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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of General Telephone Company of California, a corporation, for authority to increase certain intrastate rates and charges for telephone services.	Application 83-07-02 (Filed July 1, 1983)
And Related Matters.	OII 83-08-02 (Filed August 3, 1983) Case 82-10-08 (Filed October 28, 1982)

(For appearances see Decision 83-12-067.)

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THIRD INTERIM OPINION

I. SUMMARY OF DECISION

By our interim decision in December 1983 we authorized the General Telephone Company of California (General) increased surcharge rates to realize additional annual revenue of $150.5 million. Today's decision, issued after hearings on General's test year 1984 revenue requirement have been completed, finds General has justified another $4.3 million. Thus, the total rate increase authorized in this rate proceeding is $154.8 million. General originally requested a rate increase of $348 million, but following our staff's analysis General reduced its request to $208 million. Our decision reallocates the existing 21.3% billing surcharge on local exchange service rates, and the 13¢ surcharge on local calling area toll rates, into set rates for telephone services. Following is a comparison of monthly local exchange service rates showing the base rate before the surcharges imposed in 1983 and 1984, the rates with the 21.3% surcharge imposed starting January 1, 1984, and the final rates adopted today:

Present and Adopted Basic Exchange Service Rates

Los Angeles Metropolitan Extended Area Exchanges	Base Rate	Base Rate With Existing 21.3% Surcharge Applied	Adopted	% Increase Over Base Rate
Business				
1-party measured service	$ 7.20	$ 8.73	$ 9.10	26%
PBX line-measured	7.20	8.73	9.10	26
Suburban-4-party flat rate*	14.60	17.71	18.45	26
Semi-public coin station	17.50	21.23	26.45	51
Residence**				
1-party flat rate	7.75	9.40	9.75	26
1-party measured	2.80 (includes 30 5-min. units of use)	3.30 (18.0% surcharge)	5.25 (includes $3.00 of local calling usage)	(restructured)
Suburban 4-party flat rate*	6.90	8.37	8.70	26
Non-Metro Area Exchanges (without local measured service capability)				
Business				
1-party flat rate	17.20	20.86	21.70	26
PBX line-flat rate	25.95	31.48	32.70	26
Suburban 4-party flat rate*	14.60	17.71	18.45	26
Semi-public coin station	17.50	21.23	26.45	51
Residence**				
1-party flat rate	7.75	9.40	9.75	26
2-party flat rate*	6.90	8.37	8.70	26
Suburban 4-party flat rate*	6.90	8.37	8.70	26

*Party-line service will be phased out. As customers are regraded to single-line service they will be assessed monthly single-line rates.

**Lifeline service is 50% of the otherwise applicable rate. However, where measured service is offered there is a usage allowance of 30 untimed local calls, excess local calls are charged for as follows: 31-40 calls at 10¢ per call, and each call over 40 at 15¢.

We conclude that while overall General's telephone service has improved, and shows encouraging promise for still further improvement, there are customers in some areas that have clearly received inadequate service, and are entitled to refunds on a portion of their recurring monthly charges going back to January 1, 1984. Those are customers (totaling about 50,000) served by General's following central offices: Malibu, Zuma, Topanga, Ocean Park, Muscoy, Perris, and Los Alamos. Further, in view of such longstanding service difficulties in General's Kenwood exchange, those customers will receive similar refunds as well as a one-year deferral of today's rate increase as recompense for receiving poor service. Although there were some customers who complained of poor service in other areas, the evidence presented did not substantiate imposing penalties.

Starting in 1985 General may start charging customers 25¢ for calls to directory assistance for numbers within their area code; however, each month residential customers may make five calls without charge, while business customers can make two. This is the same charging program recently authorized for Pacific Bell. Our evidence shows that the average customer calls for local area numbers about five times per month, so on average many customers will not be impacted by the new charge per call. Many customers speaking at our public hearings opposed the charge plan, apparently believing directory assistance is somehow "free" today. However today, on average, directory assistance costs about $1.26 per month for each access line; customers may think directory assistance is free because today's costs are rolled into their rates. The adopted charge plan is intended to more directly recover these costs from those who cause them: the frequent users of directory assistance. In 1985 and thereafter the revenue from the charge program and the expense savings caused by overall less use of directory assistance will be used to offset other cost forces and keep all customers' monthly rates as low as possible.

The charge for a local coin telephone call, unchanged since the early 1950s, is increased to 20¢ or, for convenience, a quarter. The present 6¢ charge per 5-minute unit of local usage, where General has local measured service, is increased to 7¢. An optional unpublished directory listing will now cost 60¢ per month. The late payment penalty charge on overdue customer accounts is raised from .8% per month to 1.5%, and the returned check charge is $10. Optional Touch Calling service is raised from 65¢ per month to $1 for residential and $1.20 for business customers. These increases are adopted to assess costs on those who essentially cause them, and the increased revenues help defray increases on all monthly rates.

We are eliminating the monthly additive increments paid for basic exchange service by customers in less populated areas of General's exchanges, and in conjunction we are phasing out party line service. General now has the facilities to provide single line service in most areas. With the elimination of monthly mileage and special rate area increments the withdrawal of party line service has a small impact on customers; many undoubtedly subscribed to party line service because under the previous rate program it was a means of either avoiding, or paying substantially smaller, monthly mileage rates. These changes mean that General's customers in less populated areas can have an inherently higher grade of service (e.g., single line service accommodates a wide range of customer-owned telephone sets and optional enhancements available with Touch Calling).

We are ordering General to file tariffs with sale prices for the many categories of complex multiline terminal equipment it now leases (used by business customers) and to reprice telephone instruments used for single line (e.g. residential) service. This is to offer customers the option of purchasing their proven in-place leased equipment. Also, we are directing General to inform its customers that in 1986 rotary dial telephone sets can be used to obtain equal access to competing long distance carriers. We think customers, in weighing whether to buy their in-place dial sets, should be aware these sets are not obsolete.

The monthly rental rates for in-place single line telephone sets, key system sets and PBXs are increased to generally recognize higher monthly costs. For example, the standard rotary instrument goes from $1.15 to $1.50/month, while the push button instrument goes from $1.70 to $2.15/month.

We are authorizing rates today which will afford General a reasonable opportunity to realize a 12.74% return on its undepreciated rate base, which is slightly lower than the last authorized return. The driving forces behind the increase in General's revenue requirement are not related to the Bell System's recent breakup, rather they are increased operating costs and plant investment.

We are reducing General's revenue requirement by $6 million because it has not clearly demonstrated the prudency of its estimated expenditures for new digital central office switching equipment purchased from its affiliate, Automatic Electric, prior to our now required competitive bidding program.

General is directed to start taking steps to form a fully separated corporate subsidiary to market unregulated terminal equipment. We take this step because it is simply the best approach for ensuring, as time goes by, that General's customers do not subsidize a GTE corporate family venture into a highly competitive unregulated marketplace.

II. PROCEDURAL HISTORY

A prehearing conference was held on August 12, 1983 before Commissioner Vial and Administrative Law Judge (ALJ) Alderson. Hearings commenced on October 3, 1983 and largely concluded on January 20, 1984, with certain remaining issues addressed during April 1984. Fifty-two days of hearing were held. Opening briefs were filed on February 22 and reply briefs on March 5, 1984. Supplemental briefs on the limited topics subject to hearings in April were filed on April 24, 1984.

Our interim Decision (D.) 83-12-067 issued December 22, 1983 allowed General to increase its rates to generate $150.5 million in gross revenue, through surcharges of 13% on intraLATA toll, and 21.3% on almost all other services.

III. PUBLIC INPUT

Following are the locations where hearings were held specifically to receive public input, and the number of customers making statements: Los Gatos (18), Santa Monica (59), Santa Barbara (27), San Leandro (24), West Covina (33), San Bernardino (28), Indio (21), Long Beach (28), and Novato (7). From the 245 customers' statements, plus the correspondence received and the petitions submitted, we have some insight into the thinking of General's customers about General, telephone rates, and the regulatory process. Our summation of some of the thinking repeatedly expressed by customers is:

1. General is probably not doing everything it can to hold down its costs. Many large companies and local governments are struggling to hold down costs, but is General?
2. An increase in rates should only follow after good service is provided. Many customers think General's overall service is less than that provided by Pacific Bell.
3. General continually hoodwinks this Commission to get rate increases by promising to modernize and provide better service, and then not following through.
4. If General needs a 15% increase in revenues why does it want to raise some rates (e.g. basic service) by almost 100%; why should not all rates be increased by 15%?
5. If General had competition, and not a monopoly on providing telephone service, it would probably operate more efficiently, provide better service and, in overall terms, treat customers better.

6. The poor, elderly, and shut-ins must have affordable flat rate service because they are less mobile and rely heavily on a telephone line with the outside world. Likewise, low cost flat rate service is essential for local volunteer and community organization activities because many calls are made from residences.

Other aspects of public input relating to telephone service and rate design will be separately discussed in those respective sections of this opinion. Overall, although most customers were not familiar with the nuances and technicalities of ratemaking, they addressed legitimate concerns and issues. Particularly sobering is the skepticism many customers hold about the effectiveness of regulation to ensure the public is charged reasonable rates, and whether the public is getting full value and protection from the regulatory process.

IV. GENERAL'S PRESENT OPERATIONS AND A COMPARISON WITH OTHER TELEPHONE UTILITIES

General is wholly owned by General Telephone and Electronics (GTE) and is the second largest telephone utility in California. Whereas Pacific Bell has an average of about 300 subscribers per square mile in its service territory, General has about 375, making it the most metropolitan utility. By comparison, Continental Telephone Company, the third largest in California, has about 12 subscribers per square mile in its service territory.

Because, among other reasons, we heard from a fair number of General's customers attending our hearings that they did not think General is operating very efficiently compared to other utilities, we have compiled the following cost data for the three largest telephone utilities:

1983 Recorded

Telephone Utility	Annual Expense/ Rate Base ($000 omitted)	Annual Cost and Rate Base Per Access Line
Pacific Bell		
Maintenance	$ 2,115,303	$ 200.56
Traffic	395,908	37.54
Commercial	805,514	76.37
Gen. Office Salaries & Exp.	1,349,782	127.98
Average Rate Base	13,201,815	1,276.37
General		
Maintenance	472,718	186.55
Traffic	94,455	37.27
Commercial	179,549	70.86
Gen. Office Salaries & Exp.	308,449	121.72
Average Rate Base	3,331,346	1,314.62
Continental		
Maintenance	38,454	197.18
Traffic	16,170	82.92
Commercial	11,624	59.60
Gen. Office Salaries & Exp.	30,846	158.17
Average Rate Base	358,384	1,837.69

Note: This data was compiled by our Revenue Requirements Division from utility filed annual reports. For comparison purposes 1983 recorded data is used instead of 1984 estimated because Pacific Bell's 1984 expenses decline due to divestiture (e.g. transfer of toll offices, embedded terminal equipment, etc.).

The recent breakup of the Bell System means that General is now the largest telephone utility in California wholly owned by a vertically integrated holding company. Affiliated GTE family companies dealt with by General are:

1. GTE Service Corporation (assistance in telephone operations).
2. GTE Laboratories, Inc. (research and development).
3. GTE Automatic Electric (manufacturer-product supplier).

4. GTE Data Services, Inc. (data processing service).
5. General Telephone Directory Company (sale and preparation of directories).

Ratemaking adjustments directed at affiliated company transactions proposed by staff, to which General assented for purpose of this proceeding, are addressed later.

V. QUALITY OF SERVICE

The quality of a utility's service is an important consideration in ratemaking, for it goes to whether a utility is meeting its franchised obligation to provide adequate service and give full value to customers for the rates received. This has been an issue of particular concern with General going back to the 1960s, and staff in this proceeding recommends penalties relating to certain areas where it concludes there is inadequate service.

A. Staff's Position

Exhibit 51 contains staff's recommendations. Its witness, McCarroll, modified his originally distributed testimony by subsequently deleting some recommended penalties and adding others. In addition to addressing overall network access line service, staff's witness Singh addressed General's private line alarm service. Private line service is somewhat unique and staff's recommendations directed at that service will be addressed in the rate design discussion on private lines.

McCarroll concludes from reviewing service measurements reported by General, the results of staff's customer surveys and his field investigation that by and large service has improved in many areas. The improvement results from a combination of things:

1. Lower employee force turnover due to the recession, and ending the previous "12-month job rotation plan," have led to a higher level of employee expertise.
2. The slowdown in growth has allowed General to "catch its breath" and shift more attention from plant installation to central office maintenance and trouble shooting.

3. General is converting electromechanical central offices to electronic or digital, and there is a distinct correlation between modern switching equipment and fewer customer trouble reports.
4. Upgrading of step-by-step switches to better route toll calls through central offices and reduce call cut-offs.
5. Old outside plant is being modernized.
6. Automated equipment for trouble spotting and coordination of repair activity is being installed.

Our General Order (GO) 133 service measurement indices pose difficulty, according to McCarroll, when it comes to correlating technical performance into day-to-day customer experience and satisfaction. He notes that none of the measurements quantify transmission quality (e.g. static) or measure dead line occurrences caused outside a central office. Likewise, the dial service measurement does not capture trouble occurrences such as:

1. A wrong number whose cause is undetermined.
2. A busy signal when no one at the called end is on the line.
3. The calling party hearing the called phone ringing when it is actually not ringing.
4. Call attempts when no dial tone occurs.

McCarroll shows that dial service indices for a central office can be in the acceptable range under GO 133, while at the same time customer trouble reports exceed the acceptable range. The conclusion McCarroll reaches is that while some GO 133 measurements are useful in evaluating service, they should not be the sole criteria. He concludes that the most useful tool to measure the day-in-day-out experience by customers, of all GO 133 indices, is the compilation of customer trouble reports. McCarroll thinks this data is meaningful because it shows the extent that customers encounter enough of a problem to prompt them to call 611 (repair service).

The new penalty McCarroll proposes is deferral of a rate increase to customers in areas with consistently high levels of trouble reports. He analyzed trouble reports by central office and found seven central offices, serving about 2% of General's customers, that did not meet his minimum standards. He thinks inadequate service, which warrants a penalty, are:

1. Central offices whose customer trouble reports have been at or above the GO 133 standard level of 6.5 trouble reports per 100 stations every month between July 1982 and June 1983.
2. Central offices whose average customer trouble reports have been at or greater than 10.0 per 100 stations between July 1982 and June 1983.

Applying those standards, following are the central offices which McCarroll found were not providing acceptable service (Exhibit 51, Table 3-1):

Central Office	High-low range of reports over 13 months	Average of last 12 months	Number of months below GO 133 standard
Malibu	13.5-9.2	12.2	13
Zuma	19.8-8.3	13.7	13
Topanga	23.5-9.3	14.6	13
Ocean Park	15.3-9.9	12.2	13
Muscoy	14.1-8.9	10.3	13
Perris	13.2-9.2	10.6	13
Los Alamos	15.6-7.1	10.9	13

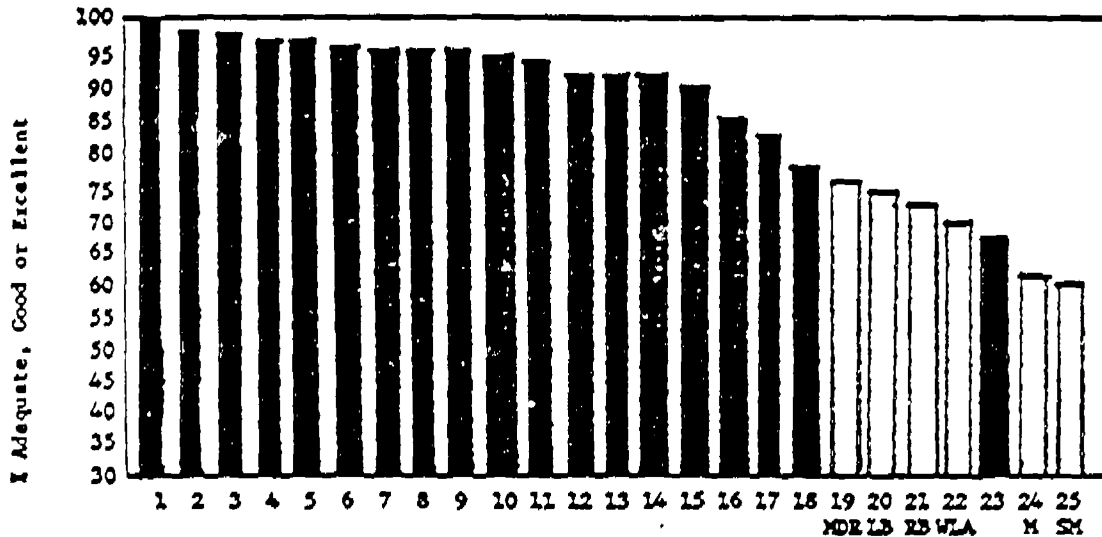
While Santa Monica did not meet McCarroll's standard, he does not include it for a penalty because service is markedly improving, which is borne out by staff's follow-up Santa Monica customer survey showing 73% think service is good or better, compared to the earlier 58%.

Staff did a mail survey of customers in coastal exchanges where five of the seven central offices with high trouble reports are located, and learned:

1. 74-83% occasionally or frequently encounter line static.
2. 32-71% " " " " a dead line.
3. 65-80% " " " do not have local calls go through.
4. 61-70% " " " do not have toll calls go through.

Staff also surveyed customers of General and 13 other California telephone utilities and its comparative results follow (Exhibit 51, Table 2-7):

CALIFORNIA INDEPENDENT TELEPHONE COMPANIES
RELATIVE SURVEY RESULTS

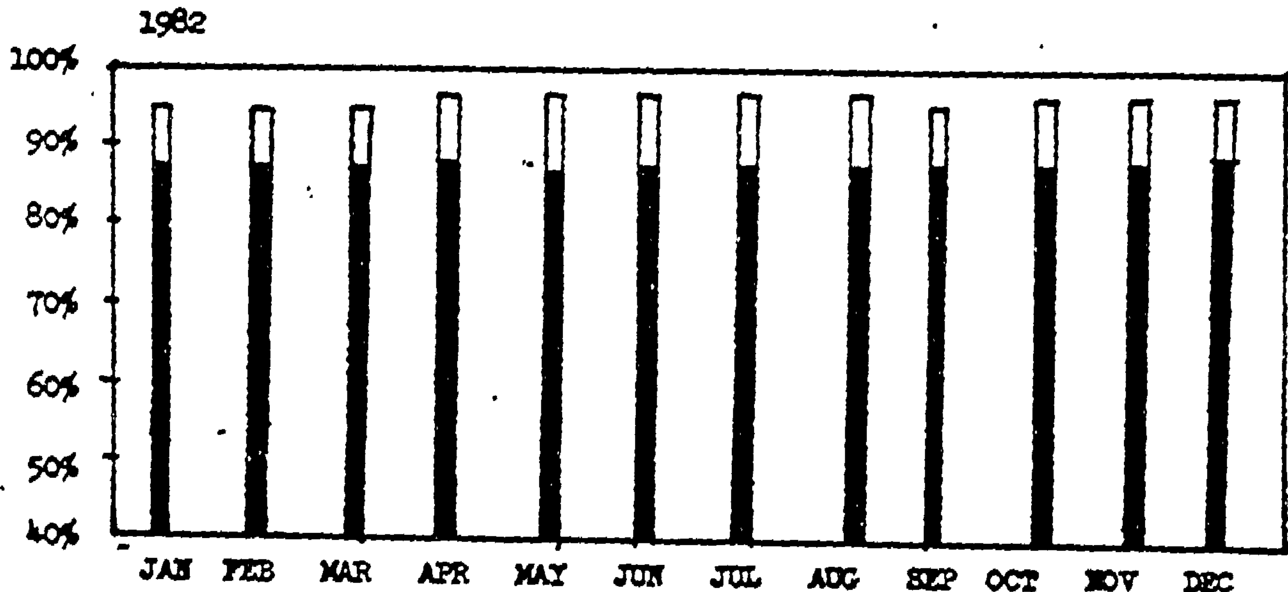


Company/Serving Area	Adequate, Good or Excellent (%)
1. Dorris	100
2. Capay Valley	98
3. Siskiyou	98
4. Volcano	97
5. CP National/Needles	97
6. Citizens/Burney	96
7. Sierra	95
8. CP National/Westwood-Lake Almanor	95
9. West Coast/Crescent City	95
10. Mariposa	94
11. Citizens/Alturas	93
12. CP National/Colusa	91
13. Citizens/Susanville	91
14. Tuolumne	91
15. Kerman	90
16. Citizens/Elk Grove	84
17. Citizens/Chester	82
18. Foresthill	77
19. CTC/Marina del Rey	75
20. CTC/Laguna Beach	74
21. CTC/Redondo Beach	73
22. CTC/West Los Angeles	70
23. Continental/Timber Cove	67
24. CTC/Malibu	59
25. CTC/Santa Monica	58

This composition represents 25 serving areas of fourteen independent telephone companies. This list is not representative of all telephone companies in California, nor is it meant to be a numerical rating of the companies. It is intended simply to show where responses for one utility fall in relation to responses from all the other utilities surveyed so far.

Staff also presented a comparison of 1982 customer satisfaction survey results from surveys conducted by both General and Pacific Bell (Exhibit 51, table 2-5):

(Solid portion of bar shows General's customers response.)



Finally staff surveyed Pacific Bell's customers in urban exchanges and found that 95-100% think service is adequate to excellent, in contrast to the 59-75% range from its survey of customers in comparable General exchanges. Results from this and the other comparative surveys must be seriously considered in ratemaking, as required by PU Code § 728:

> "In determining and fixing rates for a telephone corporation pursuant to this section or pursuant to Section 455, or in determining whether or not a proposed rate increase is justified pursuant to Section 454, the commission shall, among other things, take into consideration any evidence offered concerning the quality of the particular telephone corporation's services as compared with that of telephone corporations in adjacent territory, and the permissible rates for comparable service charged by telephone corporations in adjacent territory."

After preparing his exhibit and initially testifying McCarroll added customers served by three central offices in the Los Gatos area to those who should receive a rate increase deferral. He said that while those central offices did not meet his technical quantification of inadequate service, he would nevertheless include them. He was swayed by customers testifying at our Los Gatos hearing that many have either given up calling 611, to report trouble, or are perhaps intimidated about calling due to General's practice of initially telling customers if the trouble turns out to be caused by customer-owned terminal equipment a $55 charge will be assessed (General changed this practice in early 1984). Trouble reports for these three central offices were in a range from 4.7 to 9.5 during the first six months of 1983.

McCarroll treats the Kenwood exchange differently and recommends delaying any rate increase for one year rather than six months. The Kenwood exchange has undeniably had service problems. McCarroll concludes the central office switch installed in 1971 was relatively novel and untested, and customers unfairly had to endure for years until General finally reacted by putting in a different switch in October 1983. He thinks the new switch will be a vast improvement, but notes it is of a technology that is being phased out. He questions the long-term cost-benefit of General's decision. Sonoma County Supervisor Adams, speaking at our Novato hearing, thinks the "new" switch may well turn out to be a costly freak that will end up hard to maintain, ultimately repeating another woeful cycle of poor service to Kenwood. He supported McCarroll's recommendation that any rate increase be deferred for one year as some recompense to long-suffering Kenwood customers. Peter Gruchawka also spoke and presented a petition from 170 Kenwood customers. He said service remains poor, in contrast to Adams who said there had been a great and hopefully lasting improvement. Gruchawka also challenged General's switch selection logic. He asked for a rate increase deferral and a 15-year "rebate" for poor past service.

