and that custom-calling features produce revenue. The ratepayer is also vitally interested in avoiding rate increases, and depreciation lives which are shorter than necessary increase rates more than necessary. We are not convinced (at least at this time) that the same degree of telecommunications sophistication is necessary for a service territory like Ponderosa's as in an urban area with a greater mix of commercial telephone users.

We are also aware of Ponderosa's testimony (by witness Ewing) that in an access-charge environment, it is vital to measure and identify terminating traffic. Present equipment cannot do this, and therefore, cannot distinguish interstate from intrastate calls, which invites "arbitrage," or configuring traffic to take advantage of a lower interstate rate even though the call is between two points in California. Further future developments in equipment include the ability to locate the initiator of a 911 emergency call. Ponderosa wishes to take advantage of these improvements, and should be able to do so.

The depreciation lives adopted in this decision are not set in concrete. If future central office design charges warrant changing them, we will consider doing so. Our choice of depreciation life recognizes present factors, and balances the interests of the company and its ratepayers.

Depreciation - Station Equipment

Ponderosa recommends a seven-year total life (three-year remaining life) for "station apparatus"⁵ almost all of which is customer premises equipment, while the staff proposes ten years (five years remaining).

Barker's testimony states that with the unbundling of basic rates, Ponderosa is prepared to sell its in-place telephones to the customers to help them reduce monthly charges, and also to increase company revenues, but has to compete with retail stores. The witness pointed out that only about 5% of Ponderosa's in-place phones are push button, which most customers prefer to rotary dial as a purchase item. Company testimony points out that same customers may wish to take advantage of alternate long-distance carriers which cannot be done by use of a rotary dial phone,⁶ or of present and planned future custom calling features which require a push-button instrument.

Ponderosa is also concerned with the decision of the Federal Communications Commission (FCC) to phase out station equipment from toll settlements. Barker commented (Exh. 19, p. 15):

"Ponderosa's investment in CPE [customer-premises equipment] and associated expenses are frozen at the 1982 level. Then this CPE investment is phased out over 5 years; i.e. the amount allowed for toll settlements is reduced by one fifth for 5 years. Investment in CPE and associated

⁵ Staff and company exhibits refer to "station apparatus." Upon questioning it developed that the term includes nothing that is not included in "customer premises equipment," a more customary phrase, except terminal equipment owned by the company for its own use.

⁶ It is more accurate to state that this is not presently possible without the purchase of a tone-generator. Upon completion of network engineering changes which will make equal access to the network available to all long-distance carriers, rotary phones will be usable for this purpose. Completion of reengineering is scheduled for 1986.

expenses incurred after 1982 are not included for toll settlements, which means that such costs must be recovered from local rates."

The company's recommendation would thus coincidentally depreciate such equipment over the same period that it is phased out for toll settlement purposes.

Staff advocates a 10-year life to be consistent with customer premises equipment lives set for other companies, as follows (all established since 1981):

<u>Company</u>	<u>Years</u>
Pacific Bell	9.4*
Volcano	10
Siskiyou	10
Sierra	10
Mariposa	10
Dorris	10
Kerman	10
Tuolumne	11.5

*See subsequent discussion on Pacific Bell.
The 9.4 year total life produces a remaining life of 6.4 years, and is a recommendation in a staff exhibit dated February 1983.

Company criticizes staff's development as simply "that's the way we've always done it" and as failing to recognize changing conditions. It further notes that the depreciation lives above (except for Pacific Bell) were established by way of staff-company negotiations resulting from advice letter filings and were not subject to detailed Commission scrutiny.

We choose an eight-year total life and a remaining life of four years as the longest reasonable lives for station equipment for Ponderosa under current conditions. The remaining life here becomes important. The FCC's phaseout of toll support for station equipment

began January 1, 1984 and will end on January 1, 1988. Ponderosa intends to sell as much customer premises equipment to its subscribers as possible, but we agree that Ponderosa is faced with "stranded investment" problems because of its high percentage of rotary dial phones. A sizeable writeoff does not benefit the ratepayers, in the long run, any more than the company. The remaining life for Ponderosa should not extend beyond January 1, 1988.

While staff's citations of advice letter filings for other small companies is in point, each company must be analyzed on its own, and ten years for total life is not a magic number. In Pacific Bell's current rate proceeding (A.82-11-07 and consolidated applications) the staff's Exhibit 76 recommends a 6.4 year remaining life for Account 231 (station apparatus, telephone, and miscellaneous). In the current General proceeding (A.83-07-02 and related matters) the staff's Exhibit 34 recommends a 3.57 year remaining life for the corresponding account.⁷ In both proceedings there were extensive depreciation studies.

Our selection of eight years total, four years remaining for station equipment does not mean that we will necessarily select that figure for other small companies, or that we have ruled that all small companies should have remaining life periods for station equipment which terminate prior to 1988.

We note that on May 2, 1984, we approved Ponderosa's Advice Letter 114 (Resolution T-10820), a copy of which is attached to this decision as Appendix A. The advice letter establishes a sales plan

⁷ In each case, the account mentioned excludes large PBXs, teleprinters, and other complex equipment. The date of the staff's Pacific exhibit is, as mentioned, February 1983.

for single-line telephones as a result of unbundling of rates accomplished in our interim decision. Ponderosa has roughly 4,000 in-place rotary dial phones which now will go on sale for \$19, and other equipment available at competitive prices (see Appendix A).