B. Victor's Position

Victor, an individual representing himself, testified in Los Angeles, sponsoring Exhibit 93. He concludes from his experience as a single customer that General's overall service is lacking. He thinks General's personnel are not responsive to customers' problems and that they lack overall sensitivity. It is apparent that Victor has had numerous billing questions over the past few years, and he has received the personal attention of many of General's customer relations representatives right up to the vice president level. He also concludes General's plant construction is too costly and inefficient based on an incident near his residence, where some work done for General by a contractor apparently had to be at least partially redone. Victor recommends that no rate increase be granted until General demonstrates a changed and more positive attitude.

While we regret Victor has had such a personally disappointing experience dealing with General, his evidence does not clearly show General was unresponsive. We cannot, by inductive logic, conclude even if all Victor's claims relating to the service he received were shown to be valid, that most other customers routinely have the same experience.

C. General's Position

General believes its service has improved and it is presently satisfactory. It presented two witnesses, Shultz on switching on network service, and Gasser on other GO 133 service indices and General's customer satisfaction surveys.

Schultz testified that upgrading electromechanical switches and conversion to electronic switches is resulting in better network-trunking service. He points to both General's service measurements and a rise in the percent of customers satisfied with local dial service and direct distance/toll dialing as shown by General's Tel-Cel customer survey.

Gasser testified that technological innovations are steadily improving operator services. With respect to monthly

trouble reports/100 stations, Gasser's Exhibit 32 shows improvement from an overall annual average of 7.1 in 1979 to 6.4 in 1982, with the first nine months of 1983 showing an average of 6.2. These results are a total company average, whereas staff's McCarroll stressed trouble report data for certain central offices. Gasser shows that held orders, or customers waiting for service to be installed, have declined dramatically since 1979.

Gasser points to mechanized trouble testing, computerized trouble recordkeeping, and better coordination of repair crew resources as steps that will further reduce customer trouble reports.

General gauges customer satisfaction by results from the Tel-Cel telephone survey conducted from Indiana for all GTE operating companies by Walker Research, and Gasser was extensively cross-examined by staff, TURN, and Victor about the survey's format and mechanics. He shows overall that the percent of satisfied customers, companywide, is close to General's objective. Repair service satisfaction however most notably lags from General's objective of 92%. In 1983 General has averaged 88%, down from 1982's average of 90.25%.

General's rebuttal testimony to McCarroll's recommendations was limited to McCarroll's decision to include the three Los Gatos area central offices to his list of customers who should receive a rate increase deferral. General's Los Gatos Division Manager, Oliver, sponsored Exhibit 105. It shows trouble reports are within an acceptable range under GO 133, and are steadily declining despite General's newspaper ads placed in the area encouraging customers to call 611 if they have service problems. In brief, General disagrees that Los Gatos area customers have given up calling 611, and believes that if anything these customers have been stimulated to call 611 due to General's media campaign. Oliver said General was reviewing its procedure of initially advising all 611 callers about the potential for a charge if trouble is ultimately traced to a customer-owned instrument, and he expected a change. Ultimately General did change

its practice. Finally, Oliver cites local non-General conducted surveys showing an improvement in customer satisfaction.

D. Discussion

We find that on a companywide view General's service has improved, and it appears reasonable to expect further improvement. But while a companywide view is useful for an overall broad analysis of what most customers are experiencing, we agree with McCarroll that the indicator that best captures day-in-day-out service experience of customers is reported trouble or 611 calls initiated by customers. McCarroll's approach of devising a penalty that affords relief to those customers experiencing consistently inadequate service is equitable. It is an approach we recently adopted for Continental Telephone Company (D.82-12-045 issued in A.82-01-01). McCarroll's trouble report index underlying his penalty recommendations is reasonable. Whenever consistently more than[1] 10% or more customers call 611 during a month it can, we think, be conclusively presumed customers are experiencing an unacceptable degree of aggravation and actual service difficulty.

General believes McCarroll's proposed penalties (rate increase deferrals) must be rejected because "they amount to retroactive ratemaking." We disagree. His proposal is a variation of other types of prospective penalties imposed for substandard service that existed shortly before hearings started in rate proceedings (e.g., overall rate of return penalties). Following General's logic to its extreme, we would literally have to have evidence on the results of service presented and fully tested for the period right up to the date we issued a decision, which is of course

[1] GO 133 was revised during the course of hearings, by D.83-11-062, so that trouble reports are now reported per 100 active access lines. There are always more stations, due to extensions, etc., than access lines. Thus, when viewed in terms of trouble reports per 100 access lines or customers, McCarroll's criteria of 10 trouble reports per 100 stations means actually something more than 10% of customers when reporting trouble.

impossible. Legally we are not foreclosed from being able to adopt McCarroll's recommendation.

Our reliance on McCarroll's customer trouble report approach to analyzing the adequacy of service does not mean the service measurements and reporting requirements adopted in our last decision are flawed. Rather, it means, as McCarroll pointed out, trying to measure and quantify on some objective basis what constitutes adequate service is an evolving endeavor. This is because there are many facets to what is termed "telephone service," and there is a multitude of possible causes for chronic service difficulties. General states that McCarroll's approach is unfair because while he criticizes relying on other GO 133 measurements which are taken by the utility, he goes to the other extreme of relying on a measurement that is "self-reported by customers." But General misses McCarroll's point, which is that other indices by their nature, regardless of who takes them, are not nearly as likely to capture and quantify customers' service difficulties. Unfortunately, we lack and may never have the conceptually perfect overall service measurement. Drawing conclusions about service quality requires informed judgment based on a number of different yet interrelated factors.

General's reliance on total company GO 133 measurement results is encouraging that service is improving overall, but we do not find it a persuasive response to the specific plight of customers served by the seven central offices listed by McCarroll. We cannot place much weight on General's Tel-Cel survey results because: (1) Gasser could only very generally describe the survey's mechanics; (2) the survey samples are too small to produce results that can be afforded weight for our purposes; and (3) the Tel-Cel survey results were averaged companywide, which can gloss over specific or isolated prolonged trouble areas.

Despite the findings of staff's surveys that General's customers are not as satisfied with their service as customers who

are served by other California utilities, we think there is encouragement that things are getting better. Fewer customers appeared at our hearings for public input with details about prolonged aggravated trouble, and it appears General's service improves dramatically with central office modernization (although we note customers served by smaller utilities using only older electromechanical switching appear more satisfied with their service). The technological innovations to be instituted throughout General's service territory can only improve things; however, we think companywide dedication and committment to providing good service, from the very top down to the newest craft worker or operator, is the pivotal factor.

It is clear from customers' comments that they are frustrated because General has proceeded at a slower modernization pace than Pacific Bell. In essence they ask: what have been GTE's priorities and where have dollars from past rate increases gone? Two of our staff's witnesses, Strahl and McCarroll, point out General's central office conversion program has gone at a slower pace than it had to, primarily due to General's and/or the GTE corporate family's decision to use only Automatic Electric manufactured equipment. This is discussed more later.

While we will adopt McCarroll's recommended penalty for seven central offices, we will not adopt it for three Los Gatos central offices of Mountain, Montebello, and Blossom Hill. While he was swayed from testimony in Los Gatos that many customers have given up calling 611, we can find no basis to believe General's customers in Los Gatos, in aggregate, will have any different 611 calling patterns or practices than those in, for example, Malibu or Topanga. Trying to second guess customer thinking and psychology by region, and to rely on our guessing as a basis for deciding whether to impose a penalty, is too subjective. Just as we adopt McCarroll's recommended penalty directed at seven central offices because of his standard is quantifiable and objective, we reject the different

approach he applied to the Los Gatos central office because it is not based on a consistent quantifiable standard.

Staff's recommendation to keep in place the service measurement reporting program ordered in General's last rate decision, which can trigger a surcredit, will be adopted with staff's proposed modifications. The modifications to the previously ordered program are:

1. Instead of reporting customer trouble reports and dial service indices on all central offices General will be required to report on only the 43 listed on pages 1-6 of Exhibit 51.
2. A surcredit of $3.80, rather than $1.40, shall apply to each access line served by a central office when in 2 of any 3 consecutive months customer trouble reports per 100 lines is 10 or more and likewise, but not necessarily within the same two months, the dial service index is less than 97%.
3. General can discontinue submitting quarterly reports of the 17 indices mandated in D.92366.

These modifications will streamline General's reporting and eliminate its filing data that is no longer useful, and make the surcredit trigger tied to trouble reports per 100 stations more lenient in the sense its goes from eight to ten (however, 10 is consistent with the penalty adopted in this opinion). But the surcredit trigger works if the adopted indices are exceeded any two of three consecutive months, instead of two of three months within a given quarter, and the potential surcredit amount increases. We will delegate removal of central offices from the surcredit penalty program to our staff when the measurements for both indices for a particular central office are within the GO 133 reporting level for at least six consecutive months.

Having adopted staff's recommended penalty of a rate increase deferral for customers served by seven central offices, when should the increase deferral time period start running? The options are from January 1, 1984, when the partial increase was granted to

when the rates authorized by this decision became effective, or from today (we made the partial increase subject to refund to preserve the option). On balance, we conclude refunds are appropriate, primarily because January 1, 1984 until today's new rates are effective is a period in closer proximity to the months of unacceptably high trouble reports upon which the penalty is directly premised. Our interim decision made rates for these customers' "recurring monthly charges" subject to refund, and imposed a 21.3% surcharge. However, 34.8% of the overall $202,948,000 revenue requirement spread to produce the total 21.3% surcharge on basic exchange service was related to an earlier surcharge for 1983 attrition (Appendix A to D.83-12-067). Thus, 65.2% of the 21.3% surcharge shall be refunded.

We will treat the almost 1,000 Kenwood exchange customers differently, and order refunds and the prospective 12 month-rate increase deferral recommended by McCarroll. This step is taken because their service problems were so acute over such a prolonged period.

We put General on notice that at our direction the Commission staff will continue to monitor the problems related to switching equipment in the Kenwood exchange. The necessity for such monitoring is underscored by the updated survey materials recently transmitted to the assigned Commissioner by Sonoma County Supervisor Adams. Supervisor Adams contacted 300 constituents in a follow-up survey, to gather information about improvements in service following General's replacement of central office switching equipment in October 1983. In his June 22, 1984 letter to Commissioner Vial, Supervisor Adams enclosed 92 survey replies indicating that Kenwood exchange customers continue to complain of service problems (heavy static, busy signal when not in use, etc.), despite the recent change in central office switching equipment. In view of this response, Supervisor Adams recommended that no rate increase be granted to General without the vast majority of these problems being permanently resolved. He also stated that the Commission should penalize General

with a two-year deferral of rate relief, or alternatively, a one-year deferral with two months added for each month General has not provided adequate service since the temporary switch was installed. Supervisor Adams' letter and its enclosures will be inserted in the correspondence file in this proceeding, for use by the staff and interested parties in further analyzing the Kenwood situation. Should staff's independent follow-up analysis reveal that the problems outlined in Supervisor Adams' survey results are continuing in the magnitude reported, we will expect the staff to present a recommendation in General's 1985 attrition proceeding regarding the appropriateness of extending the one-year rate increase deferral authorized in today's decision for Kenwood customers.

General will be allowed a maximum of 90 days to make the refunds, which can be made either by billing credit or check at General's election.

At the direction of our ALJ, staff investigated the ease of telephone access by customers to General's business offices, where billing questions are handled, and repair service. Several customers attending the hearings complained of receiving no answer or long holding times. Staff's investigation found no acute problems, and it concludes new operating efficiencies by General will result in better customer access.

VI. RATE OF RETURN

The primary point of contention raised by the rate of return recommendations of General, staff, and City of Los Angeles (LA) is the cost of equity. We think the most accurate capsulation of how a reasonable rate of return is determined was made by LA's witness, Kroman:

> "The rate of return process inherently is one of exercising judgment. Even those who use a formula, they have to exercise judgment as to what formula they will use, and then they exercise judgment as to what numbers they will put into the formula. The entire process is one of judgment." (Tr. Vol. 23, p. 2221.)

Following is our summary of the parties' positions and our analysis underlying the adopted rate of return.

A. Return on Equity

General's Position

General requests a return on equity of 18% to 19%. Three witnesses testified on its behalf: its Treasurer, O'Rourke; a first Vice President with Dean Witter Reynolds, Inc.'s Regulated Industries Finance Department, Hollister; and Dr. Vander Weide, a professor of finance from Duke University.

O'Rourke, as the other witnesses for General, believes investors are not convinced that interest rates will remain relatively low, from recent historical peaks, and that concern plus new risks facing all telephone utilities dictates at least an 18% return on equity, up from the 16.5% return on equity last found reasonable for General in April 1982. The new risks cited are those posed by increasing competition, and how regulators may react to the dilemmas caused by more competition. It is harder to forecast demand and plant requirements with a market that may shift due to competition, according to O'Rourke, and this increased likelihood of either overbuilding, with resulting stranded investment, or underbuilding and having an acute shortage of plant. Much of the

uncertainty about local telephone utility revenues relating to the toll market alluded to by O'Rourke has been resolved for intrastate service, but it remains with respect to interstate toll. The increasing regulatory risk O'Rourke sees investors being concerned about comes primarily from more and more pressure on regulators to keep rates as low as possible, perhaps at the expense of shareholders. Also, he thinks investors perceive the pace and responsiveness of the regulatory ratemaking process as too slow, and results potentially inadequate. Finally, he cites discrepancies between authorized and recorded or realized returns as a factor, the fault of regulators, discouraging investors. O'Rourke selected data and applied three tests to arrive at his recommendation: The Discounted Cash Flow (DCF) method, the risk premium method, and a financial integrity test arriving at a pretax interest coverage to keep an "A" bond rating. While we are very familiar with both the DCF and risk premium methods, as discussed later, O'Rourke's financial integrity test disclosed that a return of equity of 16.5% to 19.6% would be required to, under his assumptions, produce a 3-3.5 pretax interest coverage ratio.

Hollister stresses that the disparity between authorized and realized returns greatly concerns investors and it erodes General's financial integrity. He develops, in Exhibit 8, different scenarios of future financial integrity, and ratios of book to market value of General's stock, based on different returns of equity. He must, of course, deal with surrogate stock investors as General's stock is not publicly traded and is wholly owned by GTE. While noting the 17.4% return of equity granted Pacific Bell in 1981 was a step in the right direction, Hollister repeatedly stressed that utilities must realize authorized returns. To facilitate this he suggested balancing account ratemaking for telephone utilities, and testified if General is not given balancing account assistance to realize its authorized return, then 1% or 2% should be added to the 18%-19% return which would otherwise be reasonable. When asked, as a

utility stock analyst, how he determined if a utility's not realizing its authorized return is primarily the fault of its management or the regulatory commission, he conceded it was extremely difficult. He said business acumen and diligence by management could be a factor, but in his judgment most utility companies are well managed.

Professor Vander Weide, who has extensively testified for utilities in rate proceedings, thinks investors' recent bout with high inflation and interest rates will affect their attitudes and expectations for a long time. New risks, from the investors' standpoint, cited by Vander Weide, are analogous to those listed by O'Rourke, but he summarizes by saying that investors thinking of a telecommunications company equity investment will, more and more, instead invest in companies that are unregulated and which stand a better chance of realizing higher returns. To arrive at his recommended return Vander Weide used the DCF and "spread test" method. The spread test method is studying comparable yields to bond and stock investors over time, and projecting the spread or premium necessary to predict a future return necessary to attract equity investors. He concluded the equity investor expects a spread of 5-6.5% over General's paid yield on its bonds, and assuming any new bond yields of 13-13.25%, a return on equity of at least 18% results.

Staff's Position

Staff, through its witness Mowrey, recommends a return on equity of 15-15.5%. Approaches used by Mowrey to arrive at his recommendation include a DCF analysis, a risk premium analysis, and considering the interest coverage various returns could produce. Mowrey's risk premium and DCF analysis used, for comparable companies, 20 selected electric utilities (because General's witnesses used electric utilities in their respective analyses) and five publicly traded telephone companies relatively close in size to General. Electric utilities, Mowrey notes, can be used for comparison purposes because, while the industry may have some different characteristics, they compete with telephone utilities for

equity investment. Mowrey's risk premium analysis over 1973-82, using comparable company averages as a surrogate for General's stock price (since it's not publicly traded) produces a premium of 2.65-2.56% if data from 1981-82 are excluded, and 2.22-1.82% if they are not. He would exclude 1981-82 data because in those years bond yields hit extraordinary highs. Thus, he concludes that assuming General's new bonds will cost 13%, a return on equity of about 15.6% results. His DCF analysis shows that investors require total returns of about 15-15.5%. Interest coverages, including short-term debt in General's capital structure, that could result from the 15.25% midpoint return recommended by Mowrey are 3.51 before taxes and 2.25 after. If, as in prior decisions, short-term debt is excluded from the capital structure the pre-tax coverage becomes 3.72 and after tax it is 2.39. The 2.39 after tax coverage is, Mowrey concludes, comparable to the average after tax coverage of 2.47 implied from our rate of return decisions for General from 1971-82.

City of Los Angeles

Kroman recommends a 15.2% return on equity. Much of his testimony addressed inherent subjectivity and shortcomings of using the DCF and risk premium formulistic approaches to justify a return. He thinks such approaches, which seek to develop the expectations of investors, are clothed in the language of scientific rationale, yet are fraught with subjectivity. The disparity of DCF results, for example, of General's witnesses and Mowrey was mentioned to illustrate his point. Kroman thinks his 15.2% return is fair because it recognizes General has a higher equity ratio and less corresponding risk than when we last set its return at 16.5%, it reflects a climate of lower interest and inflation rates, and it is commensurate with returns authorized for "principal" telephone utilities. Whereas Mowrey and General's witnesses used electric utilities in their analyses, Kroman does not. He believes electric utilities are not comparable because they face more risk than telephone utilities due to developing nuclear plants and from having

a far greater portion of financial statement earnings coming from funds used during construction in connection with power plant projects. He lists in Exhibit 81 the average returns on equity granted to Bell System companies in 1981-82, which is 14.75%; the corresponding average return granted GTE companies over the same period is 15.25%. Changes in the economic climate since our last rate decision to September 1983 (about the time General's rate of return witnesses testified), which are both snapshots in time, was illustrated by Kroman (Exhibit 81, Table 28):

	On or about	
	April 6, 1982	September 2, 1983
Prime Interest Rate	16.5%	11.0%
Discount Rate	12.0%	8.5%
Federal Funds Market Rate	16.80%	9.44%
Three-month Treasury Bills	13.399%	9.28%
Six-month Treasury Bills	13.243%	9.53%
Bankers Acceptance, 90 days	14.30%	9.55%
Certificate of Deposit, 6 months	14.10%	10.10%
Small-saver Certificate Rate	14.30%	10.65%
Money Market Funds, 30-day Yield	13.5%	8.74%
Moody's Corporate Bond Composite	15.71%	13.04%
Yield on Newly Issued "A" 30-year Utility Debt	16.3%	12.875%
P/E Ratio, Moody's 24 Utilities	5.8	7.62
Yield, Moody's 24 Utilities	11.91%	10.66%
Inflation Rate (CPI)	7.7%	2.4%

General's Rebuttal Showing

After the rate of return witnesses initially testified we issued our decision in Pacific Bell's rate proceeding, granting it a 16% return on equity. In January, General's O'Rourke and Vander Weide gave rebuttal testimony which, as noted by staff counsel at the time, was largely in response to our decision, explaining why General has more risk than Pacific Bell (Mowrey had testified risk to Pacific Bell and General, all things considered, is about the same). O'Rourke cites General's lower bond ratings, Pacific Bell's being relieved of embedded and potentially prematurely obsolete terminal equipment, and General's lower equity ratio as prime examples of higher risk.

Both of General's rebuttal witnesses think Mowrey and Kroman, by not giving more weight to risks posed by competition, "are refusing to face up to the realities of today's rapidly changing telecommunications industry environment."

O'Rourke thinks Mowrey's reliance on after tax interest coverage is misplaced, because O'Rourke understands that bond rating agencies disregard it as a potentially misleading measure of financial integrity, and look instead at expected and achieved pre-tax coverages.

B. Discussion

Extensive cross-examination was directed among the parties at each other's selection of comparable companies, averaging periods, and other inputs used in connection with the various formulistic-academic model approaches for deriving an equity return. Kroman's testimony, Exhibit 80, highlights well our observations about the pitfalls of placing heavy reliance on quantitative analysis techniques, and it comports with our conclusions in D.83-12-068, issued December 22, 1983 in A.83-12-48 (Pacific Gas and Electric).

The DCF model requires a lot of judgment about input data. Vander Weide, for example, used ten electric utilities and only three telephone utilities as comparable to General, and even assuming that selection process was perfect, the DCF analysis applied to the electric companies was a range of 15.1% to 21.6%. That is a broad range. For the three telephone utilities it was 16.2% to 19.2%. O'Rourke used 23 comparable companies, all electric companies but for one telephone company, and that telephone company, Continental, was not one of the three Vander Weide used. Finally, staff's Mowrey used yet another mix of comparable companies. Once a group of comparable companies is adopted, estimates of future sustainable dividend growth and the appropriate dividend yield must be derived, and the witnesses used varying approaches. To be brief, given the vagaries inherent with the DCF we cannot rely on it, although we note of the three DCF models developed staff's seems the most objective.

Different inputs and approaches were used for the risk premium analysis. The comparable companies and historical periods used to arrive at a "spread" of equity yields over bonds are pivotal to the result. Utilities, of course, like a big spread and ratepayers, if the question were put to them, would prefer a small one. We think, generally, staff's model is more objective, except excluding completely 1981-82 from the averaging period is too extreme. As General's witnesses all point out, investors have probably not forgotten the extreme volatility in interest rates over that period, and they may wonder for some time if it could recur. Mowrey's exclusion of 1981-82 recognizes that the realized premiums are probably an anomaly; however, if we were to adust staff's model, we are not sure what empirical assumptions we could use instead which would give us enough comfort to rely on the risk premium model. The greatest inherent drawback with simply relying on the risk premium model is the tendency of those who propose it to use a long-term average spread when interest rates are relatively low, and an extremely short-term average when they are high, thus producing returns that can fluctuate and which are reactive to short-term conditions; whereas, in ratemaking we strive to arrive at a reasonable estimated cost of service, including rate of return, as the basis of prospectively setting rates over a future period.

The proposed use of interest coverage ratios as a basis of determining a resultant return on equity is also not convincing. While we are interested in considering, among other things, interest coverages in our deliberations, we note that interest coverage imputed or realized, before or after taxes, is just one of many factors the various bond rating agencies consider. If we were to place primary reliance on coverage ratios, and what people tell us the rating agencies will require, we would essentially be abdicating our determination to a panel of rating agencies or, more likely, to experts telling us what they think the various rating agencies probably think.

What we primarily look to in arriving at a return are: Overall economic conditions, the range of returns prevailing for comparable companies, and the relative risk inherent with the particular utility. Weighing these considerations we arrive at an equity return that can fairly compensate investors and attract new capital.

General's witnesses and its brief extensively addressed its risk as an equity investment. It contends that General cannot be aggregated with other companies to assess risk, and that on balance its risk today is about the same as in 1978. Staff and Kroman disagree. Staff counsel points out that Exhibit 4, Standard & Poor's July 11, 1983 "Credit Analyses" that raised General from a BBB+ to an A bond rating, "...Could well serve as a succinct rationale" for staff's assessment. Standard & Poor's summary, from Exhibit 4, is:

> " Rationale: Ratings on General Telephone of California's first mortgage bonds are raised to 'A' from 'BBB+', and on outstanding debentures and preferred stock to 'A-' from 'BBB'. The 'A-2' commercial paper rating is affirmed. With the recent forgiveness of most of a potential $469 million tax liability by act of Congress, a very large financial uncertainty has finally been resolved. Recent rate relief should help restore interest coverage to stronger levels, while lower interest rates and management efforts to reduce high embedded debt costs and leverage should also prove beneficial. The company's parent, GTE Corp., provides support in the form of frequent common equity infusions. Although capital outlays still remain high, improved depreciation has bolstered internal cash generation, curtailing the need for frequent debt financings. Outlays reflect an aggressive modernization program, which management hopes will continue to resolve service problems and enhance competitiveness. The company has recently met or exceeded all service levels established by the California Public Service [sic] Commission. Operations had been hampered by heavy growth demands in the past, but the recent recession reduced this pressure, providing

> for concentration on electronic conversion and increases of outside plant margins. Although the recent final judgment, entered into by the Department of Justice and GTE Corp., requires that General Telephone of California and all GTE telephone operating companies establish exchange areas and provide equal access by the end of the decade, these requirements are not expected to burden financial well-being."

Kroman's recommended equity return of 15.2% and staff's range, 15.00-15.50%, are much closer to being reasonable than General's 18-19%. Just because telephone utilities do not have balancing account ratemaking we cannot conclude, as Hollister does, they face more risk than electric utilities; nor can we conclude General is riskier than Pacific Bell only because General has a lower equity ratio. Also, in one sense General faces less risk than Pacific Bell because although being smaller, General has the financial security of a large parent; and this is not a one-way street only benefiting General, because the vertically integrated GTE corporate family has in General a market for the many goods and services its affiliates offer. We cannot ignore this reality, and the mutual economic benefits that result for GTE's shareholders, as we derive a resonable return on equity. Telephone utilities are not subject to the commodity cost volatility energy utilities are, which led us to balancing account ratemaking for energy utilities, and they face far less uncertainty connected with recovering plant construction costs. General's equity ratio is subject to its parent's control, and it would be unfair to reward it for a relatively low equity ratio by correspondingly increasing the return. Since the last rate increase, when we reviewed General's return, it has been settled that cash flow benefits stemming from tax deferral, tax credits, and the short-tax write-off period allowed by ACRS (five years on new plant) will largely accrue to General. Likewise, General faces small risk of having any stranded CPE investment as the adopted 3.5 year average remaining life for station

apparatus used in connection with test year depreciation expense means about the time embedded CPE is deregulated, probably in late 1987, General will have had most of its capital investment returned. Any additional business climate risk for General, when counterbalanced against more opportunities on the horizon resulting from structural changes in the telecommunications industry, is extremely hard to quantify. In our view, the high end of the staff's range adequately recognizes the difficulty of precisely quantifying this business climate risk, particularly in view of our recent decision on intraLATA toll competition.

Carefully weighing these considerations we conclude that a reasonable cost of equity is 15.50%.

C. Cost of Debt, Capital Structure, and Rate of Return

Parties essentially agree on the cost of debt and the capital structure. We will adopt staff's estimated end of 1984 capital structure and, aside from common equity, we will adopt General's estimated cost factors. Weighting costs to the year-end capital structure components we derive the authorized 12.74% rate of return to be applied to test year rate base:

Component	Ratio %	Cost Factor	Weighted Cost
Long-term Debt	48.1%	11.00	5.29
Short-term Debt	3.2%	10.00	.32
Preferred Stock	5.4	7.77	.42
Common Equity	43.3	15.50	6.80
Total	100%		12.74%

We will authorize a 12.74% return on rate base, which is slightly less than the last authorized return of 12.78%.

VII. ACCOUNTING CHANGES AND STAFF'S PROPOSED $4.3 MILLION PENALTY FOR GENERAL'S NON-COMPLIANCE WITH PRIOR COMMISSION DECISIONS

A. Staff's Recommended Penalty

Two staff accountant/auditors testified on the results of their audit of General's books and records (Exhibit 34, Chapters 4-6, and Exhibit 56). They made a number of recommendations, some of which were to be used by other staff members making recommendations on specific test year expense categories, and some of which are essentially proposed changes to the way General books or records costs and transactions (called accounting changes). Because the auditors believed some of the accounting changes now recommended had been ordered previously by this Commission, and ignored by General, a $4.3 million penalty to General's revenue requirement is recommended.

None of the accounting changes were clearly and expressly ordered, for prospective application, in the ordering paragraphs of the decisions cited. Rather, a review of the decisions shows that in the body or text of the opinion test-year ratemaking adjustments were adopted that at least in part were premised on accounting treatment proposed by staff auditors. Thus, the question becomes whether the accounting changes under discussion were ordered for implementation by General. Both auditors testified that other utilities, given the same type of direction, would have changed their accounting practices. They conclude General was "grossly negligent" for not complying. They testified that after a general rate decision is issued which adopts staff proposed adjustments premised on accounting changes there is, due to limited staff resources, no immediate staff follow-up to see that the utility understands it is to make changes in its accounting, and that those changes are implemented.

We will not impose the penalty, although it was probably intended in the past decisions that the accounting changes be implemented. Some room for misunderstanding arguably existed, given the manner in which the accounting practices were dealt with in our

decisions. Our auditors were correct in bringing the matter to our attention, for we can understand their frustration at time seemingly wasted in making the same recommendation over and over in rate proceedings, only to have them "adopted" then ignored. Several steps can be taken to ameliorate this situation: First, staff's audit report should very clearly and separately identify changes in a utility's accounting practices or memoranda record keeping that staff wants ordered for prospective application; second, if accounting changes are directed, from staff's reading of our decisions, the auditors should notify the utility in writing and follow up to ensure accounting has changed. Finally, we will try to be more specific addressing the accounting recommendations of our auditors, particularly by covering them in the ordering paragraphs of our decisions.

We put General on notice, however, that if in future decisions we adopt ratemaking adjustments which stem from underlying accounting changes, regardless of whether ordering paragraphs or text clearly direct a prospective change, the accounting change will be conclusively presumed to be ordered. Unfortunately, given the many issues involved in a general rate proceeding, it is possible some will not get specifically addressed, and we think, given the expertise of General's regulatory and accounting departments, it can easily determine which adopted adjustments were premised on a different accounting treatment.

B. Recommended Accounting Changes

General does not record interest during construction (IDC) for specific projects in its memorandum records for short-term construction work in progress, thus when the plant is ultimately retired there is no corresponding retirement of a portion of IDC. The result, staff contends, is that $6.3 million of memorandum IDC has built up since 1975 which should now be retired. General told staff that the IDC on short-term projects is recorded separately from the plant from which it is computed, so as plant is retired there can

be no IDC retirement. The auditors propose a formula whereby IDC on the memorandum records would be retired at the same rate plant is retired. Staff's formula approach is reasonable and goes far toward keeping the IDC on memorandum records substantially in line with the underlying plant. General will be directed to retire $6.3 million of IDC as of December 31, 1982, and to apply staff's formula to retire IDC between then and now, and prospectively.

Staff auditors found about $4.6 million charged to materials and supplies which, as of the end of 1982, General had not been billed for by its suppliers. The auditor, McCarthy, believes if a vendor has not billed General within one year from the transaction "it is unlikely that any bill will be received or any payment will be made." Her analysis is sound. General will be ordered to exclude uninvoiced receipts more than one year old from materials and supplies for ratemaking purposes. Staff brought this up in two prior rate proceedings, and it is clearly time for the overstatement of materials and supplies to cease.

General's materials in progress of fabrication account records the cost of equipment fabricated by its employees, but staff found work orders inactive over 1½ years (totaling $156,000). It recommends that these inactive work orders, for projects General could not identify as completed or abandoned, be written off to extraordinary income charges. This recommendation is adopted, and we will direct General prospectively to write off all work orders that are inactive for one year to extraordinary income charges, both on its books and for ratemaking purposes.

A vendor billing discrepancies account is used by General to record vendor billings when payment has been made but the supplies have not been received. While General has a system so that most vendors are not paid until invoices are reconciled with purchase orders and the supplies are received, it is less circumspect in dealing with billings from its affiliate, Automatic Electric. General will pay its affiliate before received supplies are

reconciled to a purchase order. Staff believes the resulting build-up of discrepancies due to General's method of paying its affiliate inflates working cash; so, it recommends a $275,000 adjustment to working cash for pre-1982 billing discrepancies because the changes could not be verified or substantiated, and that we order General to process payments to Automatic Electric the same as those to other non-affiliated vendors. This recommendation is reasonable, and we will direct General to establish a purchase order verification system for making payment to affiliates within 90 days after today's order.

Staff auditors found that in 1982 General received a $1.6 million premium refund from its medical insurance carrier because of favorable claim experience, and credited it below the line to miscellaneous income. They believe any future refunds should, instead, be a credit to the relief and pensions account. We will adopt staff's recommendation, noting however that the portion of any refund that can be clearly allocated to unregulated operations may be credited below the line.

General, the auditors believe, should comply with past Commission decisions, and usual accounting practices, and capitalize a portion of managerial salaries to construction. While doing this previously, General stopped in 1978. In addition to a ratemaking adjustment to realign expense and rate base in the test year, staff wants General ordered to continually allocate general office salaries of "managers and above" to construction both on its books and for future ratemaking. This recommendation is reasonable and we will order the change.

Staff's auditors found that General had been accruing IDC on work orders financed by customer "advances in aid of construction." Staff recommends that General be ordered to stop this practice, and to deduct the advances account balance from its rate base. These recommendations are logical and will be adopted.

The auditors recommend that General be ordered to reclassify the plant additions made to accommodate the 1984 Olympics

to the physical property account "until definite plans are developed for their future use." We will order the reclassification. It is consistent with the other ratemaking adjustments for 1984 Olympics related expenditures recommended by staff and accepted by General. The test year adjustments are covered in the staff's test year results of operations and adopted.

General proposes to reclassify $76 million of embedded company-used station apparatus and large PBXs to Accounts 261 (office equipment) and 221 (central office equipment), and to amortize $22.8 million of "minor item" plant over five years. An order in an FCC docket is the basis for General's request. Our auditors point out that the FCC order General cites allowed new company equipment (installed after January 1, 1983) to be charged to different accounts, but left the issue about embedded equipment to subsequent decisions. So, we will not allow this accounting change now. The $22.8 million five-year amortization relates to an FCC order allowing the level of minor item costs that can be expensed to rise from $50 to $200. Staff believes General's view of the FCC order allowing a five-year write-off of capitalized minor item expense (relating to company-used station apparatus) is too broad, because: (1) The FCC said the expensing of capitalized investment should not be made to accounts with a "large investment"; (2) Station apparatus is not, given its inherent interrelationship with common and switching equipment, a minor item such a tools and furniture, as contemplated by the FCC; and (3) General is not expensing items of station apparatus costing $200 or less in other accounts (e.g. CPE).

The FCC's final order addressing these accounting changes was issued November 1, 1983. It set up a new account for company-used station apparatus, called "other communications equipment" (Account 262), but did not establish an amortization period. In view of the FCC's order, and the rationale behind staff's recommendations, we will order the following:

1. General shall include both embedded and new company official business telecommunications equipment in new Account 262.
2. General and other telephone utilities will be authorized to expense minor items having a total cost of $200 or less on an ongoing basis, starting January 1, 1983, and to amortize this category of previously capitalized investment over five years. Company-used telephones that are part of an intrasystem (e.g. with PBX, centrex or key systems) shall not be expensed.
3. General's request to reclassify company-used PBXs and station apparatus to furniture and office equipment, and central office equipment, is denied.
4. General's request to amortize $22.8 million of company-used station apparatus over five years is denied.

When General proposes remaining lives for company-used other communications equipment (new Account 262) it shall do so with a separate study recognizing the different and lighter use this equipment receives compared to when it is installed on customers' premises. Also, in view of General's steady loss of centrex customers it appears logical that there could be unused centrex capacity, which would obviate the need for purchasing new PBXs for intracompany communications system. When General submits its depreciation studies in connection with Account 262 it shall include an analysis of whether vacant centrex capacity could have more economically been used in lieu of new PBXs; if it turns out General bought new PBXs from its affiliates instead of using vacant centrex capacity, resulting in higher costs, we expect our staff to address the matter in the next rate proceeding.

The auditors are critical about General's management, concluding from their investigation that management should do more thorough analysis before launching into new programs. The example they cite in Exhibit 56 involved General's endeavor over 1980-82 to find a system for computerizing customer information, which would

enable easier and faster retrieval. A decision was reached in 1980 to use a system, but apparently without careful analysis of hardware, software, or personnel requirements. About $5 million was wasted because ultimately the initial system was dropped in 1982 and General started with another one. From the staff's engineers and General the auditors satisfied themselves that the costs related to the abandoned system were excluded from the test year estimates. This matter was raised by the auditors because they apparently want us to order General's management to be more diligent and analytical when evaluating alternatives. However, we will not order management specifically to do that which we and shareholders normally expect, which is to the extent possible to exercise due diligence to investigate and plan well to minimize costs. Enforcing such a broad order would be extremely challenging. Rather we will rely on our ratemaking process to consider management's operating efficiency and, of course, make ratemaking adjustments when it is not demonstrated estimated expenses are reasonable.

VIII. RESULTS OF OPERATIONS - SUMMARY OF EARNINGS

Our ratemaking entails adopting an estimated results of operation for a utility that covers a prospective year of normal operation, called the test year. The task is definitely more challenging in times of fluctuating inflation. Fortunately inflation has recently subsided. We think it bears repeating that our adopted test year results of operation is intended to provide a utility, such as General, a reasonable opportunity to realize its authorized return. We cannot guarantee it will earn the authorized return. And, indeed, we should not guarantee it, for we would foster complacent uninnovative utility management. When our adopted test year summary of earnings is ultimately viewed in hindsight it would surprise us if General did not spend more in some areas than we estimated, and less in others. But that is ratemaking. We hope General can in fact spend less than we estimate, through vigorous

management and innovation, because the benefits will accrue to both General and its ratepayers; in the short run General's profits can increase and in the long run the savings can be recognized in future ratesetting.

General has essentially accepted the staff's estimated test year results of operations with the exception of certain rate base issues and rate of return. The resolution of the contested rate base issues can affect other components of the results of operations, most notably test year expense for depreciation and income taxes, and toll revenue which is subject to division with other telephone utilities. Our adopted results of operations table reflects all adjustments to the staff's estimate stemming from our resolution of contested issues.

Following is our adopted separated summary of earnings for the test year, which in addition to total intrastate results at present rates, shows a breakdown by the following classes of intrastate service: message toll, private line, and local exchange service.

Adopted Summary of Earnings
Total Company and Separated
Intrastate
Test Year 1984
(Thousands of Dollars)

		Total	Inter-	---Intrastate---				
		Company	state	Total	Total Toll	MTT	PL	Exchange
	OPERATING REVENUES							
1	Operating Revenues	$2,127,171	$440,693	$1,686,478	$790,416	$762,489	$27,927	$896,062
2	LESS: Uncollectibles	38,517	11,493	27,024	18,018	18,018	0	9,006
3	Revenues after uncoll.	2,088,654	429,200	1,659,454	772,398	744,471	27,927	887,056
4	ADJ: FCC Accntg. Chg.	363	108	255	207	199	8	48
5	ADJ: Depr. Mtd.	1,251	402	849	702	674	28	147
6	Total	$2,090,268	$429,710	$1,660,558	$773,307	$745,344	$27,963	$887,251
	OPERATING EXPENSES							
7	Maintenance	$489,809	$98,055	$391,754	$199,524	$190,255	$9,269	$192,230
8	Traffic	103,488	17,593	85,895	44,603	44,500	103	41,292
9	Commercial	193,676	23,435	170,241	50,162	49,387	775	120,079
10	General Off. Sal. & Exp.	130,891	18,342	112,549	58,759	57,509	1,250	53,790
11	Other Operating Expense	194,102	35,822	158,280	77,896	75,493	2,403	80,384
12	ADJ: Management Pay	(8,142)	(1,449)	(6,693)	(3,061)	(2,956)	(106)	(3,631)
13	Subtotal	1,103,824	191,797	912,027	427,883	414,189	13,694	484,143
14	Depreciation Expense	435,272	79,285	355,987	170,866	164,082	6,784	185,121
15	Property & Other Taxes	49,626	9,148	40,478	19,197	18,343	853	21,281
16	Payroll Taxes	42,353	7,962	34,391	17,195	16,645	551	17,195
17	State Income Tax	30,622	11,381	19,241	6,667	6,385	282	12,575
18	Federal Income Tax	89,618	37,909	51,709	14,686	14,086	599	37,024
19	Total	$1,751,316	$337,483	$1,413,833	$656,494	$633,731	$22,763	$757,339
20	ADJ: ENFIA (Exp & ITX)	0	5,446	(5,446)	0	0	0	(5,446)
21	ADJ: 68-69 Flow Thru	731	137	594	295	283	12	300
22	ADJ: Automatic Electric	(1,115)	(209)	(906)	(449)	(432)	(18)	(457)
23	ADJ: Directory Company	(4,290)	(47)	(4,243)	(176)	(176)	0	(4,067)
24	ADJ: FCC Accntg. Chg.	718	134	584	289	278	11	294
25	ADJ: Depr. Mtd.	2,168	405	1,763	874	839	35	889
26	Net Operating Expenses	$1,749,528	$343,349	$1,406,178	$657,326	$634,523	$22,803	$748,852
27	Net Operating Revenues	$340,740	$86,361	$254,380	$115,981	$110,821	$5,160	$138,399
	RATE BASE							
28	Account 100.1	$5,478,354	$1,032,450	$4,445,904	$2,166,540	$2,070,249	$96,291	$2,279,364
29	Account 100.3	23	4	19	9	9	0	10
30	Materials & Supplies	33,500	7,500	26,000	13,630	13,043	587	12,371
31	Working Cash Allowance	(94,208)	(16,369)	(77,839)	(36,519)	(35,350)	(1,169)	(41,320)
32	LESS: Depr. Resv.	1,525,250	273,496	1,251,754	570,958	545,582	25,376	680,796
33	LESS: Def. Tax Resv.	549,568	106,067	443,501	222,575	212,683	9,892	220,926
34	Subtotal	3,342,851	644,021	2,698,830	1,350,127	1,289,686	60,441	1,348,703
35	ADJ: Cust. aid to Const	(731)	(141)	(590)	(296)	(283)	(13)	(294)
36	ADJ: ENFIA (Rate Base)	0	46,776	(46,776)	0	0	0	(46,776)
37	ADJ: Automatic Electric	(3,946)	(742)	(3,204)	(1,598)	(1,527)	(71)	(1,606)
38	ADJ: FCC Acctng. Chg.	(851)	(165)	(686)	(345)	(329)	(15)	(341)
39	ADJ: Depr. Mtd.	(1,084)	(210)	(874)	(439)	(420)	(20)	(435)
40	Total	$3,336,239	$689,539	$2,646,700	$1,347,449	$1,287,127	$60,322	$1,299,251
41	RATE OF RETURN	10.21%	12.52%	9.61%	8.61%	8.61%	8.55%	10.65%

The intrastate summary of earnings requires adjustment because of certain divestiture effects, which is done in the following table. First, the adopted level of access charge revenue from interLATA carriers is broken out (this is discussed more in the following section on revenues). Second, intrastate results of operations are adjusted for the additional expense General has because starting in 1984 it must pay AT&T or other carriers for its interLATA calls; prior to divestiture General did not pay for company business or "official toll" calls. The adopted increase in gross revenues is $154,837,000, which includes a reduction of $6,000,000 because we are not convinced that General's expenditures for central office switching equipment (COSE) are reasonable.

General Telephone Company of California
Adopted 1984 Intrastate Results of Operations
Including Estimated Effects of Access Charges
(Thousands of Dollars)

		Adopted Intrastate Results of Operations	Effects of Access Charges and Related Effects as Implemented 1/1/84	Revised Intrastate Results of Operations w/Access Charges
	OPERATING REVENUES			
1	Local Service	$752,947		$752,947
2	Intrastate Toll	791,325		-
3	InterLATA (access charges)	-		248,239 *
4	IntraLATA	-		539,232 **
5	Misc. Revenues	143,310		143,310
6	Uncollectibles	27,024		21,284 ***
7	Total Operating Revenues	1,660,558	1,886	1,662,444
	OPERATING EXPENSES			
8	Expenses Other Than Taxes	1,246,959	4,182	1,251,141
9	State Income Tax	22,073	(250)	21,823
10	Federal Income Tax	63,129	(941)	62,188
11	Other Taxes	74,017	0	74,017
12	Total Operating Expenses	1,406,178	2,991	1,409,169
13	Net Operating Revenues	254,380	(1,105)	253,275
14	RATE BASE	2,646,700	0	2,646,700
15	RATE OF RETURN	9.61%	-0.04%	9.57%

* Access Chg. Revenues

	232,910
(Exh.123 pg.2)	14,829
(per ALJ)	500
	248,239

** IntraLATA Toll Revenues

Net	526,954 #
Uncoll.	12,278 ##
Gross	539,232

***

Local Uncoll.	9,006
IntraLATA Uncoll.	12,278
Total Uncoll.	21,284

\#

Ratio of $\frac{\text{IntraLATA Revenues}}{\text{Adj. Net State Toll Rev.}} = \frac{522014}{766058} = 0.681429$

Adopted State Toll Revenues = 773,307

Adopted IntraLATA Revenues = 773307 X .681429 = 526,954

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Ratio of $\frac{\text{State Toll Uncoll.}}{\text{State Toll Revenues}} = \frac{18018}{791325} = 0.022769$

Adopted IntraLATA Revenues = 526,954

IntraLATA Uncoll. =

526954/(1-.022769)-526954 = 12,278

The resulting additional intrastate revenue requirement for test year 1984 is:

12.74%	authorized return on rate base
-9.57%	return at present rates
3.17%	
$2,646,700,000	(Rate Base) x 0.0317 =
83,900,390	(net revenue requirement)
x 1.917	(net to gross multiplier)
160,837,000	
-6,000,000	COSE adjustment (intrastate)
$ 154,837,000	gross intrastate revenue requirement

A. Revenues at Present Rates (Including Access and Late Payment Charge Revenues)

General will have total revenues of about $2,084,685,000 in the test year, of which $1,657,603,000 is intrastate revenue from rates set by this Commission (with the exception of yellow page advertising which is deregulated). About 36% of General's revenue will come from local service revenues, 57% from toll service revenue division (starting in 1984 a portion of this will come from access charges to interLATA carriers) and the balance, about 7%, from other sources. General will have about 2.6 million access lines in service in 1984. Initially General estimated $35.4 million less total revenue than staff, with most of the difference in intrastate toll revenue. Staff's estimates benefited from much later data and reflect the upturned economic climate. Two revenue issues warrant discussion: the level of General's charge for late bill payment and the test year revenue contribution from General's access charges to intrastate long distance carriers.