In view of what we believe to be reasonably favorable treatment to Ponderosa on the issue of station equipment depreciation lives, we expect the company to devote an appropriate amount of funds and energy to promoting sales. A successful sales effort will increase revenues and decrease plant, thus deferring further necessity for rate increases. In our opinion this decision provides Ponderosa with sufficient revenue for expenses so that its advertising can, and should, include some economical use of local mass media as well as bill inserts.

Since there is a common misconception that only push-button phones can be used, even in the future, to access alternative long-distance services (see footnote 6), we believe the sales efforts should include some effort to erase this impression.

Finally on this subject, we understand that Ponderosa is competing in a free, unregulated market for these sales. If after an attempt at sales at the resolution's prices, Ponderosa finds it needs more marketing flexibility, we will consider accepting an advice letter making those prices the maximums.

Depreciation Summary (Table)

Company-staff differences in depreciation produce, on a total company basis, a \$218,827 effect on depreciation expense and a \$109,413 effect on depreciation reserve. The following table summarizes company and staff positions, and the adopted result.

Depreciation Expense Comparison (Intrastate)

<u>Account</u>	<u>Staff Proposed</u>	<u>Company Proposed</u>	<u>Adopted</u>
Electronic central office equipment	\$339,711	\$498,952	\$392,792
Station equipment	\$29,022	\$58,629	\$43,826

Operating Expenses

Through use of data requests and information elicited on cross-examination, Ponderosa and the staff resolved many issues in this area. For instance, Ponderosa purchased a lot in Auberry and installed a trailer on it, in which it operates a Radio Shack outlet and also runs a small branch office. Staff investigation showed the office to be useful, since customers use it to pay bills, to start or regrade service, or to report service problems. Staff and Ponderosa disagreed on whether 60% or 40% of the expense of the trailer and employee wages should be apportioned to utility business. (The dollar difference was under \$5,000.) Eventually, it was stipulated that a 50% allocation is proper.

We agree because the amount involved is small and because examination of the witnesses showed that there is no precise way of allocating floor space, time, etc.

The remaining paragraphs of this section discuss remaining differences only.

Executive Automobile. This was discussed in the interim decision, where we commented that witness Ewing's testimony had not established that the activities of Mrs. Silkwood, company president, qualified her as an operating official. Ewing offered additional testimony that Mrs. Silkwood actually participated in running the company, principally concerning banking and bookkeeping, and made three trips weekly in the car on banking business. She also uses the car to attend telecommunications conferences.

Ewing's testimony still does not establish that this car is necessary in the day-to-day operation of the business. Mrs. Silkwood lives in O'Neals, across the street from the head office. She owns two other vehicles. When asked whether Ponderosa had compared the

\$12,000 amount⁸ with simply giving Mrs. Silkwood an expense account for actual business miles driven, he answered in the negative. Applicant has not shown that the expense is reasonable; the expense is disallowed.

Vacant Positions. Staff withdrew its objection to hiring a plant manager and a secretary but removed the half-year salary of \$12,500 for 1984 for a journeyman cable splicer. Staff contends Ponderosa can fill the vacancy through promotion and hire at the bottom, saving money. Staff also points out most company lines are now underground.

The staff's contentions are rejected. It is a matter of management discretion whether to promote to fill a journeyman vacancy, and depends on an evaluation of performance and potential of individual employees. Also, staff's presentation demonstrates incomplete understanding of a cable splicer's varied duties. Neither does the evidence demonstrate that Ponderosa's overall expense for cable splicers is too high.

Dues. Company maintains that we should follow the precedent established in previous advice letters and disallow 10% of the \$5,774 annual dues paid to U.S. Telephone Association and California Telephone Association,⁹ because of an indeterminate amount of legislative advocacy performed by these organizations. Staff argues that advice letters do not necessarily establish precedent because they are a summary method of handling small rate or tariff changes.¹⁰

⁸ This is the total amount of the car when purchased. See interim decision.

⁹ These organizations were until this year called U.S. Independent Telephone Association and California Independent Telephone Association. They now permit membership of the former Bell operating companies. Their primary purpose is professional information, seminars, etc.

¹⁰ It is interesting to compare staff's and company's positions on the authority of advice letters concerning depreciation.

We will follow "precedent" in this instance because, of late, much of the legislative work of these organizations concerns maintaining universal telephone service. That certainly would benefit ratepayers as much as the company, regardless of whether the benefit is seen as "direct" or "consequential." We are also attempting to assure universal service. In larger cases where a more sophisticated development is possible, we may require more detail on how much of the organizational budgets are for legislative advocacy, and how much of that category is for the preservation of universal service.

Promotions. Staff disallowed \$1,774 for promotional activities (such as free ball-point pens) which it classified as "image building." We agree.

Service Awards and Annual Banquet. Staff sees this \$5,044 expense as promotional. Ponderosa maintains these items are legitimate fringe benefits and of direct benefit to the ratepayer in maintaining a stable work force and employee morale. There is some merit to Ponderosa's argument, although such expenses also have their promotional element. We will allow 50%.

Legal Expenses. The legal affairs of Ponderosa are principally handled by the San Francisco law firm of Pelavin, Norberg, Harlich & Beck. Certain local legal work is performed by James Wagner of Fresno.

Staff found the records pertaining to Wagner, who apparently performs some duties for the stockholders, to lack proper detail, and therefore, recommended a 50% disallowance of Wagner's assumed test year charge of \$49,256 (based on 1983). Company acceded to this adjustment to expedite the proceeding. This disallowance will be made.