Late Payment Charge Level and Revenue

We will not make the $2.9 million adjustment, made in our interim opinion, to reduce local service revenues due to the reduction in the amount of General's late payment charge in late 1983, because we are authorizing General to reinstitute its original 18% per annum charge.

Interim D.83-12-067, which granted a partial increase, adjusted local revenues downward by $2.9 million due to General's use of a 10% per annum late payment charge instead of the 18% previously used. Our D.83-10-088 in Bernsley v General ordered the change, pending review of whether a charge over 10% per annum violated California Usury Law. Staff and General agree that we can lawfully impose an 18% per annum late payment charge.

General's late payment charge is not a loan but a penalty for nonperformance or untimely payment of an obligation. The late payment charge is one of several incentives to encourage customers to pay their bills when due. Other incentives include disconnection and having to make a deposit prior to reconnection. Such an incentive for timely performance charge has been held not to be subject to the Usury Law; see, First American Title Insurance v Cook, (1970) 12 Cal App 3d 592.

Assuming in arguendo, however, that the Usury Law is applicable to General's proposed 18% per annum late payment charge, this Commission, through the legislated statutory scheme for utility regulation, has plenary powers conferred under the California Constitution on matters germane to public utility regulation, specifically including having the jurisdiction to set the rates and charges of utilities conferred by PU Code § 728. As such, we may find reasonable an interest rate which exceeds that allowed by the Constitution's Usury Law; see SoCal Gas Co., (1974) 77 CPUC 293.

About 20% of General's customers are responsible for what it terms "unpaid live accounts," or accounts that are overdue but still receiving service. Such late paying customers can exacerbate the need for short-term financing. Further, a charge to encourage timely payment can ultimately reduce General's uncollectibles because customers may stay more current with payments. Since reducing the late payment charge from 18% per annum to 10%, there has been an increase in unpaid live accounts. We conclude 18% per annum is a

reasonable late payment charge to discourage unpaid live accounts. Ultimately all ratepayers benefit from timely bill payment, because the cost of service can be minimized.

Our Bernsley decision ordered General to modify its tariff rules to adopt a billing procedure so customers would know when payment had to be received to avoid the late payment charge. Exhibit 97 explains the changes and gives an illustrative bill. Its bills now list the mailing date and the date payment must be received (within 27 days). Quaintance admitted, however, that because of logistical snafus it is possible bills occasionally will not get mailed on the date printed on the bill. When asked whether in those instances the later postmark date would be controlling Quaintance said the problem would arise infrequently, and General did not have a policy. We do not think it is reasonable to expect General's billing department to know of the infrequent instances when the printed mailing date on the bill differs from the postmark date in determining if a late payment charge applies, but it is reasonable for General's tariff to provide that if a customer demonstrates the bill's postmark date is later than the printed date, the postmark date is controlling. This will result in uniform treatment.

Two parties took issue with a late payment charge: TURN and William Victor, representing himself. Victor thinks the 18% per annum rate is excessive because it well exceeds General's usual cost of short-term borrowing. TURN points out correctly that the late payment charge is a penalty and not "interest." However, it later states if we apply 18% we must then in fairness apply an 18% interest rate to customer deposits instead of the currently paid 7%. A more enlightened approach, according to TURN, would be to give a discount to customers who pay promptly. Whether it is a discount for prompt payment or 18% per annum on late payments, it still amounts to an incentive. Adjusting rates to administer monthly discounting is not worth it; billing expense could increase to administer an incentive

for prompt payment, which should be the norm. TURN recommends quantifying the amount of discount in the next rate proceeding. We will not embrace TURN's discounting alternative as, among other reasons, we do not have sufficient information about its specifics or the effect. TURN may pursue this issue in the next rate case.

Access Charge Revenue from
Intrastate Long Distance Carriers

Controversy surrounds what we should adopt for test year revenue from interLATA carrier access charges. Our interim decision establishing a partial rate increase for General accepted General's estimate made in 1983, that it would meet the original estimate of intrastate test year toll revenue. General said in 1983 that its access charges to intrastate interLATA carriers would offset the portion of toll service revenue it would no longer directly realize in 1984, or interLATA toll. The decision setting the principles or ground rules for developing access charges was issued on December 7, 1983 (D.83-12-024). The two GTE affiliated utilities, General and West Coast, were granted their requests to develop their own access charge tariff instead of concurring in Pacific Bell's. General refiled its proposed access charges by advice letter, and we approved them for application starting January 1, 1984, but subject to further review and refund; and both General and West Coast were directed to demonstrate in these proceedings that their access charges were properly developed and reasonable (Resolutions T-10779 and T-10780).

AT&T Communications Company of California, Inc.'s (AT&T) opening brief filed in March indicated it thinks General's tariffed access charges were developed wrong and are unreasonable. In July 1984 Phase II of the consolidated access charge proceedings goes to hearing. After coordination between ALJs and assigned Commissioners, an ALJ's Ruling was issued on March 5 which moved questions on the propriety and reasonableness of General's access charges into Phase II of the other proceedings. The estimated test year revenue

generation from the filed access charges was considered during the April hearings, with General, AT&T, and staff presenting evidence.

General's Position

The following page, compiled from Exhibits 40 and 123, shows the estimated revenue generation of General's access charges. The result is that with presently tariffed access charges and AT&T lease payments on toll facilities there is a gain of $1,984,000 over originally estimated revenues.

1984 InterLATA Access Charge Revenue
Relationship to the Original Pre-divestiture
Overall Estimate of Intrastate Toll Revenue

Original estimate of total intrastate toll (both inter and intraLATA)	$789,051,000
Less allocated share of total uncollectible expense	(16,762,000)
Net intrastate toll	772,289,000
Portion of revenue from intraLATA toll estimated to flow to General from settlements	526,534,000
Portion of toll revenue lost because General will not handle interLATA after January 1, 1984	245,755,000
General's October 1983 estimate of interLATA access related revenue	
Lease of facilities to AT&T	42,698,000
Access charges	203,057,000
	245,755,000
General's April 1984 estimate of interLATA access related revenue	
Lease of facilities to AT&T	46,810,000
Access charges	186,100,000
	232,910,000
Additional revenue from the common carrier line charge increase authorized on May 2, 1984 by Resolution T-10816.	14,829,000
Total	247,739,000
Total test year toll and access related revenue	
IntraLATA toll	526,534,000
Access-related revenue	247,739,000
(Not including revenue from carriers other than AT&T)	774,273,000

While General believes its access charges are correctly developed it is nevertheless concerned because they are subject to refund, and conceivably if AT&T prevails with its contentions in Phase II of the access charge proceedings General could be ordered to make refunds to AT&T and reduce its access charges prospectively. General thinks we should have some mechanism so that if it must make refunds and reduce its access charges it can be made whole both prospectively (by raising other rates) and back to January 1, 1984.

AT&T's Position

AT&T believes it will demonstrate General's access charges are unreasonable. Essentially it contends General simply used an overall revenue objective approach, working backwards from there to develop its access charge rate components, which is contrary to the criteria set by D.83-12-024. General's Hascall testified that General's charges are cost based, and it is primarily coincidence that they will generate about the same amount of revenue it would have realized from providig interLATA toll. AT&T's Sumpter testified that AT&T believes General's access charges are too high by about $100+ million (on an annual basis). Sumpter believes we should essentially assume no access charge revenue for purposes of setting General's 1984 revenue requirement. The driving force behind this recommendation is AT&T's concern that it will ultimately be harder for this Commission to direct refunds to AT&T if General's access charge revenue has been recognized in developing the 1984 revenue requirement.

AT&T developed that General's estimate of 1984 access charge revenue does not include any revenue from AT&T's competing long distance carriers. General's Hascall explained General's efforts to pursue payment from other carriers, which first entails getting their traffic volume breakdown by intraLATA, interLATA, and interstate; Hascall was not optimistic about General's short-term collection efforts. General sent letters to nine carriers seeking

their traffic data. As of April 13 it received one response, which was a denial. More recently, the Access Services Liaison Committee's status report filed on April 27, 1984 in A.83-06-65 et al. states that as of April 24 the only interLATA carrier billed by any of the local exchange companies was AT&T.

Staff's Position

The staff's witness, Marks, testified that she reviewed Hascall's development of test year access charge revenue, and that it "is appropriate for inclusion in the development of an adopted 1984 test year" (Exhibit 126). Further, if it turns out AT&T's contentions are correct, she said we should make prospective rate adjustments and not attempt any make-whole award as recompense to General going back to the start of 1984 if refunds back to then are ordered. Her rationale is essentially that we allowed General the option of filing its own access charge tariff to accommodate its preference, and if it turns out General developed it incorrectly it would be unfair for all ratepayers to make General whole. Further, Marks said potential retroactive recovery does not seem feasible because our orders in December 1983 neither established a balancing account nor made any reference to a make-whole mechanism to cover 1984.

Discussion

We authorized General to file its own tariff at its behest. General is a large telephone utility. It accordingly has enough acumen and resourcefulness that it is reasonable to expect it could follow the guidelines in our D.83-12-024. Accordingly, our view is the same as Marks'. We will essentially adopt the estimate of access charge revenue in Exhibit 123, but modified as discussed below. If General's access charges are reduced we will concurrently issue another order in these proceedings to realign rates so General is prospectively made whole. As no balancing account or retroactive recovery mechanism was established prior to January 1, 1984 we are,

as Marks suggested, legally precluded from awarding retroactive recovery, even if we were inclined as a policy matter to do so.

AT&T's competitors, including General's affiliate GTE Sprint, were still not paying interLATA access charges at the time of our April hearings. General's choices are to either: (1) bill all their traffic at the higher intrastate access charge rate; (2) disconnect or terminate service; or (3) start suing for collection. However, General is being paid by the other carriers for all their traffic under the charges for exchange network facilities for interstate access (ENFIA), but as it is interstate revenue it is not reflected in our adopted intrastate results of operations.

Hascall could not quantify how much more intrastate access charge revenue could be owed General because it does not have the carriers' breakdown of minutes of use between inter-and-intrastate traffic. But he said assuming 25% of their traffic was intrastate, General would realize, after a reduction in AT&T's share, another $600,000 annually. We are concerned about the carriers not paying General. The revenue shortfall will be borne by intrastate ratepayers through higher basic exchange rates. Troublesome also is that GTE Sprint, General's affiliate and a competitor of AT&T, is not paying; this gives GTE Sprint an unfair cost of service advantage. Under these circumstances, and because none of General's collected ENFIA revenues are apportioned to intrastate, we conclude it is reasonable to impute to General some additional access charge revenue. In a normal year of operation General should realize this revenue, and, of course, our estimated test year is designed to capture an estimated normal year's operating results; accordingly, from a ratemaking standpoint we must make some recognition of this collectible revenue. This is fair for intrastate ratepayers and it gives General more incentive to aggressively pursue collection from the carriers. We conclude conservatively that an additional $500,000 of revenue should be added to General's estimate of 1984 access

charge revenue, bringing the total to $248,239,000. On June 30, 1984, after our hearings concluded, Resolution T-10843 was issued which made minor revisions to General's access charges. The estimated reduction in revenue, perhaps $1.6 million, shall be addressed in General's 1985 attrition filing.

Following are adopted intrastate revenues:

	($000 omitted)
Local service	$ 752,947
Access charge revenue	248,239
IntraLATA toll	539,232
Misc. revenue	143,310
Uncollectibles	(21,284)
Total Interstate Revenue	$1,662,444

(Red Figure)

B. Payroll Expense and Adjustment

In interim D.83-12-067, which set General's revenue requirement on the staff's estimated results of operations, we adjusted operating expense to reflect General's more recent forecast of salary increases for management employees. Rather than having each expense category adjusted for this change, we will, in our adopted summary of earnings, reduce total expense by $8.1 million and, for the corresponding savings to capitalized construction, reduce rate base by $1.9 million.

The non-management or rank and file work force received an annualized total wage increase of 9.41% in 1983, and will receive 8.16% in 1984 and 7.12% in 1985. Some of General's customers speaking at our public hearings were skeptical about General's efforts to hold down costs, even bluntly asking what General is doing to keep costs down in view of many industries awarding small, if any, wage increases given the slowing of inflation. There is no way of knowing whether General would have negotiated the same three-year wage agreement if it were not operating under the auspices of

regulation. Little justification was provided by General. It primarily indicated the terms of the agreement and seems to think that alone, particularly if our staff does not question the agreement, meets its burden of proof. We would have less concern if we were convinced General's operation, over three years, would experience productivity gains to substantially offset the higher wage costs. But we are not convinced. The total three-year wage and salary package, in direct wages alone, will exceed $164 million, and all we see in expense categories are growing estimates. Our goal in reviewing operating expense related to labor cost is not to directly impede the collective bargaining process, but we must give careful consideration to ensuring management is vigorously pursuing productivity increases. Thus, as discussed extensively in the section addressing an attrition allowance mechanism, we are critically concerned about giving management an incentive to achieve productivity gains so costs borne by ratepayers are minimized.

General's Exhibits 20 and 21 are its showing on employee productivity and labor force estimate. Total labor force, or equivalent employees from 1979-84, is:

Year	Equivalent Employees	% Change From Prior Year
1979	26,542	7.4%
1980	27,597	4.0%
1981	28,383	2.8%
1982	29,245	3.0%
1983 (est)	27,659	(5.4%)
1984 (est)	26,988	(2.4%)

(Red Figures)

While we will allow General's 1983-84 wage agreement to be fully reflected in our adopted summary of earnings, we will be keeping the magnitude of the increases and uncertainty about the prospect of substantially offsetting productivity in mind,

particularly in addressing the issue of an attrition allowance vis-a-vis ensuring our ratemaking procedures reflect an incentive to encourage operating efficiency.

C. Maintenance Expense

After reviewing staff's showing General reduced its estimate of test year maintenance expense by about $15 million, and accepted staff's estimate of $489,809,000.

General and staff believe the fruits of modernization and technological innovation are fully reflected in staff's estimate. TURN, from its cross-examination, takes issue with this, indicating concerns about whether staff's estimate fully reflects lower maintenance expense that flows from more mechanization and the conversion to electronic or digital central offices.

Staff's witness, Hodges, testified that he investigated General's maintenance procedures and programs. He generally reviewed recorded expense for past years, investigated General's maintenance budget, and made productivity adjustments. For most categories, Hodges applied the 5% productivity gain expected of Bell System companies, believing there is every reason to expect the same gain from General. Compared to Pacific Bell, General is at the threshold of central office modernization, and there is every reason to expect at least a 5% annual productivity gain.

While we will adopt staff's maintenance expense estimate, we are curious why Continental Telephone Company in its A.83-12-57 shows a decrease in total maintenance expense per access line, while the estimate we adopt for General is an increase. In particular, General's expense for central office maintenance is increasing by $24.8 million over 1982 while Continental's decreased slightly over the same period. Maintenance is the expense category with the largest impact on results of operations, second to depreciation, and it is essential that test year estimates fully reflect productivity improvement. While we will rely on staff's estimate for this

proceeding, we want other facets of maintenance expense investigated in the next rate proceeding, particularly an analysis of the extent to which the impact of central office modernization is indeed reflected in overall maintenance expense and whether General's maintenance work force has been reduced or reassigned in view of modernization.

Another aspect of maintenance expense which concerns us is that staff did not, or could not in the time allowed, thoroughly investigate General's allocation or assignment of maintenance (for terminal equipment) between regulated and deregulated activity. Thus, in short, we are left with General's assertion that it has correctly assigned costs. This issue, in the broader sense, will be discussed in a following section on staff's proposal to order a separate stand-alone subsidiary for marketing and maintaining unregulated terminal equipment.

Following is the breakdown of maintenance expense we adopt:

Account	Category	Amount (000 omitted)
602	Repairs of Outside Plant	$ 62,566
603	Test Desk Work	39,605
604	Repairs of Central Office Equip.	175,442
605	Repairs of Station Equipment	181,190
606	Repairs of Buildings & Grounds	12,577
610	Maintaining Transmission Power	14,796
612	Other Maintenance Expense	3,633
	Total Maintenance Expense	489,809

D. Traffic Expense

Whereas General initially estimated total company traffic expense of $105.4 million, it accepted staff's slightly lower estimate of $103.5 million. General shows a trend of traffic expense increasing annually less and less since 1979, and traffic expense as a percent of total operating expense is remaining about the same.

Staff assumed 291 fewer operators in 1984 than 1983 and, despite an overall increase of 15% in toll call volume, a 4% reduction in operator-assisted calls. It is presumed by staff that General correctly allocated out traffic expense related to customer instruction for purchasers of deregulated PBXs.

TURN was generally critical of staff's efforts at identifying and giving full effect to productivity gains which could be coming from technological innovation.

More is needed, we think, in estimating General's traffic expense than a trending review. Staff's witness, for example, trended growth in General's operator force and then applied a 5% personnel reduction because the Bell System generally indicates such a productivity gain stemming from innovation. We note that General seems on the relative threshold of traffic office automation, whereas Pacific Bell is much further along. In view of this we are not sure it is adequate to simply apply today's Bell System productivity factor to General's situation. A more careful analysis of recorded or historical traffic costs is in order as a starting point, particularly vis-a-vis other utilities, to determine the reasonableness of recorded costs before trending and imputing possible prospective productivity gains. Given our adopted directory assistance charge plan, which will phase in over 1985, and the largest intrastate long distance carriers now charging for intrastate long distance directory assistance, there should be considerable calling volume repression. Also, when the FCC authorizes end user charges for interstate long distance directory assistance calling there will be still further repression. While we can review to some extent related 1985 and 1986 expense savings in connection with the attrition filings, an in-depth analysis of such changes on General's traffic expense should be undertaken in the next rate proceeding.

E. Commercial Expense

Background

Commercial expense results for activities such as billing and collecting, taking customer service orders, marketing and sales (including advertising), regulatory affairs, and intercompany relations and settlements.

Test year commercial expense was originally estimated by General to be $201.3 million, but it later accepted staff's estimate of $195.6 million. Following is the recent history of General's commercial expenses:

Year	$ million	Percent Increase Over Previous Year
1979	106.5	16.1%
1980	123.7	16.1
1981	141.3	14.2
1982	170.3	20.6
1983 (est.)	181.4	6.5
1984 (est.)	195.6	7.3

The breakdown of total commercial expense by category which General and staff agree to is:

Account	Category	($000)
640	General Commercial Administration	13,830
642	Advertising	4,685
643	Sales Expense	14,357
644	Connecting Company Relations	1,775
645	Local Commercial Operations	93,461
648	Public Telephone Commissions	2,740
649	Directory Expenses	64,804
650	Other Commercial Expenses	24
	Total Commercial Expense	195,676

We will adopt, as discussed below, $2 million less, or $193,676,000, for test year commercial expense.

Staff's witness, Howard, was extensively cross-examined by TURN, particularly on the depth of staff's investigation of commercial expense and General's allocation and/or assignment of a portion of this expense to General's unregulated marketing of customer premise or terminal equipment. Components of commercial expense most affected by an allocation of expense are Accounts 640, Commercial Administration, 643, Marketing and Sales (encompassing General's 28 phone marts). Howard said he had not investigated General's assignment or allocation of expense to unregulated operations but, rather, had looked at the growth in General's estimates as allocated by General.

We are not comfortable with the level of test year commercial expense General and staff agree to, and most of our concern is caused by questions surrounding expense allocation. Our ensuing analysis of the evidence addresses cost allocation both as it affects commercial expense, with repercussions for other expense categories, and the later section of this opinion addressing the question of whether General must ultimately have a separate stand-alone subsidiary for its unregulated activity. Marketing activity, part of commercial expense, is probably the most visible area affected by allocations.

General's Estimated Commercial Expense

Unlike the largest telephone utility we regulate, Pacific Bell, General wants to continue offering unregulated terminal equipment services without a separate stand-alone subsidiary. To continue as it has means ratemaking for General entails careful review of how its combined regulated and unregulated activities and costs are segregated.

In preparing its entire estimated results of operations, General made either direct assignments or allocations of expenses to unregulated operations leaving, in theory, only estimated expenses for regulated activities.

General's controller, Pertler, testified on how costs were assigned or allocated. He believes about 95% of the costs for marketing, installing, and repairing unregulated multiline terminal equipment (e.g. Key Systems and PBXs) can be directly assigned below the line, because General has a separate "division" for such activity; the remaining 5% involves shared costs, and were allocated by the ratio of unregulated business to such things as total plant, commercial, and accounting expense (Tr. Vol. 5 pp. 508-510). However, the breakout is not as simple when it comes to assigning and allocating costs to activity for marketing unregulated single line terminal equipment. This is largely due to the combined activity of General's 28 phone marts.

With respect to marketing unregulated single line terminal equipment through phone marts, Pertler did not appear to have detailed knowledge of exactly how phone mart expense was derived and the test year effect of cost assignment or allocation. For example, he was not familiar with the study done by General to allocate test year phone mart employee time to unregulated activity (Tr. Vol. 5, p. 519), nor did he know how many total phone mart employees were assigned to unregulated activity or have a clear idea about employee functions (pp. 514-521).

Further, the record shows that General markets embedded or regulated multiline terminal equipment (e.g. Key Sets and PBXs) without a tariff on what it terms "demand." It was apparent from the testimony of General's Borghi that General's multiline marketing has all the appearance of a potential conflict of interest. For example, if a multiline customer is about to change from in-place leased embedded equipment, he could be told of terms under which he could buy it, but possibly only after he would not purchase General's new unregulated equipment (Tr. Vol. 10, pp. 1003-1008). Obviously valuable sales leads for selling unregulated equipment can stem from the interaction and sharing of information between the unregulated

and regulated sides of General's overall marketing operation. How this was recognized in estimates of 1984 expense allocation was unclear (Tr. Vol. 6, pp. 529-530).

General also assigns and allocates to unregulated activity expenses for purposes of interutility settlements of toll revenue, otherwise it would receive toll revenues based on expenses including those for unregulated activities. While the method for allocating common costs is the same as that used to prepare its estimated results of operations, the other allocations might not be done the same (Tr. Vol. 6 p. 531).

Some review of how General's series of phone marts came into being is useful to understand how the expense allocation issue has evolved. Marina Del Rey received the first phone mart, a stand-alone center which was not part of the area's commercial office, in the late 1960s. Steadily the number have increased to 28, and it seems General is now uncertain about establishing more. In localities where it does not have stand-alone phone marts General services customers who need face-to-face contact through "convenience centers," which are generally integrated with local business offices. But before phone marts and convenience centers General simply had "public offices" that were integrated with its business offices, consisting of a bill paying area and service counter (Tr. Vol. 6, pp. 556-558). This operation did not entail the rent expense for a stand-alone retail store, as does the phone mart. Phone marts, set up as a place where customers must go with certain needs related to General's regulated operations, are by nature an ideal place to channel customers and promote deregulated single line terminal equipment; it is the ultimate in customer traffic routing, with a total annual cost of about $24 million. We are left with the strong impression that stand-alone phone marts may be good for selling unregulated terminal equipment, but that the resulting overall price for serving the needs of customers with regulated transactions may be

too steep. We can only wonder whether if General had continued its use of a portion of the space in its local office and commercial office facilities for face-to-face customer contacts its overall costs for these essential contacts would be less. General, of course, makes the point that its move toward phone marts occurred over time under the auspices of this Commission's regulatory oversight.