Staff contends that Ponderosa's legal expenses are high compared to other small companies. Ponderosa points out that in

addition to the present complaint which is consolidated with the rate increase application, it has had to twice defend itself in recent years in formal complaints on the issue of OCMS. Table 8-E in staff's Exhibit 29 shows the following 1982 comparison among small telephone companies:

<u>Company</u>	<u>Access Lines</u>	<u>Legal Expense</u>
Tuolumne	3,520	\$ 5,490
West Coast	8,000	12,860
Mariposa	4,960	17,510
Kerman	3,860	20,030
Sierra	3,660	52,730
Volcano	5,400	55,730
Siskiyou	3,500	64,820
Ponderosa	4,900	92,140

Staff suggests that Ponderosa could save a considerable sum by hiring a staff attorney. We will not discuss this testimony in detail because we consider such a move to be within management's discretion. At any rate, we agree with the testimony of A. H. Pelavin that there is a great deal more expense connected with starting a legal department besides hiring a lawyer.

However, we believe the evidence demonstrates that an adjustment should be made to the Pelavin law firm's non-rate case test year estimate. The 1984 Pelavin total is \$94,257, of which \$34,390 is charged to the rate application and \$6,657 to the Gillham complaint. Thus the test year estimate for non-rate proceeding expenses for the Pelavin firm is \$53,210. If one adds that to the reduced Wagner estimate, the test year total excluding rate case expenses is \$77,838.

We recognize that in the volatile regulatory climate created by reregulation of the telephone industry, legal expenses are likely to be greater than a few years ago. We also are mindful that

Ponderosa, in the last few years, has had to defend itself in two previous complaints on the OCMS issue. (See discussion in interim decision.) Even considering all of that, we are unwilling to trend 100% of the non-rate case expense into the future. This proceeding will eventually settle the OCMS issue, and additionally, we believe Ponderosa should make a greater across-the-board effort to control its legal costs.

The Pelavin non-rate proceeding test year estimate will be adjusted downward \$10,000.

Legal and Accounting Expenses of this Proceeding.

Ponderosa charged \$31,470 of accounting expense to this proceeding (all of it to the application) as well as the previously mentioned legal fees, for a grand total of \$72,517.

Staff does not challenge the expense totals themselves (nor is there any issue over other accounting expenses) but regards them as extraordinary and recommends a 50% disallowance plus a three-year amortization for accounting and a five-year period for legal.

Ponderosa concedes the nonrecurring nature of the expenses and proposes that the entire charge, not 50%, be amortized over two years.

Staff suggests the 50% disallowance because it believes the Gillham complaint complicated matters, as did the necessity for handling interim relief. Ponderosa points out that the "complaint" is really a rate design issue and that the hearing time would have been necessary anyway to deal with customer service problems and the demand for OCMS by Gillham and others regardless of whether a formal complaint was filed.

Staff also regards the filing of a formal application by a small telephone company for general rate relief to be an aberration created by the breakup of the Bell System, recent FCC rulings on settlements, etc. Staff points out that this is the first such

application since the 1950s, that, as in the past, further adjustments can be handled by advice letter, and goes so far as to predict "Ponderosa will most likely never have to file a formal rate application again." (Exh. 29, p. 8-13.)

We agree with Ponderosa concerning the Gillham complaint and will not make the 50% adjustment. However, we agree with the staff that a longer amortization period than recommended by Ponderosa is reasonable. Small telephone companies will continue to handle some rate increase matters by advice letter, but since the interstate toll settlement arrangement as we have known it is dead and there is substantially more pressure on telephone utilities to increase local monthly service charges, the bucolic days of formal rate proceedings every 20 or 30 years are over.

In our opinion, even with advice letters, it is reasonable to estimate a formal rate proceeding approximately every five years, and we will amortize the entire accounting and legal expense on a five-year basis.

Results of Operation Summary

The following table compares the original company and staff positions with the adopted results of operation on an intrastate basis.

Ponderosa Telephone Company
Summary of Earnings, Test Year 1984
Intrastate Operations

<u>Account</u>	<u>Staff Proposed</u>	<u>Utility Proposed</u>	<u>Adopted</u>
<u>Operating Revenues</u>			
Operating Revenues After Uncollectibles	\$4,233,269	\$4,513,522	\$4,316,633
<u>Operating Expenses</u>			
Maintenance	845,993	856,643	856,643
Traffic	20,640	20,640	20,640
Commercial	143,344	146,555	143,999
General Office	383,816	383,816	383,816
Other Oper. Exp.	<u>445,725</u>	<u>524,014</u>	<u>452,556</u>
Subtotal	1,839,518	1,931,668	1,857,654
Depreciation Exp.	840,884	1,031,656	908,767
Taxes other Than Income	138,282	138,282	138,282
Taxes on Income	<u>395,603</u>	<u>395,780</u>	<u>395,320</u>
Total Oper. Exp.	3,214,238	3,497,386	3,297,464
Net Operating Income	1,019,031	1,016,136	1,016,610
Rate Base	\$11,343,442	\$11,286,072	\$11,303,850
Rate of Return	9.0%	9.0%	9.0%
Revenue Requirement	\$905,000	\$1,015,000	\$930,000

III. SERVICE ISSUES

The individual service complaints that were the subject of testimony at our Fresno hearings were analyzed in company evidence at our San Francisco hearings. These individual problems have been satisfactorily rectified insofar as Ponderosa was able to make contact with the customers. (OCMS is discussed under rates.)

This leaves outstanding the issue of party-line service in which one customer is a business and the other is residential. One residential customer testified at the Fresno hearings that he was placed on two-party service with a business, which made it impossible to use his phone during business hours. (This customer's service has since been reconfigured.)