Staff's Analysis of General's Commercial Expense

The staff's Howard was responsible for analyzing General's estimate of commercial expense (Exhibit 34, Chapter 10). He accepted all of General's allocations between regulated and unregulated activity without any investigation of the various activities and allocations, explaining that he had left the task of analyzing General's allocations to the Revenue Requirements Division's auditors.

He adjusted advertising expenses by $904,000 to disallow General's contribution for national advertising campaigns, by its parent, as recommended by the staff's auditors, because they do not directly benefit General's ratepayers. Other than that adjustment, he accepted General's 1984 advertising estimate because it looked reasonable in relation to 1982 expenditures, with an increase from $4.8 million to $5.6 million. He did not analyze in any depth why overall advertising expense or marketing expense is increasing for ratemaking purposes while more and more of General's marketing and promotion are presumably directed toward selling unregulated equipment. However, he concluded, almost as an afterthought, that much of General's marketing and advertising expense, beyond what General allocated, could be below the line because of the benefits that will directly or indirectly inure to its unregulated sales activity (Exhibit 34, Chapter 10-3). Howard did adjust Account 645, Local Commercial Operations, by $3.8 million because his trending produced a lower estimate.

Discussion

Fairly allocating expense and benefits between regulated utility activity and other operations, and reviewing the reasonableness of charges to utilities by affiliated companies, are high among the more challenging dilemmas faced in utility regulation. We are not convinced from its showing that General has correctly assigned and allocated commercial expense between its activities. However, even if we were convinced its cost allocations were technically correct, there remains a value to unregulated operations connected with its phone marts because of the systematic channel of customer traffic to phone marts. The customer service and marketing activity combined in phone marts concerns us, in ratemaking, from yet another standpoint, which is that essential face-to-face customer contact might cost less had General continued using part of its existing local and commercial offices' space. The facilities could have been less elaborate and, in contrast to separate storefront locations, potentially less costly. Integrated marketing and service contact activity handled through phone marts is the GTE corporate family's marketing approach; and it is obviously of potential value to an integrated vertical services corporate structure, encompassing product development, manufacturing, and marketing of terminal equipment.

Staff's Howard raises the point that as much as 50% of General's advertising budget for 1984 could actually be for benefits primarily flowing to its unregulated sales endeavors. Likewise, he notes that much of marketing and sales expense (totalling $14.3 million) could perhaps be allocated to unregulated activity. However, he did not investigate enough to quantify these general observations into a ratemaking recommendation. As we discussed above, local commercial operations expense, even if phone mart expenses are perfectly assigned, would not reflect the value to unregulated sales stemming from a channeled flow of customers, with a

variety of needs, to phone marts. Getting foot traffic into the proximate vicinity of any retailing activity, with the potential for foot traffic to turn into retail customers upon exposure to displays, is a pivotal challenge for any retailing business. General and/or GTE have arrived at an ideal solution from their standpoint. However, the solution may be better for GTE than General, because while GTE will wholesale single line equipment to other retailers, General is left to only pursue sales through phone marts. Thus, GTE has pitted its operating subsidiaries to compete against other vendors of GTE manufactured or supplied equipment, but the subsidiaries confine themselves to marketing through phone marts.

All terminal equipment not in General's embedded inventory as of January 1, 1983 could be sold or leased on a deregulated basis. Yet we notice advertising (Account 642) has gone from $4.8 million in 1982 to an estimated $5.6 million in 1984 (General subsequently accepted Howard's estimate of $4.7 million, which reflects the national advertising expense adjustment). Likewise sales expense (Account 643) declines slightly over the same period from $17.9 to $14.3 million. We do not understand why these expenses should not be declining more with the promotion of newest state-of-the-art terminal equipment presumably falling on General's unregulated operation since 1981.

Given overall uncertainty about the various aspects of General's commercial expense discussed above, including levels of expense, allocations to unregulated operations, and the inherent value to unregulated operations stemming from integrated phone mart marketing, we will adopt $193,676,000 as test year commercial expense, which is $2 million less than the estimate General and Howard agreed to. The reasonableness of a larger allowance or estimate has not been demonstrated.

F. General Office Salaries and Expense, Other Operating Expense, and Affiliated Company Adjustments

General office salaries and expense are operating costs for General's executive force and its law, accounting, treasury, personnel, public relations, and other departments. These expenses are in Accounts 661 to 665. Other operating expenses (Accounts 668-677) include operating costs not falling into other categories, such as insurance, employee fringe benefits, rents and general services and licenses (which includes payments to affiliated companies).

General accepts staff's estimates which, generally, were lower than General's initial estimates. Also, General accepts staff's proposed ratemaking adjustments relating to General's payments to affiliated GTE companies.

Following is a summary, by account, of the adopted expense:

General Office Salaries and Expense

Account	Description	Amount (000 Omitted)
661	Executive Dept.	$ 2,896
662	Accounting Dept.	73,005
663	Treasury Dept.	1,321
664	Law Dept.	1,021
665	Other salaries and expense	52,965
	Subtotal	131,208
Adjustments:	Lobbying expense	(302)
	Good Government Club	(15)
	Total adopted	130,891

(Red Figures)

Other Operating Expenses
(Before Commercial Expense Adjustment)

Account	Description	Amount (000 Omitted)
668	Insurance	$ 1,259
669	Accident & Damage	910
671	Operating Rents	21,269
672	Relief & Pensions	146,704
674	General Services & Licenses	31,228
675	Other Expense	4,045
677	Expense Charged to Construction	(10,908)
	Subtotal	194,507
Adjustments:	Dues, Donations and EEO costs	(179)
	Total adopted	194,328

(Red Figures)

Account 674, General Services and License Expense, was estimated by staff to be $39.9 million, before adjustments, whereas General initially estimated expense of $44.9 million, then allocated $920,000 to its unregulated operations, resulting in about $43.9 million. Both estimates reflect a lot of growth in this expense area, given that 1982 recorded expense was about $26.9 million. Staff's estimate is based on its analysis of costs affiliates will most likely bill General for in the test year, a 6% escalation factor between 1983 and 1984, and changes in the GTE corporate family affecting expense.

Starting with the $39.9 million estimate of general services and license expense, staff made the following adjustments:

1. $1.6 million to GTE Service Corporation's billing because staff found Service Corporation's marketing department could not segregate out the portion of its activity directed at unregulated operations. From analyzing project summaries staff determined $1.6 million of marketing expense allocated to General primarily benefited unregulated operations.
2. $6.2 million of GTE Laboratories expense because staff found some projects and functions could not be shown to primarily benefit ratepayers (applying our guidelines in D.82-04-028).
3. $355,000 of GTE's corporate communications and Washington, DC expense allocated to General because these overall activities "intermix" benefits to shareholders and ratepayers.
4. $14,000 of expense connected with GTE's international treasury (because General has not used this service since 1982 and has no plans to use it in the future), and the human resources group (because it primarily relates to international operations).
5. $438,000 connected with Service Corporation's billing for servicing fees, because if Quebec Telephone was billed on the same basis as other GTE units General's cost would be that amount less.

Staff applied our adopted Automatic Electric (AE) Adjustment, which is one measure to ensure ratepayers do not suffer because of General's purchases from its affiliated manufacturing and product distribution company. AE's income, related to General's purchases, was reduced and reflected in both the expense and rate base categories. The result is a $4.1 million reduction to rate base and $1.1 million to expenses.

GTE Data Services (GTEDS) provides computer-related services to GTE telephone units, such as General; this includes data processing, development of computer systems, and leasing computer equipments. Staff made no adjustment because it is estimated GTEDS' return in 1984 will be considerably less than that allowed General.

General Telephone Directory Company, based in Illinois, provides directory related services such as selling yellow page advertising, compiling directory information, and having directories printed. Historically, we have an affiliate adjustment comparable to the AE Adjustment to ensure an affiliate is not used to realize a higher profit for providing services to the detriment of ratepayers. General and staff both developed an adjustment for 1984. Staff finds the Directory Company will earn a 26% return from its business with General in 1984 and recommends a $4.3 million expense adjustment (applying General's last authorized 12.78% rate of return, whereas General uses a 13.78% return). For simplicity, in view of only a $57,000 difference, we will adopt staff's adjustment as the return used in staff's computation is far closer to our adopted return.

G. Operating Taxes (Other Than Income Tax)

General and staff differ on ad valorem taxes because they differ on test year rate base; that is, the higher the adopted test year rate base, the higher are estimated property taxes. We will adopt staff's ad valorem tax estimate, subject to adjustment based on our resolution of the contested rate base issues.

Other operating tax expense are categories such as payroll and local taxes. General accepts staff's slightly lower estimates in these categories.

Following is our adopted test year operating tax expense:

Operating Taxes	Amount ($000 omitted)
(e.g. property tax and State and local taxes)	$49,626
Payroll Taxes	42,353
Total taxes other than income	$91,979

H. Federal and State Income Tax Expense and the Net-to-Gross Multiplier

General is eligible for the tax benefits of accelerated cost recovery (depreciation) and investment tax credit because for ratemaking purposes tax expense is normalized. The Economic Recovery Tax Act of 1981 requires such normalization for eligibility. Most simply put, this means ratemaking tax expense is calculated ignoring the full impact of accelerated depreciation and tax credit in arriving at test year income tax expense. However, California Corporation Franchise Tax (CCFT) was determined by flowing through tax expense reductions stemming from accelerated depreciation.

Staff points out in Chapter 12 of its Exhibit 34 that there are some questions stemming from the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 yet to be clearly addressed by treasury regulations, and the ultimate resolution could ultimately affect how ratemaking tax expense is derived. While we presently exclude interest during construction, which for nontelephone utilities is called allowance for funds used during construction, as a deduction in the ratemaking tax expense calculation, TEFRA could potentially be interpreted to require a 10-year amortization of this expense in our calculation. Also, while we now make a deduction for property taxes on construction projects, because the underlying land

is classified as plant held for future use, TEFRA could require capitalizing such taxes and a 10-year amortizing deduction. Absent any treasury regulation on this point being brought to our attention in this proceeding, and since eligibility for General to realize other tax benefits does not hinge on this determination, we will, as staff recommends, continue with our usual tax expense calculation. Treasury regulations, if they are ultimately issued on these points, may be considered in the next general rate proceeding.

The adopted level of test year income tax expense, based on our adopted revenue and other expense, is:

State Income Tax	$30,622,000
Federal Income Tax	$89,618,000

The net-to-gross multiplier is used to convert an additional net revenue requirement into the requisite gross revenue increase. We will use the 46% federal income tax rate and the incremental CCFT rate of 1.83% and an uncollectible rate of 1.61%, which equates into a net-to-gross multiplier of 1.917. Thus, for each $1,000 of new net revenue requirement $1,917 in gross revenue is needed.

IX. RATE BASE AND DEPRECIATION EXPENSE

Rate base, to which an authorized rate of return is applied to determine if net earnings at present rates are adequate, is comprised of several components. Telephone plant in service at the start of the test year is determined, to that is added test year additions (which are weighted so, for example, plant that goes into service late in the test period does not earn a return from the start). Added to test year plant in service is plant held for future use, an allowance for working cash, and materials and supplies. Finally, the total cumulative depreciation reserve, including test year depreciation, is deducted, along with the reserve for deferred income tax, to produce a test year rate base.

A. General's Construction Budget 1983-84

General's annual construction program has gone from $170 million in 1975 to $698 million in 1982. It estimates a $746 million construction budget in 1984. Having 95% of its central offices converted from electromechanical to digital equipment by 1991 is General's goal, and for just this conversion program it estimates spending $186 million in 1983 and $244 million in 1984. Staff accepted General's total estimated construction budget for 1983 and 1984 with the following adjustments:

1. 1983: $27.1 million is added because of higher estimated growth in telephone stations, and $663,000 of general expense should be capitalized and added.
2. 1984: $25.1 million is removed because growth in telephone stations will be less than General estimated; $6.9 million was removed because staff estimated a lower nonlabor escalation factor for 1984, and $723,000 of capitalized general expense is added.

Staff's adjustments are reasonable as they are based on more recent available data from which to forecast test year telephone stations and anticipated construction costs, and we will adopt staff's respective estimates of total construction expenditures.

B. End-of-year 1982 Telephone Plant In Service

General and staff differ by $7.2 million on end of year 1982 plant in service. This difference stems from the following: (1) a $6.3 million reduction to retire accrued IDC associated with retired projects (as recommended by staff's audit team); (2) an $87,000 reduction for special plant related to the 1984 Olympics which staff believes cannot be used for other purposes; (3) a $1.3 million reduction for the capitalized portion of General's extraordinary voluntary incentives separation allowance (VISA) costs in 1982. (The VISA program, to encourage early retirement by management employees, started in 1982, and expenses were not included

in General's test year showing); and (4) $482,000 was added to reflect the audit team's recommendation that a portion of managers' salaries should be allocated to construction. We have accepted the audit team's recommendation, and, accordingly, will adopt staff's end of year 1982 plant balance of $4,792,347.

The adopted end of 1983 plant in service estimate is, in turn, the starting point for adding 1984 plant additions, and arriving at weighted average 1984 plant in service. We have already adopted gross construction budget estimates for both 1983 and 1984, and adjustments to 1982 telephone plant, which carry through with varying effects on estimates of telephone plant for the two successive years. The differences remaining result from General's and staff's estimates of the breakdown of the construction budgets between telephone plant put into service and construction work in progress, and whether the central office conversions to digital switches will be on line in the time frames General originally estimated.

C. Ratio of Test Year CWIP To Plant in Service

Average year end CWIP balances (for Account 100.2) were estimated by General and staff from a ratio of CWIP to plant in service. A ratio is developed for the major categories of plant. The difference between staff and General result from the ratio of end of year CWIP to gross plant additions in the outside plant category. Following are the outside plant gross additions to year-end CWIP balances, upon which the different test year estimates hinge:

($ millions)

Year	A Outside Plant Gross Additions	B Year end CWIP Balance	C Ratio
1975	$ 27.7	$ 8.9	32.3
1976	33.1	8.6	26.0
1977	57.5	21.2	36.9
1978	87.0	36.8	42.3
1979	115.8	63.1	54.4
1980	147.1	95.4	64.9
1981	144.0	76.3	53.0
1982	189.3	47.1	24.9

Staff's witness, Shiu, developed his ratio by averaging the actual ratios of the past five years, 1978-82, resulting in a ratio of 46.8. General used its 1982 ratio of 24.9, resulting, of course, in a much higher estimate of outside plant in service. Shiu's rationale is that to arrive at a normal ratio actual experience over a number of years should be used to arrive at a ratio reasonably indicative of the future. General's witness, Cecil, testified in rebuttal that we should apply just the 1982 ratio, because General has adopted some new administrative procedures to more timely close, on its books, outside plant work orders. Lack of the controls, he testified, caused the relatively high ratios in 1979-81. Cecil, however, was not conversant about the new procedures or familiar enough with them to convince us that the 1982 ratio will necessarily be indicative of the future; he also did not know what effect the new procedures would have had, if they had been in place, on ratios from 1975-81. An averaging approach, as recommended by Shiu, should be applied. However, given fairly wide year-to-year fluctuation in the ratios, we think it is more reasonable in these circumstances to not limit an average to just five years, and we will use the eight years of

1975-82, resulting in an average ratio of 44.6% for outside plant,[2] in contrast to staff's 46.8% ratio.

D. Progress of General's Digital Switch Conversion Program in 1983-84

General estimates it will spend $140 million in 1983 to convert to 11 additional digital switches, and $204 million in 1984 to add another 16. The switches are AE GTD-5 models. Staff's investigation of the progress of General's scheduled conversions led its witness, Monson, to conclude there would be delays or schedule slippage, resulting in less plant being put into service in the time frame originally estimated by General. Past delays stemmed, partly, from AE not giving timely delivery of software to allow the switches to be operative. Staff adjusted General's switch cutover schedule by three months in both 1983 and 1984 to compensate expected delays, and adjusted end of year plant in service for both years accordingly. Any initial GTD-5 delivery installations and cutover problems occurring in 1982 and 1983 are, according to General, solved. Staff agreed to continue to monitor General's 1983 and early 1984 conversion program progress, essentially giving General more time to prove its assertions that the conversion schedule could be kept, and further evidence was presented in April 1984. In April staff and General further addressed this issue. While General had not put the new central office switches in service on the schedule it originally estimated, Monson concluded it had done better than he originally predicted. He raised his estimate and concluded in Exhibit 110 that General's original weighted plant in service estimate should be reduced by $15.6 million, which General accepted.

TURN is skeptical about staff's acceptance of General's revised conversion schedule, pointing out that General's original schedule did not hold up and staff's Monson said he did not have time

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[2] The total from Column B divided by the total of Column A.

to undertake further investigation of the issue in 1984. The alternative, suggested by TURN, to allocate risk between General and its ratepayers, is to review the actual conversion history in early 1985 and order refunds if General lags behind its estimated schedule. While Monson did not undertake a detailed or field investigation in 1984, he said he reviewed General's revised schedule and found it reasonable, essentially exercising engineering judgment. Given the review of the issue, albeit not as exhaustive as TURN would prefer, we will accept Monson's recommendation. Test year rate base, and its various components, is estimated, just as revenues and operating expenses in prospective rate setting. We know recorded experience in each of the results of operations components will probably not exactly coincide with our estimates, and we find no compelling reason to treat this portion of the plant in service estimate any differently. Accordingly, we will not order General's rates subject to refund for further analysis of its conversion schedule.

We are, however, making a $7.4 million adjustment to test year 1984 revenue requirement due not to slippage in the conversion schedule, but because of our not being convinced that the estimated capitalized expenditures are reasonable. The $7.4 million adjustment is discussed later in this opinion.

E. <u>Materials and Supplies</u>

Materials and Supplies (M&S) consists of items held in inventory to facilitate maintenance, installation, and construction of telephone plant. General's estimated total M&S will be $55.9 million, and it proposes including that total amount directly in rate base. While staff's witness Monson does not take issue with the amount General budgets for M&S, he recommends including only 17.86% in rate base, or about $10 million. That represents the portion assignable to repair and installation work, while the balance will be used for both long- and short-term construction. His rationale is

that the inventory destined for construction should be in an account eligible to accrue interest during construction, and should not, since it is nonoperative, be directly placed in rate base. Of total M&S about 42% is destined for short-term construction in Account 100.1 (such construction is included directly in rate base), and about 40% will be used in connection with long-term construction projects that, of course, accrue IDC before going into rate base.

General objects primarily because it does not physically segregate its M&S inventory into the ultimate end use categories under discussion, and it thinks the accounting involved implementing Monson's proposal is, accordingly, too complex. Its rebuttal witness, Cecil, said if we were to adopt Monson's approach, it should be limited to just allocating M&S for long-term interest bearing CWIP out of rate base.

We will allocate 40.11% of M&S to long-term construction in Account 100.2, and remove the resulting $22.4 million from test year rate base as Monson proposes, but the 42.03% associated with short-term noninterest bearing construction, or $23.5 million, will be included in rate base. We make this distinction because M&S associated with short-term construction must be part of rate base, as plant in this category never moves from bearing IDC into Account 100.1. Rather, it is always in Account 100.1. Thus, our total adopted estimate of M&S is $33.5 million.

The accounting procedure General can follow to charge M&S inventory associated with Account 100.2, Long-term Construction, to the plant account is a clearing account. General points out in Exhibit 98 that our treatment of M&S, and allocating a portion to Account 100.2, may be inconsistent among telephone utilities. We expect our staff to review this matter in subsequent rate proceedings for other utilities.

F. Depreciation Expense

One factor affecting test year depreciation expense is the amount of plant in service from which depreciation expense, or return of capital, is calculated. In this proceeding that is the only difference between General and staff, and the test year plant in service differences have been reconciled above.

A new remaining life approach was proposed by General for switching equipment put into service in 1984, and thereafter. It is called the remaining life unit depreciation (RLUD) method, and differs from the direct weighting method of arriving at composite remaining lives. Staff accepts General's RLUD method; the RLUD or reciprocal weighting method was best explained and illustrated by General's witness Bush in Exhibit 41:

> "General's Electronic Toll Switching Equipment account consists of three locations. Two of these are obsolete analog switches (ETS-4) scheduled for replacement, and one is the latest Western Electric digital toll switch (4ESS) recently placed in service. The approximate amount in the account is tabulated below using remaining lives based on Company construction plans.

Location	1982 Investment	Forecast Retirement Date	Remaining Life (Years)
A (old)	$15,000,000	1985	3
B (old)	20,000,000	1984	2
C (new)	25,000,000	2007	25

> "Our goal is to arrive at a composite remaining life for this account which will allow the most equitable capital recovery during next year (1983). Since there are only three locations in this account, and assuming no salvage or reserve, intuitively the proper 1983 depreciation would be $16 million, that is, $5 million for location A ($15 million/3 years) plus $10 million for location B ($20 million/2 years) plus $1 million for location C ($25 million/25 years). This is the actual amount of capital to be consumed in 1983.

"Q. Based on your example, what is the estimated rate of capital recovery in 1983 using a Direct Weighting procedure?

"A. To apply Direct Weighting, in compositing the remaining lives, each location investment is multiplied by its remaining life. These products are summed and then divided by the total investment.

	Col. 1	Col. 2	Col. 3 = Col. 1 x Col. 2
Location	1982 Investment	Remaining Life (Years)	Direct Weighting ($ Years)
A	$15,000,000	3	45,000,000
B	20,000,000	2	40,000,000
C	25,000,000	25	625,000,000
	$60,000,000		710,000,000 $YRS

$$\frac{710{,}000{,}000\ \$YRS}{\$60{,}000{,}000} = 11.83 \text{ years composite remaining life}$$

"The account depreciation expense for 1983 would be the total investment divided by the composite expectancy, or $60 million/11.83 years which equals $5.1 million. Comparing this figure to the $16 million actual capital consumed in 1983 shows that, in this account, Direct Weighting forces General to under-accrue by nearly $11 million in 1983. This short-fall is then passed on to the future ratepayers.

"Q. Using the same example, what is the estimated rate of capital recovery under your proposed Reciprocal Weighting procedure?

"A. Determining the future composite remaining life by Reciprocal Weighting (RLUD) is similar to the previous approach, except each location's investment is divided (inversely weighted) by its remaining life. The quotients are summed and then divided into the total investment.

	Col. 1	Col. 2	Col. 3 = Col. 1 x Col. 2
Location	1982 or Investment	Remaining Life (Years)	Direct Weighting ($ Years)
A	$15,000,000	3	5,000,000
B	20,000,000	2	10,000,000
C	25,000,000	25	1,000,000
	$60,000,000		16,000,000 $YRS

$$\frac{60{,}000{,}000\ \$YRS}{\$16{,}000{,}000} = 3.75 \text{ years composite remaining life}$$

> "The 1983 depreciation expense for the total account is calculated just as it was for Direct Weighting, i.e., the total investment divided by the composite remaining life, or $60 million/3.75 years which equals $16 million. Thus, Reciprocal Weighting, applied yearly, allows recovery of the exact amount of the total account investment forecasted to be consumed."

We will adopt the RLUD method for the plant categories proposed by General.

General proposed two other depreciation methodology changes, the equal life group (ELG), and product life cycle (PLC) approaches. The ELG method was rejected by us in both General's last rate decision and, more recently, in D.83-08-031 relating to Pacific Bell. Accordingly, our ALJ properly granted staff's motion to eliminate this issue. General withdrew its proposed product life cycle approach to deriving the remaining life of station apparatus or customer premises equipment (CPE), which would have produced a remaining life of 2.75 years for this plant. It accepted staff's determination that 3.57 years should be used. Staff's remaining life results from the rate of actual retirements applied to the vintage and mix of General's embedded CPE. From the standpoint of potential stranded investment, this means in 3.5 years General's investment in embedded CPE will be recovered, thus its long-term exposure to much obsolete CPE stranded undepreciated investment is virtually nil. The ramification of this average remaining life, which we will adopt, is discussed further in the section of this opinion on General's embedded CPE sales program.

We will adopt test year depreciation expense of $435,272,000 which is based on the test year plant in service adopted in our analysis of rate base.

G. Adopted Test Year 1984 Rate Base

	Adopted Amount ($000)
Plant in Service (Weighted Average Net)	$5,478,354
Plant Held For Future Use	23
Materials and Supplies	33,500
Working Cash	(94,208)
Depreciation Reserve	(1,525,250)
Deferred Tax Reserve	(549,568)
Rate Base before Adjustment	$3,437,059
Adjustments To Rate Base	Adjustments To Rate Base
ENFIA (Total company)	0
1968-69 Flow Through	(731)
Automatic Electric Adj.	(3,946)
FCC Accounting Change	(851)
RLUD Depreciation Method (1984)	(1,084)
Total Adjustments	(6,612)
Total Adopted Test Year Rate Base	$3,430,447

(Red Figures)

X. STAFF'S RECOMMENDATION ON A SEPARATE STAND-ALONE SUBSIDIARY FOR MARKETING UNREGULATED CUSTOMER PREMISES EQUIPMENT (CPE)

A. Background

Our staff recommends, as the best means of ensuring General's unregulated CPE marketing endeavor is not subsidized by ratepayers, that we order General to form a separate stand-alone corporate subsidiary. Its rationale is that structural separation will prove more effective than trying to devise, perfect, and administer an accounting separation, analyzed in each rate proceeding, to ensure costs are charged correctly. In reaction to staff's proposal General proposes as an alternative forming separate divisions and following an accounting-cost allocation formula in

conjunction with ongoing monitoring by our Revenue Requirements Division. Staff thinks General's proposal is off target from this Commission's directive in Resolution T-10597, issued on September 22, 1982, which ordered General to:

> "Develop and provide, within 60 days of the effective date of the resolution, a plan for establishing a separate CPE subsidiary and submit and present substantive testimony in its current NOI pertaining to this separable subsidiary plan."

Establishing a separate subsidiary, in staff's view, means a separate corporate entity and structural separation; even if some limited sharing of resources is allowed between the new separate corporate entity and General, staff believes we will face far fewer complexities stemming from continuing to attempt accounting separation in subsequent rate proceedings.

B. Staff's Position

Staff's Exhibit 83 was sponsored by two auditors, Johnson and Galvin. Johnson explains his conclusion that the results of General's CPE sales activity is "unauditable." He points to General's changing accounting practices during 1982-83, which made it impossible to track the cost assignment of unregulated multiline CPE sales, and found "cost of service results for new CPE sales are not reasonably verifiable." Johnson's review was confined to recorded periods, and he did not attempt to review the reasonableness of General's allocation and assignment of prospective test year costs between regulated and unregulated operations. Finally, Johnson concluded some marketing agreements for unregulated CPE between General and other GTE affiliates had or have terms "patently unfavorable" to General, which are not in the best interests of General's ratepayers. Since the agreements concerned marketing unregulated equipment or services we need not address Johnson's concern, despite his conclusion that they may be "devices by GTE to

divert revenues from General's CPE sales activities to unregulated affiliates of General without compensatory benefits to General."

Galvin testifed that a "fully separate subsidiary is the only approach that will substantially eliminate the potential cross-subsidization between regulated and unregulated operations" (Exhibit 83, Chapter 2). A fully separate subsidiary is defined by Galvin as an entity with a separate corporate structure, operating facilities, management, personnel, and financing. He would allow some limited sharing of "corporate oversight" facilities, but would confine it to officers and directors. Any more extensive sharing of resources would, according to Galvin, not eliminate "internal competition between regulated and unregulated operations for financial funds, personnel, advertising and market share." Once the fully separate subsidiary is in place Galvin believes our regulatory scrutiny would be limited to reviewing any "sharing arrangements" for facilities and personnel which are specifically authorized by this Commission. Galvin recommends that we allow General six months from today to set-up its separate subsidiary, leaving it to staff and General to resolve any issues about shared resources or facilities, and if General does not comply to reduce its authorized return or equity by 0.5%. He summarizes his conclusions leading him to that recommendation:

> "1. It is doubtful that General's regulated operation will benefit from the joint use of its assets and personnel with its unregulated CPE activities. This is supported by General's own statement that the present value of the future benefit it would receive from the joint use of its assets and personnel in regulated and unregulated activities in comparison to establishing a separate subsidiary is unknown.
>
> "2. A fully separated subsidiary requirement will eliminate much of the inevitable controversies concerning cross-subsidization and proper cost allocations.

"3. A fully separated subsidiary requirement will greatly reduce the Commission resources that will be needed to review these activities." (Exhibit 83, p. 3-1.)

C. General's Position

General had two witnesses on this issue. Borghi was the policy witness and Pertler, whose testimony is also discussed under commercial expense, testified about test year assignment and allocation of expense between regulated and unregulated operations. As vice president - marketing, Borghi sponsored Exhibits 74, 75, and 76, and explained why General's separate divisions approach is reasonable.

The separate division structure, instead of a fully separate subsidiary, is proposed by General despite the directive in Resolution T-10597, because (Exhibit 74):

1. The FCC held in its second computer inquiry decision that GTE was a nondominant carrier and was not required to provide CPE through a separate subsidiary. ((1980) 84 FCC 2d 50. The FCC's decision was affirmed by the U.S. Court of Appeals, D.C. Circuit.
2. General believes application of GTE established nonregulated activities accounting guidelines (NAAGs), in conjunction with integrated phone marts, is the only way it can compete in the single line CPE market. Otherwise the marketing may be uneconomic and General would cease.
3. General's single line CPE marketing is premised on continuing a "one stop shopping concept" where customers can pay bills, order network services, and buy phones.
4. Costs to consumers can be reduced by integrated CPE sales conducted with joint facilities.
5. General's separate division for multiline CPE, the Business Terminal Sales and Service Division (BTSS), should be conducted jointly with General's continued offering of regulated or embedded CPE as a means of

> ensuring protection of the embedded base while accomplishing a smooth transition to the nonregulated business environment.

In response to Galvin's recommendations, Borghi supplemented his original testimony. Exhibit 76 states that General, in order to alleviate staff's concerns, would move toward an organizational structure allowing it by 1985, to directly charge and assign all revenues and costs for all unregulated CPE activities (except for corporate oversight and "indispensable services"). For example, the phone marts' direct costs would all be initially assigned to the unregulated division, then this division would bill the regulated operations for any services rendered which benefit regulated operations. Space for each of the 28 phone marts would be subleased to regulated operations. While "sales associates" in phone marts would handle unregulated and regulated transactions, a charge to the regulated operation would be made for each regulated transaction. Borghi cites repeatedly that the mechanics and actual billings will be furnished to our staff and can be reviewed on an ongoing basis. He concludes that General's proposed structure, particularly keeping an integrated phone mart network, will benefit customers by avoiding duplicative costs and maintaining a system they have grown accustomed to.

General's reply brief states that if we adopt staff's recommendation we must in fairness, given staff's distaste for any continuing "sharing arrangements," address the extent to which the sharing of facilities and resources will be permitted. We should, according to General, follow the approach of the FCC with respect to the regional Bell operating companies, which allowed:

1. Joint billing for CPE up to 4 years after divestiture.

2. Referral of dial tone customers with CPE needs to the separate subsidiary, provided that they are informed alternative CPE vendors exist.

3. Joint installation and maintenance for residential and business single-line CPE.

4. Administrative and support services sharing.

D. Discussion

We cannot find that we are jurisdictionally foreclosed from ordering General to conduct unregulated CPE marketing through a stand-alone separate subsidiary. The FCC order cited by General ordered only Bell System operating companies to form separate subsidiaries, but the question relating to non-Bell or nondominant carriers was left open for State action (Paragraph 86):

> "Our decision does not foreclose state authorities from establishing protections for the benefit of state ratepayers. Where this Commission has not required separation, regulatory tools such as accounting requirements and structural separation are available to the states in meeting their legitimate regulatory interest in insuring that an intrastate carrier's participation in unregulated activities is not at the expense of the communications ratepayer." (Emphasis added.)

General, in cross-examining Galvin, asked why any potential subsidization problems or issues should not be left to the courts to consider in the context of antitrust litigation, as an alternative to this Commission's ordering structural corporate changes to head off possible cross-subsidization. We would be remiss and not fulfilling our obligation to General's ratepayers if we totally abrogated the policing of potential anticompetitive conduct to the antitrust laws. Further, under California law we must consider potential anticompetitive ramifications of our regulatory decisions (see NCPA v PUC (1971) 5 C 3d 370). The perspective on our role, and the extent to which we must be concerned, as articulated by Galvin, parallels the position that the U.S. Department of Justice has taken before the FCC on the question of separate subidiary requirements for Bell System companies (summarized by the FCC in Paragraph 27 of its November 23, 1982 decision in CC Docket 83-115):

> "The Department of Justice correctly points out in comments that a limited definition of cross-subsidization, where competitive costs are subsidized with monopoly revenues to reduce the price charged for competitive products, is not the only type of cost-shifting with which we should be concerned. In Computer II we were also concerned with other detrimental cost-shifting arrangments, which include situations where costs that are common to regulated and unregulated operations, such as where the same personnel market regulated and unregulated products and services, are improperly allocated between regulated and unregulated operations. A further problem arises where all costs of an activity should be billed to unregulated operations, such as advertising for specific unregulated products or services. All of these cost-shifting techniques are of concern to the Commission in fulfilling its duty to protect ratepayers from overcharges."

General implies that we have the staff resources to thoroughly review its accounting and cost assignments both during and between its rate proceedings. We do not. This inherent resource limitation is an important factor leading us to find structural separation is necessary. The evidentiary record in this proceeding demonstrates that our staff finds a complete review of General's cost allocation and assignment in all expense categories an overwhelming task. Exhibit 35 shows at least 26 expense categories affected by cost allocation. Ratemaking is challenging enough without forevermore in future rate proceedings devoting the time and resources, which we do not have to start with, to exhaustively ensuring no cross-subsidization exists. Thus, Galvin's conclusions that a structurally separate subsidiary will eliminate many of the "inevitable controversies concerning cross-subsidization" and "reduce Commission resources that will be needed to review these activities" are, if anything, understatements.

Borghi's point that General's proposed use of unregulated corporate divisions reporting to the marketing vice president will better ensure the embedded base of CPE is protected (and regulated revenues enhanced) is unpersuasive. General, as discussed in Interim D.83-12-067, now operates under a structure posing "great potential for a conflict of interest." It can stress sales of new unregulated CPE and leave the promotion, either by lease or sale, of embedded CPE to drift under benign neglect. And it has taken prodding by us to get General moving in the direction of selling in-place embedded CPE. The day is approaching, probably in late 1987, when the embedded CPE base will be deregulated for non-Bell companies. We cannot envision a better way for that CPE (with ancillary employees and resources) to then be segregated for ratemaking purposes than for it to be transferred to a separate subsidiary at fair market value.[3] Thus, having a separate corporate subsidiary established now will ultimately result in a smooth transition when embedded CPE is deregulated: there will be an in-place entity for it and related employees to be transferred to, and ratemaking can be materially easier.

Another reason a separate subsidiary should be ordered which was not directly developed by the parties, but which nevertheless is important, is the potential problems General's existing structure poses for the settlements process. When reporting monthly its costs of service for intraLATA toll and other revenue division with all telephone utilities General must now allocate and assign out costs for unregulated activities. If its regulated costs of service are overstated General will realize more than its due share of settlement revenue. We are not sure about the extent to

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[3] This CPE should be transferred, or in essence sold, to the subsidiary at fair market value because given the 3.5 years of remaining life on this CPE used for depreciation expense it is likely that the net book value will be nil when the FCC deregulates it.

which other carriers have the inclination or resources to vigorously audit General's monthly settlement-pool submittals and take issue if they believe General's cost assignments are wrong, but it is in any event another potential dilemma that can best be mitigated by General's having a separate subsidiary.

A separate stand-alone CPE marketing subsidiary, whether a subsidiary of General or its parent, GTE, will make future rate proceedings far less complex, even if we allow some limited transitional resource sharing. Limited resource sharing between General and the new structurally separate subsidiary means there would be a cross-flow of billing between the two in some limited expense areas. This is far more preferable than General's proposal for quasi-separated operating divisions, for they would still entail detailed review of accounting and allocations over almost the entire spectrum of test year results of operations components. Given the evidentiary record before us we conclude it is in the public interest to act now, notwithstanding our recently issued OII 84-03-02, instituted to gather preliminary information from all telephone utilities so we could make some tentative recommendations to the Legislature (in response to Assembly Bill 2064 and amended PU Code § 7902.5). Ultimately the regulatory questions posed by either integrated regulated and unregulated operations or separate subsidiaries must be addressed on a case-by-case basis. We cannot say that ordering a separate corporate entity for marketing unregulated CPE will solve forevermore all related regulatory questions or issues, but we know that while they may be of a different nature there will be far fewer recurring in General rate proceedings. That is progress.

We conclude structural separation of General's unregulated CPE sales, in contrast to further attempts at accounting or ratemaking separation, is in the best interests of ratepayers. Likewise, it is probably in the best interest of General from the

standpoint of avoiding potential antitrust litigation. Staff recommends that we order the separate corporate subsidiary and leave resolution on the nature and extent of any interim resource sharing arrangements to it and General. However, we agree with General that we should not leave things so open ended, particularly as staff and General have such differing ideas on resource sharing.

E. Guidelines and Permitted Resource Sharing for General's Separate Subsidiary

We will require full complete corporate separation of resources devoted to unregulated CPE sales, and no sharing of resources and facilities, except for:

1. Corporate oversight, officers and directors of the separate corporate subsidiary, their headquarters, and immediate support resources.
2. Legal and accounting support for a maximum period of two years.
3. Customer billing and phone mart facilities and resources until such time as embedded single line CPE is deregulated.

Costs for corporate oversight and legal and accounting resources may be billed to the separate subsidiary. All direct phone mart costs shall, essentially, as Borghi proposed, be borne by the separate subsidiary; it, in turn, may bill General's regulated operations for the reasonable cost of services and facilities furnished that directly benefit regulated operations. We will allow this sharing and billing only until all single line CPE is deregulated, by that time we expect General to have established other locations for essential face-to-face customer contact relating to network service and bill paying, which may mean a return to using local business or commercial office facilities, or extended use of the more modest facilities that General calls "convenience centers." This transition period is allowed because it would be unduly burdensome on General to make an overnight total shift in

operations. Likewise, costs for customer billing resources in connection with continued joint billing can be billed to the unregulated subsidiary until all CPE is deregulated; after that, the subsidiary, as any CPE vendor, must directly bill for CPE itself.

We will not allow shared installation and repair resources in connection with unregulated CPE because maintenance expense is such a large expense category and meaningfully auditing expense allocation would be a herculean task. General already has a separate division for multiline CPE installation and repair, and essentially expanding that work force by transferring the needed employees and support resources to deal with single line CPE will not be unduly burdensome. Requiring these changes now can only lead to an easier transition when embedded single-line CPE is also deregulated. Also, we do not want to go through yet another rate proceeding trying to determine a reasonable estimate of prospective maintenance expense when our staff does not have the resources to thoroughly investigate maintenance expense assignment. Our resolution of this resource sharing issue is different than the FCC's approach for divested regional Bell operating companies, but the circumstances warrant it. A pivotal consideration is that, unlike the Bell companies' situation, General is further down the path of structural separation because it already has a separate division for multiline CPE repair and installation.

If General does not structure itself as ordered within six months, and complete the physical separation within one year, we will, for ratemaking, assign all phone mart costs to unregulated CPE operations, as it so materially benefits from the existing structure in terms of a traffic flow of potential customers, and adjust General's test year 1984 revenue requirement and rates accordingly. Also, we will adjust downward, as proposed by staff, the authorized rate of return by reducing the cost of equity 0.5%. These adjustments will be made in connection with determining the 1985

attrition year revenue requirement if General does not demonstrate a definite move toward compliance with our order, and they will be made in connection wih the 1986 attrition filing if General has not compiled. We trust General will understand our reasoning, and the long-term benefits the new structure offers it, and proceed with an orderly reorganization (as Pacific Telesis has done with CPE marketing).

Finally, while staff contemplates that General would be the immediate holding company of the separate subsidiary, GTE itself could be the immediate holding company. At this juncture we will leave this decision to General and/or its parent, GTE.

XI. GENERAL'S SELECTION OF AUTOMATIC ELECTRIC MANUFACTURED SWITCHES AND MODIFICATIONS TO GENERAL'S COMPETITIVE BIDDING PROCUREMENT PROGRAM

We have ordered General to let its purchases of central office switching equipment (COSE) out to competitive bid. Its program in response to that order has been found in 1982, by Resolution T-10642, to be reasonable, but it was the subject of further analysis by staff's Strahl in this proceeding. It was Strahl's recommendation which led us to our ordering the competitive bidding requirement, which was ultimately upheld on review by the California Supreme Court, (1983) 34 C 3d 817.

Strahl agrees with General that the competitive bidding guidelines should be modified to limit bids to three suppliers whenever General reaches the point that it has purchased switches of a given technology from three suppliers. He explains that having a switch technology supplied by more than three vendors can cause General to have more training and parts inventory costs, which could, over time, more than offset any direct purchase price savings. Also, he believes individual switches which are identified as "test units," to test new technology, should be able to be purchased without competitive bids. We accept his rationale and will order these changes.

Directly related to General's competitive bid program is Strahl's recommendation that we order General to exclude in its "bid analysis" all cost factors relating to switch compatability with General's existing centralized electronic switch administration and maintenance centers, known as RCMS. Both Pacific Bell and Continental Telephone Company have comparable RCMS programs, but their systems will interface with switches from all vendors. Having set up an RCMS program compatible with only an affiliated manufacturer's switch is, in light of other options, unreasonable in Strahl's view. If Strahl's contentions are correct, they highlight the problems posed by a vertically integrated telecommunications company and why we required competitive bidding. To eliminate this limiting factor and possible unfair advantage for AE switches in evaluation studies, Strahl recommends that we order General to eliminate RCMS compatibility and associated costs such as those related to training and parts inventory from its studies for the current host/remote digital level of technology. General's Miller testified in rebuttal, indicating Strahl is mistaken about the capabilities of its RCMS systems. He said General uses two types of RCMS, one system manufactured by AE and another by Western Electric, and that while the AE supplied RCMS can easily be made to be compatible with switches made by other vendors (e.g. Northern Telecom and Stromberg Carlson), the Western Electric system cannot. General's point is that given the diversity of its RCMS systems and capabilities it cannot be said any particular switch vendor is favored in the economic bid analysis review. Our record shows that the economies of RCMS compatibility as a consideration in bid analysis is extremely small ($17,125) in relation to the average cost of a new switch, about $6 million. We conclude, given the facts presented by General, that its bid analysis considerations related to RCMS compatibility and costs do not unduly favor any particular switch vendor, and we will not adopt Strahl's recommendation.

Strahl points out that during the 16-month grace period we allowed General to gear up for competitive COSE bidding it proceeded to "firm up orders for a substantial number of GTD-5 digital switches from AE." These orders were placed before the first cutover of a GTD-5 switch on General's system, which was in the Banning central office during June 1982. It turned out that GTD-5 switch had considerable problems, which were experienced by both General and other purchasers:

1. It needed field augmentation because the original version did not have the capacity to handle the designated call volume.
2. Purchasers were apparently misled by AE with respect to the GTD-5's efficacy. Features or capabilities were promised before software releases were ready and available to accompany the GTD-5.
3. While non-GTE companies either canceled contracts to purchase GTD-5 switches when its problems were apparent or pursued collecting damages, General did neither. General, unlike other purchasers, had no liquidated damages provisions in its contracts to apply if there were delivery delays or malfunctioning.
4. General's GTD-5 switch at Banning was to handle 9,000 lines, but at the eventual cutover in June 1982, it could handle only 1,700 lines and required an old step-by-step back-up switch. Strahl thinks it is likely other GTD-5 installations may also require back-ups or else there could be massive outages.

In view of these developments Strahl thinks we should put General on notice that any unusual maintenance or plant expense associated with General's GTD-5 switches which purchased prior to the usual "shakeout or trial period" should be disallowed for ratemaking. Also, he recommends that any new GTD-5 switches that had to have a costly colocated back-up switch should ultimately be reflected in an adjustment to rate base and maintenance expense, otherwise ratepayers

will bear the additional costs caused by General rushing to use an affiliate's product at any cost before it was field-tested and proven for the intended application.

As a closely related subject, Strahl concludes that in addition to General's more recent GTD-5 switch orders and those attendant problems, General has acted imprudently in other aspects of its switch selection. Its planners made decisions to buy AE switches over the years when the switches did not meet General's needs and had them installed in areas where larger switching capability was clearly required. He determined that Pacific Bell and Continental Telephone Company have historically made switch purchase decisions only after thorough economic needs studies, while General has not. The added costs caused by not undertaking an economic study and having colocated or different switches installed to meet demand because of this lack of planning should, according to Strahl, be borne by stockholders. He wants us to put General on notice that we expect it to perform economic studies in connection with switch selection, and to include clauses in its purchase contracts to protect ratepayers from added costs caused by COSE that does not turn out to meet General's specifications. Both are approaches commonly used by other telephone utilities. The history of General's selection process, illustrating the need for new procedures, was set out by Strahl (Exhibit 34, Chapter 16):

> "1. In the early 1960s the Bell System (Western Electric) developed an electronic switch, the No. 1-ESS, and put it into service beginning in 1965. The switch was (and is) capable of handling up to 30,000 lines in an urban environment (heavy traffic loading). AE's answer to the 1-ESS was a switch called No. 1-EAX, a machine with rotating drum system (rather than solid state) memory, capable of handling up to 30,000 lines in an urban environment. The No. 1-EAX was put into service in 1972. In 1977, AE developed another electronic switch, the No. 2-EAX. The new machine was rated at 30,000 lines

with a No. 2A solid state processor, and since it was architecturally different from the No. 1-EAX, it made the No. 1-EAX obsolete. There were no installations of new No. 1-EAX machines in California after 1978. Economical production of new line additions for the 1-EAX machines has been discontinued. General has 10 locations in California with No. 1-EAX machines; all of these locations will now require capping (no growth) with the growth shifted to another collocated machine, or will accommodate some growth if 1-EAX machines in other locations are cannibalized. In either case, extra costs will be incurred due to cost of removal and reinstallation, cost of intermachine trunks (to enable two collocated machines to communicate with each other), and the cost of upkeeping a product which is no longer in production.