Ewing's testimony shows that this is a last resort, and done only in remote areas where there are no other subscribers so that a different configuration is not possible without major expenditures. Ewing concedes the undesirability of such a hookup but states that the alternative is no service in isolated locations.

The evidence also shows that Ponderosa has not kept a separate list of these configurations, so that unless a customer complains, the arrangements may continue even after they could be eliminated. Staff recommends that Ponderosa keep track of them, that no new service of this sort be started without joint consent, and that every effort be made to reconfigure the lines as soon as possible. On argument, staff counsel questioned whether such service discriminates against the residential customer and violates Public Utilities Code § 453(c), at least without the consent of the customer.

Counsel for Ponderosa stated on argument that it would be willing to file tariffs requiring it to keep a list of such connections, to institute them only as a last resort, and to terminate them as soon as possible without waiting for a customer to

complain. He cautioned against forbidding the service, stating that in isolated cases it might preclude telephone service.

We will order Ponderosa to file the tariff changes without forbidding the service. We note Ewing's testimony that new, relatively inexpensive line equipment may lead to quicker reconfiguration. This should be used to the maximum extent possible in keeping with sound economics. Ponderosa will also be ordered to furnish the Communications Division with up-to-date information on the location of these connections on an annual basis. Lastly, the residential customer should be notified, upon request for service, that the other party will be a commercial location, so that the customer may choose whether he or she wants the service on that basis before paying installation charges.

IV. RATE DESIGN

Evidence of Complainants

Because the issue of rate design is necessarily interwoven with whether OCMS should be instituted, we will begin by summarizing evidence presented by Lois J. Gillham and others at our Fresno hearings.

The closest point of the service territory is some 15 miles from Fresno. There is no full-service community within Ponderosa's territory. Most of those who are Ponderosa's customers shop, receive their medical attention, bank, and perform other commercial and personal transactions in Fresno, and to a lesser extent in Clovis, also in Pacific's territory.

Complainants contend that straight toll service to Fresno and Clovis produces excessive bills for many of them. They advocate systemwide OCMS between Ponderosa's area, Clovis, and Fresno. Over 700 customers of the Auberry exchange signed the complaint for OCMS.

Lois Gillham testified her telephone bills average between \$50 and \$200 a month. All government offices, she pointed out, are in Fresno. Calls to Fresno and Clovis are not usually for social

purposes, she said. She presented various bills from Auberry exchange customers to illustrate the problem.

Gillham recommended that if OCMS is instituted that CCMS bills should separately state the calls made, because of past billing disputes.

Donna Lechman of the Friant exchange, which already has a form of OCMS, testified in support of separately stated calls appearing on the bills. She presented a bill which showed the OCMS calls as so many minutes for a certain total. (180 minutes as a "base" is allowed for a rate of \$9. Excess minutes are billed at an additional charge.) There had been a problem with the billing equipment, which was rectified, but billing with no detail made the complaints harder to straighten out. (Exh. 6-9.)

A few additional witnesses testified in support of OCMS. Others appeared at the hearing in support of OCMS without testifying.

On argument, Gillham maintained that Ponderosa would not suffer financial hardship because persons now on two-party service would have to upgrade to one-party service to take advantage of OCMS. Ponderosa's Position on OCMS

Ponderosa opposes institution of OCMS at this time and did not include it in its rate design.

Barker conceded there would be little immediate impact on company revenues from its institution, but explained that it would decrease Ponderosa's contribution to the intrastate toll pool,¹¹ which it has a responsibility to keep flowing in proportion to distributions to it.

¹¹ During the final minutes of the last hearing day, Barker further testified that the annual decrease in Ponderosa's "toll pot" contribution would be roughly \$123,000. He generally explained this figure but it was never mentioned earlier, and no workpapers concerning it were submitted for analysis.

Pelavin testified that, as attorney for 17 small telephone companies including Ponderosa, he participated in lengthy negotiations with Pacific to convince that company not to discontinue the intrastate toll settlement agreement after divestiture. An agreement to continue the "toll pot" was finally worked out, but the small companies promised not to dilute their contributions by liberal expansion of extended area service or OCMS. The contract has a 120-day cancellation clause, which Pelavin believes would be exercised if Ponderosa and other small companies make wide use of OCMS.

Barker also pointed out that in Pacific's present rate increase application, shortly to be decided, major issues have been raised concerning rate increases and revisions to that company's ORTS (Optional Residential Toll Service) and OCMS forms. Both Pacific and our staff have recommended changes which would place more restrictions on the services and reduce the discount levels.

Barker concluded by recommending that if the Commission believes some form of optional wide-area service should be considered, the issue should be deferred until after the decision establishing Pacific's new rate design issues. Then, he said, we should consider adoption of some form of OCMS or ORTS similar to Pacific's.¹²

Staff's ORTS Views

Staff believes OCMS should be adopted now, and then modified after the Pacific decision issues, to make the form comparable to what is in use elsewhere.

In Exhibit 31 (McCarroll) staff states that adoption of optional wide-area service would actually stimulate calls from Ponderosa's territory to Pacific's, thus increasing allocation of plant to toll (the allocation is one factor in the settlement

¹² When both Pelavin and Barker were asked by the ALJ about the effect ORTS rather than OCMS would have on toll pot contributions, they said they had not analyzed it.

formula), which in turn would increase toll revenue and decrease exchange revenue requirement.