"2. By the mid-1970s, Western Electric (WE) found it necessary to react to the needs of the Bell operating companies for larger electronic switches with more features. WE elected to prolong and extend the life of the older 1-ESS switches by designing a new processor which could be retrofitted to an older 1-ESS machine, thereby vastly enlarging its capacity and features. The new configuration (called 1A-ESS) can accommodate 60,000 lines in an urban environment and can provide features such as enhanced 911, EBSS, remotes, and even a special digital path for customers in need of special data switching. WE intends to provide additional software releases for the 1A-ESS and keep it updated and well-supported for at least another 20 years. The impact of this is that even though there will be no new 1-ESS or 1A-ESS machines installed in California by Pacific Telephone after January 1, 1984, the Pacific Telephone ratepayers will not be burdened with obsolete equipment.

"3. The No. 2-EAX with the 2A processor of AE was originally (1977) rated at 30,000 lines; but, as General found out, the rating was dependent upon the demand put on the

> processor. This means that the machine will serve 30,000 lines in a low-call volume area; however, as the call volume increases, and as custom calling and other features are loaded up on the processor, the line capacity must be reduced or else service problems might arise. In an urban environment the No. 2-EAX with a 2A processor is only rated for 20,000 lines. AE's solution was to introduce a new processor called 2B in 1979 to resolve some of the 2A shortcomings; unfortunately, the 2B was also misrated, as it was represented as capable of carrying 50,000 lines, where in fact it can only handle 30,000 in an urban environment. A retrofit from the 2A to the 2B processor costs around $500,000 per location and it extends the capacity of the machine by only 50%.
>
> "4. In the late 1970s, General's planners specified No. 2-EAX machines for at least 29 locations throughout California. In 15 of those locations, the No. 2-EAX was specified even though the projected near load of the central office exceeded 30,000 lines, which means that obsolescence and capping were built into the design. Augmentation will be required, and indeed, in the case of quite a few offices such as Thousand Oaks, Palm Springs, Cucamonga, Rowland, and Upland, GTD-5 machines are currently being placed to augment the No. 2-EAX machines, with the consequence of increased costs due to intermachine trunks, special training, and spare parts inventory."

Strahl's assessment is sound, and his investigation of how other utilities assess switch needs and costs shows that General has proceeded over the years without the careful cost analysis behind its COSE decisions that we expect. Strahl said staff did not have time within the confines of this rate proceeding to do the detailed location-by-location study necessary to precisely quantify excessive plant and current costs resulting from General's COSE selection.

It is apparent, both in view of Strahl's testimony and that of Monson (addressing the progress of the COSE conversion program), that there is serious doubt about the prudency of General's expenditures in connection with installing both No. 2 EAX and GTD-5 COSE. Given this evidence we cannot conclude that General has met its burden of proof to justify the reasonableness of test year plant expenditures in connection with the COSE conversion program. Given this evidentiary deficiency we cannot adopt General's net test year plant costs for the COSE conversion program, totaling $305 million. Our interim solution is to allow General a return on 90% of capitalized test year expenditures, after retirements. The $305 million will stay in rate base until further order, but a return will not be recognized on $30.5 million, which results in a reduction in intrastate test year revenue requirement of $6 million. It should be noted the net loss to General will be about half of that amount as it will not pay taxes on that gross revenue.

Our staff should thoroughly investigate this matter and we will review it further in connection with General's attrition filing for 1986, when we will decide the extent of any permanent ratemaking adjustment to rate base. Within six months from today General shall submit the following information to aid our staff in its investigation:

1. Copies of the cost studies or justification that existed prior to General's selecting No. 2 EAX COSE.
2. Copies of all cost studies or other economic justification for colocating new digital COSE next to No. 2 EAX switches.
3. Quantification of the full incremental capitalized costs caused by colocated COSE, broken down by each central office location.

Our final observation on these issues is that ordinarily we prefer not to impose our judgment on details of day-to-day utility

management; however, General's COSE selection process is an area where, given the circumstances, we have had no choice. We expect our staff to closely monitor General's competitive bidding program, as the evidence in this and the last rate proceeding shows General's selection process has been less than adequate for some time. Given the GTE corporate family's vertical integration there are obviously potential conflicts of interests that will continue. This warrants our continued close oversight.

XII. ATTRITION: 1985 AND 1986

A. Background

During the last 4-5 years there has been increasing interest in "attrition allowances" for utilities to enable revenues to be increased during the year following the test year. The driving forces leading to various methods of quantifying attrition were inflation and wildly fluctuating interest rates. The debt cost component of utilities' capital structure was relatively volatile. We have almost reached the point where attrition mechanisms, regardless of the level of inflation, are viewed by utilities as a right, and we are told the financial community expects nothing less than a dollar-for-dollar pass-through of any and all additional costs through rates. The danger we run devising and administering attrition mechanisms is the potential disincentive for utilities to vigorously apply management acumen to hold down operating costs. The distinction between having Californians pay utility rates based on reasonable costs of service as compared to costs-plus is very real. Our underlying goal in approaching the attrition proposals of General and staff is to balance anticipated cost increases against the need to ensure General has a meaningful incentive to minimize its costs.

As discussed later the issue of assumed productivity during attrition years is particularly critical with telephone utilities. They, unlike energy utilities, provide a service that is extremely

labor intensive, and the continuing march of technology and innovation means there are efficiencies that can directly reduce labor-related and other costs per access line, while resulting in better service. If there is to be any error in anticipating future productivity it is, we think, more preferable to err on the side of estimating more productivity gain. We prefer to instill management with the incentive to maximize efficiency, rather than to adopt conservative productivity factors which could lessen its incentive.

B. Two Attrition Years: 1985 and 1986

Staff's McVicar proposed a comprehensive methodology for addressing operational attrition in both 1985 and 1986. He stressed that his proposal in Exhibit 113 was designed with an uppermost concern being to as much as possible have a prequantified easy to administer approach. Interested parties, he stressed, would probably find any methodology which left a lot of input determinations in 1985-86 to resolution by staff and General both unfair and unpalatable. If many elements are left to staff review and judgment, entailing review and reconciliation based on work papers supporting an advice letter, McVicar thinks that the attrition filing reviews will evolve into "mini-rate cases," and if it is an ex parte process it may not be fair. He stresses that the need for two attrition years results from staff lacking the resources to process rate cases for both General and Pacific Bell with 1986 test years. TURN made a continuing objection to the receipt of evidence on proposals for two attrition years, pointing out such proposals reflect a major policy shift not contemplated by our Rate Case Plan. However, that Plan is not inviolate and can, when good cause is shown, be deviated from (See Rule 87). While not disputing this point, the tenor of General's testimony is that it is disgruntled because its NOIs are consistently "slipped" in deference to Pacific Bell's. We agree with McVicar's observation that it is highly desirable to have Pacific Bell and General tender NOIs with alternate test years. After

McVicar testified we issued Resolution ALJ-151 on June 6, 1984. It changed the NOI filing schedule for major utilities, and set 1987 as the next test year for General. Thus, we will devise an approach for two attrition years. General and staff differ on how attrition allowances should be processed for 1985-86, and on the extent to which recent actual data and/or analysis should be used in connection with attrition advice letter filings (which are normally handled ex parte).

C. Operational Attrition

Staff's McVicar proposed a comprehensive approach for calculating the 1985 and 1986 attrition allowances, and General essentially reacted with some specific modifications. McVicar's proposal is attached as Appendix A (13 pages). One factor specifically not encompassed by his proposal is the revenue and expense savings effect of local directory assistance charging in both years; as discussed later under rate design, General can phase in the adopted charge plan over 1985.

Productivity Factor For Labor
and Related Overhead Expense

While McVicar proposes to use 5% for productivity increases[4] in 1985 and 1986, General's Cecil thinks this element of the attrition allowance should be left open for resolution between General and staff each year. Cecil's rationale is that over the past five years the annual average labor productivity gain has been 1.1% and McVicar's assumption could be too optimistic. McVicar explained that a study prepared by General at staff's request showed that General realized a 6% gain in 1983 over 1982, and Cecil admitted on cross-examination that General's own figures indicate that the 1982 gain was 7.2%. Central to McVicar's conclusion is that given its modernization programs General should start consistently realizing productivity gains from year to year of roughly the same magnitude Pacific Bell realized in recent years. We cannot leave this matter open-ended at this point, for staff and General to repeatedly negotiate over the next two years, because this issue is inherently too controversial for ex parte treatment. We conclude McVicar's assumption is well reasoned, and we will adopt a 5% factor, exclusive of additional incremental gains from local directory assistance charging, for use in 1985 and 1986. This gives General's management a realistic target to achieve and an incentive.

Revenues and Local Directory
Assistance Charging

While McVicar proposes simply using annual revenue growth over the preceding 60 months in connection with the 1985 and 1986 attrition filings, General thinks there could be too much revenue volatility because of: (1) declining local service revenues from

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[4] The productivity factor relates to labor cost per access line, after adjusting out the growth in lines and the awarded wage and salary increases.

leased CPE; (2) division of intraLATA toll revenue uncertainty; and (3) outstanding questions on access charge revenue from interLATA carriers. General recommends an annual reassessment of revenue growth.

General's situation differs from Pacific Bell's in that in 1985 General will have a new local directory assistance charge plan in place and it still has embedded CPE, which we are encouraging it to sell. These factors, plus the relative uncertainty surrounding its access charge revenue, mean we must allow for a current consideration of these forces on revenues in 1985 and 1986. The fairest and most open way to do this is to hold limited hearings in connection with the advice letter attrition filings. We will allow a more current view of some revenue factors:

1. Changes in local service revenues directly attributed to CPE, local directory assistance charging, ZUM extension, and lifeline service.
2. Changes in toll revenue attributable to the final intraLATA toll settlements agreement.
3. Access charge revenue from interLATA carriers.

We will also review the means of estimating system growth and overall changes in revenues.

While we will apply expense savings from directory assistance charging of at least the amounts quantified in the section of this opinion on that subject, we will allow parties to make showings on whether there will be incremental traffic expense reductions exceeding that estimated by General; this is because as discussed later, staff has not reviewed or analyzed General's estimated 1985-86 expense savings from local directory assistance charging. Also, the advent of end-user directory assistance charges for interstate and intrastate long distance calls will undoubtedly further repress directory assistance calling and expenses. Our adopted approach affords General some flexibility with respect to revenue uncertainty each year, but in exchange for using more current revenue growth data.

Ad Valorem Tax

Rather than use adopted 1984 ratios of assessed valuation to the net book value of assets, General thinks it is fair to incorporate any changed assessment ratios adopted by the State Board of Equalization. Ordinarily this is known each May, and the ratio has changed over 1981-83. Any such change can be easily quantified in the attrition filing, so we will adopt General's recommendation.

Materials, Rents, and Services and Rate Base

After hearings concluded in these proceedings we analyzed, in the recent Pacific Bell decision, D.84-06-111, staff's proposed method of deriving attrition year changes in materials, rents, and services, and rate base (among other categories). We are concerned about the validity of staff's methodologies for these items (see D.84-06-111, pp. 55-58). We will be holding hearings this fall in connection with the attrition mechanism for Pacific Bell, and we think it is logical to simultaneously consider these matters as they apply to General's 1985 and 1986 attrition filings. Accordingly, we will hold joint hearings on attrition for Pacific Bell and General, although the scope of issues to consider vary to some extent between the two utilities.

In these further hearings, parties should not present any attrition calculations based on trends using monetary data unadjusted for inflationary factors. While we recognize that industry characteristics may warrant somewhat different attrition mechanisms for telephone utilities compared to energy utilities, parties should consider the consistency of their attrition proposals for General and Pacific Bell with the attrition methodologies we have adopted for energy utilities.

Depreciation Expense/Reserve

General believes McVicar's methodology must allow for reflecting any Commission approved depreciation represcription in attrition year revenue requirement. McVicar said he would not object to this, so long as the depreciation changes had been properly ratified by this Commission.

General's Bush also proposed that what he terms "technical updates" be reflected in the attrition filings. This would be, from

his view, fine tuning of adopted depreciation elements, adjusted for updated survivor curves, etc., as resolved between General and staff. We do not have the staff resources to undertake comprehensive depreciation represcription review in connection with both 1985 and 1986. We will allow General to propose only technical updating in connection with 1985, and if the technical updating is approved by us before the October 1 attrition advice letter filing the revenue requirement effect on 1985 will be recognized. A represcription review may be proposed by General in 1985 in connection with the 1986 attrition year.

Conclusion-Operational Attrition

We will adopt McVicar's approach in Appendix A with the exception of the specific changes adopted above with respect to: (1) revenues; (2) directory assistance expense reduction; (3) ad valorem taxes; (4) depreciation represcription and updating; (5) materials, rents, and services; and (6) rate base.

D. Financial Attrition

General's original attrition proposal for 1985, testified to by Hascall, did not make any allowance for financial attrition. In reaction to staff's proposal for two attrition years General revised its showing and addressed financial attrition. Essentially General wants an opportunity to seek an increase in the adopted cost of equity if "conditions" change. Also, it wants its authorized rate of return to be applied during 1985 and 1986 to be adjusted to reflect any increase in the ratio of equity in its capital structure. Staff's Mowrey testified that if interest rates climb to 16% for long-term debt then his projection for General's refinancing of outstanding high cost debt issues may not be realized, which could erode interest coverage. In brief, he said if debt cost conditions drastically change in either direction we should have some process to reconsider and possibly revise the adopted capital structure costs. He disagrees that the rate of return should automatically be

recomputed to reflect any increase in the equity ratio, stating that while it is true that by holding the rate of return constant in 1985-86 the resulting return on equity will decrease somewhat as the equity ratio and the weighted cost of equity increase, it would be offset by less overall risk from: (1) having more equity and (2) an improved interest coverage ratio. General's O'Rourke responds to Mowrey's view of declining risk resulting from a higher equity ratio: "Even if financial risk were to decline to some lower level, investor perception of our business risk will be greater in 1985 and 1986 than in 1984 and will more than offset any minimal decrease in financial risk" (Exhibit 120, p. 9).

O'Rourke recommends that we allow General to propose a higher return on equity in 1985 or 1986 if any of the following occurs:

1. General does not obtain an "A" rating from both Moody's and S&P by October 1, 1985;
2. Regulatory or legislative changes occur which in General's opinion threaten its revenue streams as forecasted in this proceeding, and therefore significantly increase its perceived business risk;
3. Expected 1986 "A" bond interest rates as forecasted by DRI or UCLA or Chase Econometrics or Wharton, on or after October 1, 1985, rise to a level higher than 200 basis points below the return on equity authorized by the Commission in this case" (Exhibit 120, pp. 16-17).

Discussion - Financial Attrition

We will not adopt any of the trigger point criteria for reopening the cost of equity issue. First, tying a reconsideration to rating agency activity as of a date certain is subject to too many vagaries, and besides it places too much emphasis on rating agency determinations and their timing. Second, as discussed above, we will be reviewing for each attrition year the operational attrition

factors which could most materially affect General's "revenue streams." Given that review in connection with operational attrition we can directly address factors affecting revenues. This mitigates any need to reconsider the cost of equity. Finally, we suspect at least one out of the four economic forecasting entities will have a more dismal debt cost forecast than the others, and besides we are adopting today a return on equity to apply over time, irrespective of short-term fluctuations in debt costs or economic conditions. Accordingly, we will not use any forecast in 1985 of economic conditions in 1986 as a basis for triggering a reconsideration of the cost of capital.

Our adopted test year capital structure is that estimated at the <u>end</u> of 1984, so by its very nature it is an average capital structure over 1984-85. Thus, there is no need to readjust General's rate of return based on any additional equity infusion expected in 1985; that has already been recognized in adopting today's authorized rate of return. But 1986 is a different matter. While we think Mowrey is technically correct that all things being equal a higher equity ratio in 1986 means less overall risk, which O'Rourke technically concedes, we are not convinced, as O'Rourke points out, that debt investors will necessarily view things with the same level of sophistication. This is particularly true as we are for the first time requiring two attrition years. We are hopeful that General will achieve the 47.4% equity ratio in 1986 which O'Rourke projects, and not adjusting rate of return to reflect such an equity ratio could be a disincentive to General's parent and sole stockholder to infuse equity. Thus, we will allow the rate of return to apply in 1986 to be adjusted to reflect a maximum equity ratio of 47.4% if General's 1986 attrition filing is convincing that it will achieve such a higher equity ratio in 1986. We set O'Rourke's estimate as a limit because we do not want the overall rate of return automatically driven up because General's parent may decide in 1985 that the best available investment happens to be General.

Other than the possible adjustment to the 1986 rate of return if General's equity ratio rises, we will not reconsider the cost of capital or debt in connection with the attrition filings. Today's adopted capital structure costs are consciously adopted with an expectation that over time they are reasonable. Our approach to financial attrition gives General both some certainty and incentive, and when viewed in connection with the operational attrition mechanism, we think our overall approach to attrition affords General an opportunity to do well.

E. Rate Design for Spreading Revenue Requirement Changes from Attrition Filings and/or the Inflow of Additional Settlement Revenue

Only General had a recommendation on how to spread additional 1985 and 1986 revenue requirement. Quaintance testified that General wants the option to propose specific rate changes, but he is not certain which rates it would propose for adjustment, particularly as he testified before today's decision was issued. However, he said the overall priority would probably be to price private line service at cost, based on General's cost estimtes, as well as service connection charges. After that, General would spread any increase on basic access line and local service usage rates. Short-haul toll rates could, he thinks, warrant a reduction depending on competitive forces, and he said it is foreseeable General might propose such a reduction. We have difficulty understanding the mechanics of a toll reduction by an advice letter filing, given the potential settlement revenue reductions for other utilities that would occur by reducing the uniform statewide intraLATA toll rates. General's proposal clearly leaves rate design too open-ended and would invite almost with certainty protests and the need for protracted hearings. Although Quaintance's approach is theoretically perfect, it literally defeats the purpose of an attrition filing, where the scope of any hearings, if they must be held, should be tightly restricted.

We should establish now how General's rates in 1985 and 1986 will be adjusted so all parties can plan accordingly, and questions on rate design do not arise either in connection with the attrition filings or from a potential inflow of settlement revenue from the next Pacific Bell rate proceeding, which could have a decision in late 1985 based on a 1986 test year. Our goal is to have a straightforward approach that is easy to explain, while also fairly apportioning revenue requirement changes. Any rate increases resulting in a cumulative change in revenue requirement for 1985 and/or 1986, from that adopted today, which do not exceed $50 million shall be made through a uniform surcharge on all intrastate services, except message toll, ORTS, WATS, OCMS, ZUM, inter-exchange private lines, directory advertising and local calls paid for in coin at pay stations. Likewise, any reductions occurring before the cumulative revenue requirement has increased by $50 million will be made by a surcredit on these rates. When, at any time, the cumulative revenue increase exceeds $50 million the total cumulative surcharge revenue requirement shall be respread and the new surcharge applied equally on all intrastate exchange services on a bill-and-keep basis. Bill-and-keep means the surcharge on toll calls will be retained by General and not submitted for revenue division with other utilities. Thereafter, any reduction will be made uniformly to the uniform surcharge on essentially all intrastate services.

F. Attrition Advice Letter Filing and Processing Procedure

General shall file its attrition advice letter filing no later than October 1 in 1984 and 1985, complete with prepared testimony. Simultaneously the filing shall be served on all appearances in this proceeding. It shall submit a draft filing to the Revenue Requirements Division by September 1. The filed advice letter shall clearly show how each results of operations component

was derived in compliance with our adopted attrition mechanism, and it shall include billing base data upon which a billing surcharge can be computed for the prospective year. General's work papers supporting its attrition advice letters shall be furnished to any party requesting them. The date for the limited hearing on the 1985 attrition filing will be announced.

XIII. GENERAL'S SALES PROGRAMS FOR EMBEDDED CUSTOMER PREMISES EQUIPMENT (CPE)

A. Background

General, as discussed extensively earlier, sells new single and multiline CPE on a deregulated basis. It also has what is termed embedded CPE which is still under our regulation. Ultimately, this embedded CPE will be deregulated, but we are not sure when. The FCC released a notice of proposed rulemaking on June 21, 1983 (CC Docket 81-893) which proposed that the embedded CPE of non-Bell companies be deregulated no later than the end of 1987. The FCC has not issued an order on this issue.

We have already directed a sales program for General's embedded single-line CPE.[5] After finding General was very sporadically selling multiline CPE by negotiation, without a tariff, we directed it to file a proposed multiline sales program in these proceedings. The proposal was filed and, as Exhibit 119, was considered in the April hearings.

It turns out that given the vintage-mix of General's embedded CPE it has an average remaining life for depreciation purposes of 3.5 years. This means about the time it is likely to be deregulated General will have substantially recovered its capital investment through depreciation expense, borne by all ratepayers.

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[5] Resolution T-10651, as modified by D.83-06-090 on June 29, 1983 in A.83-05-12.

B. General's Sales Plan

General's sales plan covers the following categories of in-place or inventoried multiline CPE:

1. Model 17A and 10A2 key systems and auxiliary equipment (including single-line CPE).
2. Non-expandable dial PBXs: Leich 40 and 80 systems.
3. Vintage PBXs (manual and cordless): AE 320-SXS, AE 301-SXS, S-C 800 and 400A, and AE GTX 400.
4. Telephone answering service cordboards.
5. Special assemblies.

Newer more state-of-the-art electronic PBXs (GTD-120, Rolm and Focus) are not covered with set prices as existing tariff schedules already allow customers with those in-place systems to make a payoff and receive ownership.

The proposed sales prices were calculated with the following components:

1. The unit's depreciated or average net book value (at the end of 1982).
2. Factors for administrative and warranty costs (coinciding with the 90-day warranty term).
3. Sales transaction costs.
4. A return on sales applied to items sold from inventory - a 43% markup on some items.

With these prices and its proposed terms General estimates that through 1985 it may sell 278 in-place key systems and 52 PBX systems.

General will notify all multiline customers within 90 days of the availability of multiline CPE for purchase and the overall terms. Interested customers will be contacted by multiline CPE sales representatives and a specific price quote will be developed. Quaintance testified that the marketing force making these contacts will be separate from the employee force that sells new or unregulated CPE, which potentially competes with embedded CPE. Overall, the terms and sales program's specifics closely parallel those approved in 1983 for Pacific Bell's embedded multiline CPE.

C. Staff's Analysis

The Communications Division reviewed General's proposal. Its witness, Betts, recommended we order a sales program tracking system like that ordered for Pacific Bell in D.83-09-024. Also, Betts asked that we order General to provide staff, within 90 days, a pricing comparison of embedded key systems and General's comparable new or unregulated key systems. He said this comparison would enable staff to evaluate whether prices for embedded CPE should be periodically lowered to make it competitive.