Staff states additional delay might produce further formal complaints, of which there have been three, including the present Gillham complaint, with attendant legal expenses. Staff estimates that upgrades to one-party service necessary to use wide-area service would add about \$18,000 in annual local revenues, while the increased cost to itemize calls would be only \$2,700. (Exh. 31, pp. 3-2 and 3-3.)

Other Rate Design Issues

Other issues relating to final rate design may be outlined as follows:

1. Both Ponderosa and staff propose two steps, but Ponderosa recommends step two be effective January 1, 1985, while staff recommends it go into effect one full year after institution of step one.
2. Staff's rate design limits the service order, central office connection, and service restoration charges to a maximum of 50% to avoid "rate shock." Company's rate design does not, stating its analysis, justify higher charges in some instances and that such higher charges relieve the pressure on basic rates.
3. In designing rates to the revenue requirement, Ponderosa estimated 15% repression in supplemental equipment, reducing revenue estimates to a total of \$56,134 for this category. Staff makes no such assumption citing lack of a formal company study and the fact that Ponderosa has no sales plan in effect. Staff's estimate is \$72,189.
4. Ponderosa wants to cancel its PBX and KTS tariffs, "grandfathering" present users. Staff recommends the tariffs remain open and that embedded equipment be offered until it is disposed of in normal course.

Wherever possible, Ponderosa has tried to place the increase in nonrecurring charges or in categories other than basic service, and to eliminate noncompensatory rate forms (example: a vacation rate under which a part-time resident did not pay the basic service charge during months when not in residence). Staff has no quarrel with this aside from the "50%" dispute (see 2, above). Differences in actual rate levels are traceable in most instances to different assumptions as to rate relief. (See also previous discussion on growth of revenues.)

The ALJ directed company and staff to submit alternative rate design recommendations essentially in the form of a surcharge to intrastate rates, should the Commission prefer such a rate structure on a temporary basis pending decision in the Pacific rate application. No one advocates such rates permanently.

Discussion

We choose to adopt a surcharge at this time, and to hold further hearings on final rate design, including ORTS/OCMS.

Some form of wide-area service, on an optional basis, is desirable for Ponderosa (though it may have to be not as liberal as Ponderosa's customers would like). What should it be? The record, in our opinion, is not adequate for us to decide. Barker's general testimony on the effect of OCMS on toll settlements was not tested, and, in any event, he had not studied the ORTS option. Pelavin's testimony regarding Pacific's attitude toward continuing the intrastate toll settlement agreement concerned OCMS only, and he stated he was not sure what Pacific's position on ORTS would be. Finally, counsel from Ponderosa stated on argument that there were (or at least would be) resellers in Fresno which would create a problem if wide-area options were instituted. This was not explained further and was not the subject of any testimony. Neither side offered any detailed, expert, traffic analysis of the installation of

either OCMS or ORTS. No survey was taken on its demand, and therefore, there is no detailed information of record on what percentage of Ponderosa's customers in various exchanges other than Auberry would regrade to single-line service (where available) to obtain it. How elastic is the demand for it? What plant additions, if any, are necessary? Staff's exhibit on the subject is no more specific than the company's evidence, and consists essentially of a review of past consumer complaints on the subject and general rebuttal to Ponderosa's position.

Added to the problems of the record in this proceeding is the status of Pacific's application. When the staff first conceived its recommendation for present installation of OCMS subject to later adjustment, the suggestion might have had merit. Now, Pacific's case is submitted and ready for decision. Customer confusion and indecision, with an excessive number of regrade orders, is likely to result from "interim" OCMS followed by substantial modifications or a switch to ORTS.¹³

Further hearings will be held on the ORTS/OCMS problem, and on final rate design, since rate design adjustments may be necessary after the particular form of wide-area optional service is determined, in order to produce the correct amount of gross revenue.

Concerning other rate design matters which should be finally decided at this time:

¹³ The basic difference between the two forms is that in ORTS, the subscriber pays a flat additional charge to be able to call one or more areas without toll charges until a dollar limit is reached, while under OCMS, one pays an additional monthly charge for so many hours of wide-area service without regular toll charges. ORTS does not have a "free" off-peak calling period. OCMS does, and during the period there is a zero contribution to the toll pot. (It is possible, of course, to design either form without a "free" period, thus avoiding an inadequate toll pot contribution.) Gillham and the other complainants are essentially concerned with reaching Clovis and Fresno during business hours. This means that lack of an untimed period would not be a major drawback.

1. In our final rate design we will use the staff's "50% rule" of raising rates as a guideline rather than an absolute limit. It is better to exceed 50% in some cases than to place more of the revenue requirement in basic rates.
2. Regarding 1. above, we agree with staff that company time estimates for dealing with customer orders are grossly excessive when compared to other companies, and inherently improbable (as to what the times should be rather than what they are) and the 50% rule will apply to such charges.
3. We will not, in final rate design, assume 15% repression in supplemental equipment for reasons the staff has presented.
4. We will order Ponderosa to leave its PBX and KTS tariffs open, since if any customer prefers renting company equipment rather than purchasing, this adds to revenue. This will not be a requirement that Ponderosa refrain from retiring the equipment if it is obsolete and not marketable, or if maintenance costs become excessive. Tariffs should indicate that service is limited to available stock.

V. SUMMARY OF RATE DEVELOPMENT

Phase One

In our interim decision we awarded rate relief of 13.0% plus increases due to unbundled rates, for a total of 16.6%. Company's revised request for rate relief (Exh. 25) was the amount of \$1,015,000, of which it requested \$622,888 for phase one. \$622,888 equals 61.4% of final rate relief, including interim relief. For Phase One purposes, we will apply this 61.4% to the adopted intrastate revenue requirement and award an additional amount in surcharge form (except for pay phone rates, which are impossible to surcharge) so that total phase one relief equals 61.4% of the adopted revenue requirement.

To keep basic rates as low as possible we will apply the surcharge to all rates and charges and not just to recurring charges, as the staff had suggested, except for coin telephone rates, which are impossible to surcharge.

A table follows summarizing the development.

PHASE ONE SURCHARGE

Total revenue requirement (final)	\$930,000
x 61.4% (company's phase one request)	571,020
Less revenues from unbundling basic rates	83,629
Surcharge revenue requirement, phase one	487,391
Total percentage increase for phase one ($\$487,391 \div$ adopted intrastate billing of \$2,206,175)	22%

Note: Since interim decision awarded \$375,000, percentage increase from interim rates to phase one rates is approximately 9%.

Phase Two and Further Proceedings

Target date for the Phase Two increase and installation of some form of optional wide-area service accessing Clovis and Fresno will be January 1, 1985. Company is entitled to its full return on that date rather than one full year from the effective date of phase one. If phase two is effective concurrently with optional wide-area service, its effects are mitigated. We consider it undesirable to insert a "phase one and one-half" during which wide-area optional service is effective at lower than final rates. At the same time, consumers should not have to wait a full additional year for the optional service. This target date will give company and staff adequate time to develop more information on wide-area service, specifically:

1. The rate forms adopted for Pacific should be considered when analyzing optional wide-area service for Ponderosa to assure there is not an undue drain on contribution to toll settlements.

2. If Ponderosa seriously contends that "Fresno resellers" (or any other industry innovations) are a serious threat to its revenues if wide-area options are allowed, specific and expert traffic evidence should be offered.
3. The wide-area optional form (or forms) suggested should be the subject of specific studies, including the possibility of detailed billing as an option for an additional charge, as compared to compulsory detailed billing for everyone.
4. The proposed rate form (or forms) should be the subject of customer surveys to establish need in other areas besides Auberry and to ascertain what features are popular or unpopular.
5. Sufficient estimates on revenues shall be offered so that the overall phase two rates are set correctly.

The above points are not necessarily exclusive. An additional prehearing conference will be scheduled as soon as possible after the Pacific decision issues, and the ALJ may require further information on rate design issues remaining open (i.e., the form of the optional wide-area toll service to be instituted, and necessary adjustments to the rest of the final rate design).

Findings of Fact

1. Staff's rate of return analysis correctly reflects current economic trends and correctly treats Ponderosa's preferred stock as part of common equity for this type of closely held company. A rate of return of 9% on rate base is reasonable.

2. While Ponderosa's development of a 3% revenue growth factor based on main station counts and population trends is essentially accurate, some weight should be accorded population growth estimates based on housing trends, and it is reasonable to adopt a 3.5% growth factor for estimation of local service revenues.

3. Based upon conditions in the industry, and to balance the needs of the company and its ratepayers, it is reasonable to adopt the following depreciation lives:

- a. Central office equipment: a total life of 15 years producing a remaining life of 12.5 years.
- b. Station equipment: a total life of eight years producing a remaining life of four years.

4. Company evidence has not adequately justified expenses associated with the car used by Mrs. Silkwood, and they should be disallowed.

5. The inclusion of wages in connection with a vacant journeyman cable-splicer position is reasonable.

6. Under current conditions, we should follow past practice and allow 90% of association dues.

7. It is reasonable to disallow \$1,774 for promotional activities.

8. Ponderosa's service awards and employee banquet have both promotional elements and employee fringe benefit elements, and 50% of the expenses should be allowed.

9. Ponderosa's non-rate proceeding expenses are high for this size company and should not simply be trended into the future with no adjustment to encourage the company to economize. It is reasonable to adjust the revised Ponderosa non-rate proceeding legal expenses for the test year by \$10,000.

10. A formal complaint of the type consolidated with this rate increase application did not double the cost of the proceeding, and it is unreasonable to disallow 50% of the legal expense.

11. Based upon the likely time between now and the next formal rate increase proceeding, it is reasonable to amortize legal and accounting expenses connected with this proceeding over five years.

12. Two-party service with a residential customer sharing the line with a nonresidential customer is undesirable. Ponderosa should

keep an accurate record of all such connections, and, in keeping with sound economics, eliminate them as soon as possible without waiting for a complaint. New connections of this type should be established as a last-resort alternative to no service, and only upon prior notification to the customers. Ponderosa should report these connections annually.

13. In all other respects, Ponderosa's service is now adequate.

14. It is desirable to establish some form of optional wide-area service to Clovis and Fresno, but the record is inadequate for us to decide what form this should take, and how liberal or restrictive it should be. Additionally, an interim service of this type is undesirable, and we should await the forthcoming decision dealing with rate design for Pacific before holding further hearings on the subject.

15. Because of the facts in Finding 14, we should establish phase one rate relief based essentially on a surcharge of rates. The surcharge should reflect the percentage of final relief requested by Ponderosa in Exhibit 25, applied to the adopted results.

16. We should employ staff's "50% rule" of raising nonrecurring charges as a guideline in the final rate design rather than as fixed ceiling.

17. It is not reasonable to assume a 15% repression in supplemental equipment for final rate design.

18. PBX and KTS tariffs should remain open until company-owned equipment becomes obsolete or is retired or salvaged for other appropriate reason. Tariffs should indicate that they are limited to equipment on hand.

Conclusions of Law

1. Ponderosa is in need of additional revenue for test year 1984 totaling \$930,000, with \$571,000 assigned to Phase One, based on a return on rate base of 9%.

2. Phase One rates should be set based upon application of a surcharge, on a "bill and keep" basis.

3. Service and tariff changes should be required as set forth in the Order.

4. The order in this proceeding should be effective on the date it is signed because we are already approaching the middle of the test year.

5. This proceeding should remain open for further hearings and a final order on rate design.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. Ponderosa Telephone Company (Ponderosa) is authorized to file tariffs placing into effect a total Phase One surcharge of 22%. The surcharge shall apply to all intrastate billings (but not to coin telephone rates) and shall be effective until our further order. The entire surcharge shall be collected on a "bill and keep" basis.

2. Ponderosa may revise its tariffs for company-owned PBX and KTS equipment, limiting them to equipment on hand.

3. Ponderosa shall deal with two-party service as set forth in Finding 12, and shall file an annual report with the Communications Division setting forth remaining two-party connections in which one party is a nonresidential customer.

4. This proceeding remains open for further hearings on final rate design.

This order is effective today.

Dated MAY 16 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President

VICTOR CALVO

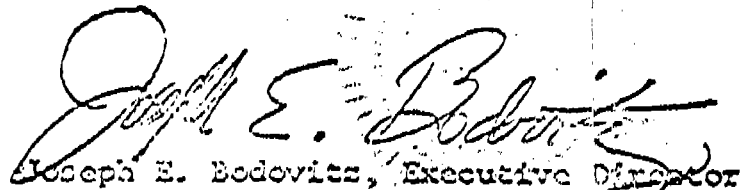
PRISCILLA C. GREW

DONALD VIAL

Commissioners

Commissioner William T. Bagley
being necessarily absent, did
not participate.

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY.


Joseph E. Bodovitz, Executive Director

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

C-1

Copy for:

Orig. and Copy
to Executive Director

RESOLUTION NO. T-10820

COMMUNICATIONS DIVISION
DATE: May 2, 1984

R E S O L U T I O N

Director
Numerical File
Alphabetical File
Accounting Officer

SUBJECT: The Ponderosa Telephone Company. Order authorizing a sales-program for telephone sets, in-place or from inventory.
Resolution No. T-10820.

WHEREAS: THE PONDEROSA TELEPHONE COMPANY, by Advice Letter No. 114, filed March 19, 1984 and Supplement filed April 5, 1984, have requested authority to establish tariff provision covering the sale of in-place telephone sets in their existing inventory. After the effective date of this resolution all customers will receive written notice of these new provisions in the next billing by the company.

The sales plan filed by Ponderosa includes a 3 month installment billing purchase option and a warranty of 90 days for both in-place sets and sets purchased from inventory. Ponderosa's sales plan does not contain specific provisions covering out-of-warranty repairs or exchanges. The following is a listing of the prices under Ponderosa's sales plan:

In-place Single-line Telephones

<u>Product</u>	<u>Price</u>	<u>Installment Billing *</u> <u>3 Mos.</u>
Standard Telephone		
Rotary Dial	\$19.00	\$ 6.52
Touch Calling Dial	34.00	11.67
Slenderet Telephone		
Rotary Dial	34.00	11.67
Touch Calling Dial	49.00	16.82

(California Sales Tax applies to the charges shown.)

Single-line Telephones From Utility Inventory

<u>Product</u>	<u>Price</u>	<u>Installment Billing</u> <u>3 Mos.</u>
Standard Telephone		
Rotary Dial	\$35.00	\$12.02
Touch Calling Dial	55.00	18.88
Slenderet Telephone		
Rotary Dial	55.00	18.88
Touch Calling Dial	75.00	25.75

(California Sales Tax applies to the charges shown.)

* Installment billing charge includes an interest rate of 1.5% per month on the unpaid balance.

The Commission finds that the rates, charges and conditions authorized in this resolution are just and reasonable and present rates, charges and conditions, as they differ from the rates, charges and conditions authorized in this resolution are for the future unjust and unreasonable; and good cause appearing,

IT IS ORDERED that:

(1) Authority is granted to make the above revisions effective on May 3, 1984.

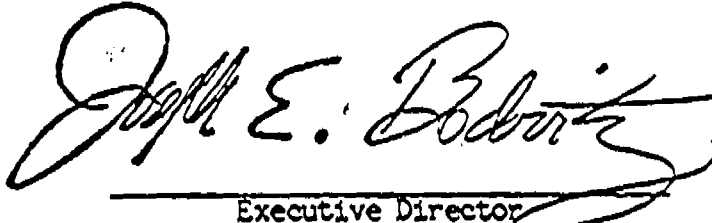
(2) Revised Cal. P.U.C. Sheet Nos. 737-T, 738-T, 739-T, 740-T and 744-T shall be marked to show that such sheets were authorized by Resolution of the Public Utilities Commission of the State of California No. T-10820.

The effective date of this Resolution is today.

I hereby certify that the foregoing Resolution was duly introduced, passed and adopted at a regular meeting of the Public Utilities Commission of the State of California, held on May 2, 1984, the following Commissioners voting favorably thereon:

LEONARD M. GRIMES, JR.
President

VICTOR CALVO
FRISCILLA C. CREW
DONALD VIAL
WILLIAM T. SAGLEY
Commissioners


Executive Director

(END OF APPENDIX A)

12 ^{9%} In the interim decision staff recommended, and we adopted, a 7% interim return. The principal issue at the interim stage was what staff rate of return witness Terry Mowrey termed "Ponderosa's extremely highly leveraged capital structure, comprised of over 90% relatively low-cost debt and preferred stock which warrants an equity return higher than that which would be considered reasonable for a typical telephone utility." However, the staff witness's calculations convinced him that Ponderosa's request of 10.26% for final relief would produce an unreasonably high return on common equity of 38.40%.

A. H. Pelavin, one of the attorneys for Ponderosa, testified that he and his law firm had established the unusual capital structure (6,606 shares of common stock and 79,272 shares of preferred stock) for estate planning purposes, as was pointed out to the Commission in the various applications authorizing this sort of stock issuance.² We summarized his testimony in our interim decision as follows:

"Low-dividend paying preferred stock causes substantial reduction of the book value of the common stock. By allowing older-generation family members to retain only preferred stock, with its fixed redemption value, the value is fixed for estate tax purposes as well (i.e., growth of estate tax liability is eliminated).

"According to Pelavin, the preferred stock does not constitute, in its dividend rate, a reflection of the cost of capital. It is not, he said, what the market would have caused to be the dividend rate on such an issue of stock.

"When the 6% preferred stock was authorized in 1974, (see footnote 3), in round figures Ponderosa had total assets of \$3,800,000, with a debt of \$2,700,000 and the debt, according to Pelavin's testimony, was subject to increase

² Ponderosa Tel. Co., A.55269, D.83736 (October 28, 1974); Siskiyou Tel. Co., A.54755, D.82720 (March 27, 1974); Volcano Tel. Co., A.57383, D.87678 (August 9, 1977). See Exhs. 13-18.

for single-line telephones as a result of unbundling of rates accomplished in our interim decision. Ponderosa has roughly 4,000 in-place rotary dial phones which now will go on sale for \$19, and other equipment available at competitive prices (see Appendix A).

In view of what we believe to be reasonably favorable treatment to Ponderosa on the issue of station equipment depreciation lives, we expect the company to devote an appropriate amount of funds and energy to promoting sales. A successful sales effort will increase revenues and decrease plant, thus deferring further necessity for rate increases. In our opinion this decision provides Ponderosa with sufficient revenue for expenses so that its advertising can, and should, include some economical use of local mass media as well as bill inserts.

Since there is a common misconception that only push-button phones can be used, even in the future, to access alternative long-distance services (see footnote 6), we believe the sales efforts should include some effort to erase this impression.

Finally on this subject, we understand that Ponderosa is competing in a free, unregulated market for these sales. If after an attempt at sales at the resolution's prices, Ponderosa finds it needs more marketing flexibility, we will consider accepting an advice letter making those prices the maximums.

Depreciation Summary (Table)

Company-staff differences in depreciation produce, on a total company basis, a \$218,827 effect on depreciation expense and a \$109,413 effect on depreciation reserve. The following table summarizes company and staff positions, and the adopted result.

Depreciation Expense Comparison (Intrastate)

<u>Account</u>	<u>Staff Proposed</u>	<u>Company Proposed</u>	<u>Adopted</u>
Electronic central office equipment	\$339,711	\$498,952	\$392,792
Station equipment	\$29,022	\$58,629	\$43,826

Ponderosa, in the last few years, has had to defend itself in two previous complaints on the OCMS issue. (See discussion in interim decision.) Even considering all of that, we are unwilling to trend 100% of the non-rate case expense into the future. This proceeding will eventually settle the OCMS issue, and additionally, we believe Ponderosa should make a greater across-the-board effort to control its legal costs.

The Pelavin non-rate proceeding test year estimate will be adjusted downward \$10,000.

Legal and Accounting Expenses of this Proceeding.

Ponderosa charged \$31,470 of accounting expense to this proceeding (all of it to the application) as well as the previously mentioned legal fees, for a grand total of \$72,517.

Staff does not challenge the expense totals themselves (nor is there any issue over other accounting expenses) but regards them as extraordinary and recommends a 50% disallowance plus a three-year amortization for accounting and a five-year period for legal.

Ponderosa concedes the nonrecurring nature of the expenses and proposes that the entire charge, not 50%, be amortized over two years.

Staff suggests the 50% disallowance because it believes the Gillham complaint complicated matters, as did the necessity for handling interim relief. Ponderosa points out that the "complaint" is really a rate design issue and that the hearing time would have been necessary anyway to deal with customer service problems and the demand for OCMS by Gillham and others regardless of whether a formal complaint was filed.

Staff also regards the filing of a formal application by a small telephone company for general rate relief to be an aberration created by the breakup of the Bell System, recent FCC rulings on settlements, etc. Staff points out that this is the first such

3. Service and tariff changes should be required as set forth in the Order.

4. The order in this proceeding should be effective on the date it is signed because we are already approaching the middle of the test year.

5. This proceeding should remain open for further hearings and a final order on rate design.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. Ponderosa Telephone Company (Ponderosa) is authorized to file tariffs placing into effect a total Phase One surcharge of 22%. The surcharge shall apply to all intrastate billings (but not to coin telephone rates) and shall be effective until our further order. The entire surcharge shall be collected on a "bill and keep" basis.

2. Ponderosa may revise its tariffs for company-owned PBX and KTS equipment, limiting them to equipment on hand.

3. Ponderosa shall deal with two-party service as set forth in Finding 12, and shall file an annual report with the Communications Division setting forth remaining two-party connections in which one party is a nonresidential customer.