D. Discussion

General's Quaintance acknowledged that given the average 3.5-year remaining life of all embedded CPE (single and multiline), which on average enables recovery of the now undepreciated investment by about the time this CPE could be deregulated, General now has little economic incentive to sell it. Little risk of stranded CPE investment faces General. When asked whether the sales prices should be recomputed and lowered each year in view of this short remaining life, he said they could be if that is the approach this Commission prefers.

General computed initial sales prices by using average net book value at the end of 1982. This is too high. The average net book value for 1984[6] should be used initially as the program will start in 1984. Accordingly, we will order General to recalculate the net book value components of the sales prices. The sales prices of the electronic PBXs (GTD-120, Rolm and Focus) shall be determined by the same approach adopted for other multiline CPE, with the prices tariffed, and customers allowed the informed option of purchasing either under the price formula in their contract or the tariffed sales price, whichever is lower.

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[6] Calculated by adding the particular CPE plant category's average end of 1983 regulatory net book value with the end of 1984 net book value and dividing by 2.

We think it is fair to order the sales price recalculated and refiled in June of 1985 and 1986 based on the average regulatory net book value of the multiline CPE for each of those years. No other price component shall be changed. Further, we will order General to each year simultaneously recompute the net book value component of its single-line CPE on the same basis and also file lower sales prices for 1984; it shall do this when its tariffs for the multiline sales program are to be filed, or 30 days after today.

We think the 43% markup on key system CPE sold from inventory is excessive. General offered no rationale for such a markup. The equipment in inventory has been refurbished, so its sales price should be higher by some increment. Given our evidentiary record we conclude this markup should be limited to 25%, which is the markup applied by General to other inventoried multiline CPE.

While General proposes a one-time lump sum payment from multiline CPE purchasers, Quaintance said an installment payment option might make purchasing more attractive to customers. We will order General to offer an optional installment payment plan on purchases over $1,000, with a maximum of six months to pay, at the same interest rate we are adopting for General's short-term debt (10% per annum).

No other points on multiline CPE sales terms or prices require discussion, and aside from the specific changes to the multiline sales program discussed above, it is approved. General's single-line CPE prices shall be revised as discussed above.

Our interim order directed all negotiated sales of multiline CPE after December 22, 1983 to be subject to downward price revision and customer refund depending on the outcome in this decision. Within 60 days after filing tariffs with the 1984 prices ordered by this decision General shall make a compliance filing in these proceedings showing the results of its repricing as applied to the negotiated sales, and demonstrating that refunds, if due, were made.

We will order the sales tracking data filed as recommended by Betts, but in view of the annual book value price adjustment ordered we do not think it is necessary to also order General to file the price comparison data (on embedded and unregulated key systems). This is because periodic price revisions contemplated by Betts will be made automatically.

Quaintance testified that customer response to General's sales program for in-place single line CPE has been very sluggish. Our ordering single line CPE repriced based on average 1984 net book value, and repriced again in 1985 and 1986, may stimulate sales. However, we believe coupled with this a great inducement to residential customers to purchase would be increased customer awareness that the in-place CPE can be purchased. This can best be accomplished by requiring General to separately itemize on monthly residential bills the lease charge for the CPE, referenced to a short notice also on the bill that it is available for purchase by a through-the-mail transaction. We will allow General 60 days to start this itemization. Coupled with prices set on more current net book value, itemization can only increase interest in the sales program, with any additional costs to General being nil. Finally, many customers may be under the impression that a rotary dial set is obsolete in that it cannot now, without a pulse converter, be used to access all long distance carriers; however, with the advent of "equal access" in 1986 rotary sets can be used (although General and GTE are not bound by the MFJ which settled Bell System divestiture, it is undertaking to provide equal access). Unless customers are apprised of this they may elect not to purchase their in-place embedded rotary dial sets because they are not fully informed. In view of our ordered repricing of embedded single line CPE, and our concern about customer awareness about the use of rotary dial sets to obtain equal long distance access in 1986, we will order General to send residential customers a bill insert notice within 120 days that lists the revised sales prices and clearly informs them of dial set equal access capability that will come to most areas in 1986.

XIV. GENERAL'S FEMALE/MINORITY BUSINESS ENTERPRISE (F/MBE) PROGRAM AND PROPOSALS FOR IMPROVED TELEPHONE SERVICE TO THE HANDICAPPED

A. General's Female/Minority Business Enterprise Program

Exhibit A-1 to General's application summarizes its efforts in the area of affirmative action for female/minority business enterprise (F/MBE) development. Its report was required by D.82-12-101.

The incremental cost of its program was $131,503 in 1982. General "establishes rough dollar objectives for purchases in categories in which experience shows there is a significant availability of F/MBEs." For illustrative purposes, General provides its 1983 goals:

Underground construction	$ 3,000,000
Printed forms	150,000
Office supplies	150,000
Building construction	800,000
Janitorial - landscaping	1,500,000
Building maintenance	200,000
Vehicle fleet products	400,000
Equipment rehabilitation	400,000
Outside plant	15,000
Tools - test equipment	700,000
Equipment leasing	2,500,000
Switching related work	450,000
Miscellaneous	100,000
Total	$10,215,000

Following are the recorded F/MBE expenditure results for 1978-82, and the estimated 1983 expenditures:

Purchasing Statistics

Year	Total Company-wide Amounts Disbursed for Goods and Services	Amounts Disbursed to F/MBEs for Goods and Services
1978	$421,398,000	$ 3,286,120
1979	529,996,000	5,285,322
1980	562,558,000	4,991,311
1981	545,962,000	7,838,163
1982	612,345,000	15,927,935
1983 (est)	N/A	10,215,000

Staff's witness Low sponsored Exhibit 55, which concludes that while General has complied with D.82-12-101, a different format for reporting data would aid in standard reporting and progress evaluation. General accepts staff's recommended reporting format, and it will start using it in 1985. However, in D.84-06-101, our recent decision in the Pacific Bell general rate case, we considered the reporting format recommended by staff and concluded that greater specificity was needed. We required Pacific Bell to reports its F/MBE data according to the ethnic classifications used by agencies of the State of California and to break out total contract expenditures and F/MBE contracts for each category in which $5 million of business or more was done in a prior year. We also required Pacific Bell to establish F/MBE goals for 1986 and to file semiannual reports as a means of tracking the company's progress. Pacific Bell was directed to meet with minority group representatives in implementing our decision. We would like General to follow a similar procedure and will direct it to do so in our order.

B. Proposals for Improved Telephone Service to the Handicapped

Ben Rockwell and Ann Peterson testified on behalf of the Access California Advisory Committee, which is a citizen's advisory committee for San Bernardino County. They recommended a number of telephone services and practices to aid the disabled. Rockwell sponsored Exhibit 79, and General prepared Exhibit 106 in response. Rockwell requests that we establish:

1. Free phone service for the disabled.
2. Expansion of local calling areas.
3. Specialized yellow page directory assistance (to assist the blind locating a particular type of business).
4. Provision of loaner TDDs at local phone marts so the customer can have a TDD while his unit is being repaired.
5. Mobile pay phones in hospitals and rest homes (many rest homes in particular will not pay for wiring in semi-public pay phone outlets to facilitate a mobile phone).
6. Direct TDD plug-in capability at pay stations to reduce background noise interference.
7. Better GTE phones, comparable to Western Electric's sets, to give more sound amplification.
8. Discounted toll rates for all disabled and TDD users, with even greater intraLATA toll discounts.
9. A choice of TDD colors.

Proposals for discounted intrastate toll rates for the disabled and/or TDD users were recently addressed in Pacific Bell's rate decision, where similar recommendations were made by other parties, which was the proper forum as uniform statewide toll rates were set in that proceeding. Likewise, free or reduced price basic service was the subject of our OII 83-11-05, to implement universal telephone sevice. General indicates options for go-between assistance in connection with directory yellow page searches for the handicapped are under study. We have no jurisdictions over rest

homes, and their apparent balking at having wiring installed to facilitate mobile public pay stations is, in our view, a matter for those who regulate their facilities and service. Single line telephone instruments are now available from so many sources, and we think those who find GTE sets inadequate can select from another vendor; so we will not order General to upgrade its instruments. We will also not order General to stock TDD instruments in a variety of colors. The TDD program is subsidized to benefit the handicapped, and we think funds can be more usefully used to promote the availability of TDDs than for expanding instrument colors.

Rockwell's request for free calling between San Bernardino and Redlands was analyzed by General. There are no optional discounted toll services (e.g. OCMS or ORTS) available now in these areas, and General finds the self-contained nature of the two cities makes such optional service inappropriate. The long-range solution, according to General, is a restructure of these exchanges in connection with implementing fully measured local service, which it will be proposing in the future. We do not have enough evidence to support redrawing exchange boundaries in the area or to order OCMS or ORTS.

General notes that it is following the results of Pacific Bell's trial study of equipping pay stations with jacks so TDDs can be directly plugged in. Also, it is considering installing longer headset cords and a lower shelf in pay stations so headsets may more firmly be connected to TDDs. This could result in less background noise. Given the consideration underway on this matter, we think it is premature to issue an order.

We will require General to keep at least two exchange or loaner TDDs at its phone marts and/or convenience centers so TDD users bringing in a TDD for repair can leave with a TDD. General's practice is to ship a replacement TDD within 1-2 days. Keeping at least two TDDs in stock at phone marts is a very small inconvenience

to General while it may turn out to be a great convenience for hearing-impaired TDD users, who deserve an opportunity to use the telphone network at all times.

XV. RATE DESIGN

The adopted increased gross revenue requirement from this proceeding is $154,837,000 ($160,837,000 minus the $6 million COSE adjustment). In addition we are eliminating $45.9 million in surcharge billing revenue connected with General's 1983 attrition allowance (the $52.4 million increase in billings is, in this final decision, converted from a pre-to-post settlements basis and, accordingly becomes $45.9 million). Today's decision will set discrete rates and eliminate the present billing surcharges of 21.3% on local exchange service and 13% on intraLATA toll.

General again raises its request for a special surcharge over the balance of 1984 to retroactively recover any difference in test year revenue requirement adopted in today's decision over that adopted in our interim D.83-12-067. We clearly explained why General's request could not legally be granted in D.83-12-067 and we denied the request. General did not appeal that decision. It now offers the same arguments. This matter has been conclusively settled, and we do not appreciate having it raised again.

We have the latitude to adopt rate changes other than those specifically proposed by parties where the evidence supports our conclusions, particularly as we have consolidated our overall investigation into General's rates with these proceedings, OII 83-08-02.

A. Summary Table of Adopted Additional Revenue by Source from Adopted Rate Changes

Following is a summary of the net revenue (after settlement loss) generated by our adopted rate changes:

Summary of Net Revenue Generated by Adopted Rates
($000 omitted)

(Bracketed numbers are negative)

General's Tariff Schedule	Description	Dollar Increase	% Revenue Change on Billings
A-1	Basic Exchange Service		
	Residence	$ 40,696.8	26.3%
	Business	16,639.4	26.3
	Semi-Public Coin (monthly rate)	1,383.5	51.1
	Measured Local Service Units Increase from 6¢ to 7¢.	6,989.0	16.7
	Touch Calling Service Increase charge.	6,110.0	63.2
	Reservation of Telephone Number Increase charge.	125.2	150.2
	Verification/Interrupt Service Increase charges.	408.5	219.0
	Increments for Special Rate Areas and Zones Eliminated.	(242.1)	(100.0)
A-2	Datatel Service Increase rates.	370.0	10.3
A-3	Electronic Business System Service Increase access line rate.	300.4	26.4
A-4	Mileage Rates - except dedicated facilities and FEX Eliminated.	(2,019.2)	(100.0)
A-5	Services for the Handicapped Increase charge.	12.5	10.0
A-6	PBX Service		
	Direct inward dialing service rate changes.	285.1	39.0
	Centrex - increase access line rate.	119.7	26.0

General's Tariff Schedule	Description	Dollar Increase	% Revenue Change on Billings
A-12	Farmer Line Service and FEX Rates increased 21%.	$ 0.3	21.0%
A-13	Joint User Service Discontinue - move to A-1.	109.1	105.0
A-15 and 15a	Supplemental Services (CPE) Increase monthly rates and certain non-recurring charges.	6,828.1	15.0 ✓
A-16 and 23	Emergency Reporting Service Increase rates.	8.4	10.0
A-17 and 33	Special Billing Number and Interexchange Receiving Increase rates.	17.5	24.4
A-19	Foreign Exchange Service Increase certain rates and measured unit rate.	3,182.5	25.2
A-21	Coin Station Service Increase local call to 20¢.	9,546.0	72.2
A-24	Telephone Answering Service Increase rates.	179.8	10.0
A-31	Line Extension Increase rate to $1.75/foot.	594.8	250.0
A-34	Push-button or Key-set Telephone Service Increase certain rates.	2,218.0	10.0
A-38	Billing Surcharge from 1983 Eliminated. (post settlements basis)	(45,870.2)	(100.0)
A-41	Service Connection, Move and Change, and Repair Visit Charges Increase rates.	23,174.1	59.6
B-4 and B-5	ORTS/OCMS Increases adopted in D.84-06-111.	(Included below under D.84-06-111 settlement revenue)	

General's Tariff Schedule	Description	Dollar Increase	% Revenue Change in Billings
D-1	Directory Listing Service Increase charges for unpublished number and for additional listings.	$ 2,553.9	84.0%
D-3	Directory Assistance Charges	(No 1984 revenue effect)	
E-1	Special Assemblies (CPE) Increase rates as proposed but with a 50% cap for 1984, with an additional maximum increase of 50% over today's existing rate where applicable in 1985. Incorporates arrangements formerly under contract into tariffs.	713.4	31.7
G-1 thru 7, and G-9,13, 18,22, and 26	Dedicated Channels and/or Private Line Service and Related Charges Increase CPE non-recurring charges by 13% and monthly rates by 17%.	756.2	17.2
	Services (no increase in mileage rates).	2,312.9	29.0
H-1	Zone Usage Measurement (ZUM) Increases to Zone 2 & 3 charges adopted in D.84-06-111.	(Included below in total settlement revenue effect)	
D & R	Returned Check Charge Increase rate to $10.	610.4	100.0
	Total settlement revenue flowing to General from rate changes, etc. in D.84-06-111.	77,123.0	N/A
	Settlement flow from Pacific to General resulting from today's adopted revenue requirement.	(400.0)	N/A
	Total:	$154,837.0	

B. Terminal Equipment

General proposes, with some exceptions (e.g. PBXs), increasing customer premises equipment (CPE) recurring or monthly rates by 6.5% and nonrecurring rates by 13%. This is CPE still under regulation, called embedded CPE, but which will ultimately be deregulated. These amounts are derived not from cost studies, but by applying the consumer price index (CPI), and limiting increases to mitigate customers' switching to other suppliers, thereby eroding the revenue base.

We conclude a slightly higher minimum increase for recurring charges is appropriate, and instead of the 6.5% General and staff propose, we will adopt 10%, which is close to General's original proposal of a 9% increase. CPE recurring charges have been subject to an 18.03% surcharge during most of 1983, and a 21.3% surcharge since January 1, 1984. Thus, even adopting a 10% increase is a reduction from the present surcharged rates. A 10% increase will, we think, be a better balance between ensuring CPE rates contribute their fair share to revenue requirement recovery, yet not pricing them so high that the revenue base is unduly eroded. As the minimum recurring charge increase was derived by essentially a value of service analysis, we have the latitude to adopt a higher increase, particularly in view of General's tariffed sales plan for in-place CPE (while General has had a tariffed sales plan for single-line CPE during most of 1983, today's opinion orders a sales plan for multiline CPE). We will adopt General's 13% increase for nonrecurring charges (e.g. installation, move, and changes, etc.) as we conclude from Exhibit 44 that it is more cost based than the increase proposed for monthly charges.

We will address CPE rates below by categories, and we adopt staff's overall recommendation that, for <u>all</u> items or services where increases are based on a percentage, rates and charges should be rounded to the nearest 5¢ and $1, respectively.

Datatel Service (Schedule A-2)

Datatel service is CPE to facilitate data transmission. General proposes a 6.5% recurring and 13% nonrecurring charge increase. Staff agrees. While we will adopt the 13% nonrecurring charge increase, we will increase recurring rates by 10% instead of 6.5%, as discussed above. These increases will generate revenues of $370,000 in the test year.

Supplemental Services (Schedules A-15 and 15a)

This category includes single-line telephone instruments and ancillary equipment best termed as enhancements for single-line instruments (e.g. answering devices, headsets, louder bells, etc.). Staff notes that General proposes increases of 1.7% to 30% for single-line instruments, and staff thinks the minimum increase should be 6.5% as proposed for most other CPE. Consistent with our overall approach to CPE rates we will adopt a 10% minimum increase for all items in these schedules, and allow the proposed increases exceeding 10% where proposed by General. Staff's Betts thinks there will be repression in demand for supplemental services CPE caused by the proposed rate increases, as does General, but he determines that in addition to revenue reduction there will be a $1.7 million saving in maintenance expense that is not reflected in General's showing. General's only response on this point, in rebuttal Exhibit 100, is that "cost savings resulting from units removed from service, assuming that they exist, do not affect General's proposed rate design." General misses the point. It did not, in response to Betts' testimony, show specifically that the repression was accounted for in its test year maintenance expense estimates, so we must adjust for the cost savings in calculating the annual revenue effect of the adopted increases to Schedules A-15 and 15a. The annual revenue produced by the adopted increases, with Betts' adjustment, is $6,828,100.

Emergency Reporting and Call Receiving
Systems (Schedules A-16 and 23)

Emergency reporting systems are used, for example, for roadside service. Call receiving systems are used to route and distribute incoming calls. We will increase these recurring rates by 10%, and consistent with other terminal equipment categories, impose a 13% increase on nonrecurring charges. This results in additional revenues of $8,400.

Telephone Answering
Services (Schedule A-24)

This equipment is used by telephone answering services and the only rates subject to dispute were those proposed by General for its cord-type "attendant positions." Aside from this attendant position, we will increase all recurring rates in Schedule A-24 by 10%, and nonrecurring rates by 13%, except for the exceptions General lists in Exhibit 59, pages 30-32. The proposed rates listed in those exceptions will be adopted since they align prices for this terminal equipment closer to rates in other schedules for comparable items and services.

Rates for the cord-board attendant positions have consistently engendered differences. General proposes to increase the present installation charge of $665 to $5,310, and the monthly charge from $133 to $295. Both the Telephone Answering Services of California (TASC) and staff think this increase is excessive, pointing out that in the last rate proceeding General estimated 20.5 hours of installation time and no rehabilitation expense for this CPE, but it now states 75.5 hours are required for installation and $2,509 is needed for rehabilitation. General states that TASC criticized its last cost study because it was premised on installation labor estimates, whereas its current study is based on historical data. Betts thinks we should only raise monthly rates by 6.5% and nonrecurring charges by 13% because he has reservations

about General's cost study, and he is concerned that General may want to price this older vintage CPE high to encourage sales of new unregulated CPE alternatives. Under present rates there are 17 units in service and General estimated 12 additional refurbished units now in inventory could be installed. However, under General's proposed rates, there would be repression among the 17 installed units and no "inward movement" of rehabilitated units now in inventory. Over the last two years about 89 units have been retired by General.

The CPE at issue is not state of the art and in several years it will be deregulated. Answering services that want to keep this CPE over the long term should seriously consider buying it from General. Even assuming General's latest cost study is reliable, the increases proposed would be the death blow to this CPE. In the broad view there is very little revenue generated by these remaining cord-board positions, which are in the twilight of their market life, and we conclude staff's approach is reasonable. Staff also makes recommendations about refinements to General's cost study methodology for its next cost study; while they appear reasonable, we will not order them because with deregulation on the horizon, we do not think continued efforts at cost studies and further litigation about this CPE's rates are worth the time and cost involved. Answering services should, however, realize that when this CPE is deregulated General will very likely raise the rates substantially. They should start now planning accordingly (these cordboards are available for purchase under the sales program discussed elsewhere in this opinion). We will adopt a 10% increase on recurring and 13% on nonrecurring charges, instead of the increases General proposes. There is no need to address the staff's issue about the level of associated cost savings stemming from repression at General's much higher proposed rates because we are adopting staff's rate approach.

The revenue generated by the adopted increases in Schedule A-24 rates is $179,800.

Key-set or Push Button Telephones (Schedule A-34)

General proposes a new and more unbundled rate structure for new key-set installations, keeping the existing structure for in-place systems, and increasing monthly rates under the present structure by 6.5% and nonrecurring rates by 13%. Staff believes that all customers, new or old, should be subject to the same rate structure for the same service. Staff prefers the new structure. However, staff thinks General's cost studies inflate nonrecurring charges, which can exacerbate repression. This could cause a loss in revenue and lead to more stranded investment which, until this CPE is deregulated, would be borne by ratepayers. Pricing embedded key-sets too high can, of course, potentially benefit General's unregulated marketing of new systems. Staff's proposed Schedule A-34 rates are more reasonable and will apply uniformly to all key-set customers, except that monthly charges will be increased by 10%.

Staff estimates its proposed key-set rates will generate $5.54 million in new revenue, but due to repression in new demand caused by higher rates there will be a decrease in installation charge revenue of $3.32 million, resulting in a $2.22 million net revenue increase with our adopted rates.

Special Service Arrangements (Schedule E-1)

These are relatively novel one-of-a-kind installations to meet specific customer needs and applications. Some of these rates were adjusted in the last rate proceeding, but some were overlooked, and others, formerly under contract, have not been adjusted for many years. Those rates adjusted in 1982 would, under General's proposal, be adjusted by 6.5% and the others would be adjusted by applying CPI increases from the time they were set or last adjusted to today. Staff thinks the time and expense necessary to prepare a cost study for the many and various special installations is prohibitive. It agrees with General's CPI cost indexing approach. Many of the proposed increases, particularly for special installations formerly under contract, result in almost doubling rates.

The sudden and significant increases posed by General's approach stems from its inattention to many of these rates, and although the CPI cost indexing approach may be a reasonable way to realign Schedule E-1 rates closer to today's costs, we think in fairness, these customers should not bear the sudden and probably unplanned for increases of the potential magnitude General proposes.

We think a fair approach is to limit all Schedule E-1 rates to a maximum increase of 50% now and to allow another maximum of 50% increase over existing rates one year later (or a total increase of no more than 100% from existing rates). General shall notify affected customers of the pending second step of the increase within 90 days from today. Also, all of these customers shall be notified that they may purchase the in-place CPE from General and told who they can contact at General to receive a price. The increased monthly rates for Schedule E-1, with the adopted 100% cap, will generate revenue of $713,400. The total increase, although spread over two years for some installations, will be combined for purposes of compiling the test year revenue generated by the new rates; we do this because the revenue from the second year increase is very small, and because we are having to step these increases because of General's past inattentiveness to keeping many of these rates relatively current.

CPE for Private Line, Speaker Microphone, Private Line Teletypewriter, Data Transmission Channels, Loudspeaker Paging and Intercom Services (Schedules G1, G-2, G-3, G-4, G-13, and G-18)

General proposes, as for many other CPE items, a 6.5% increase in recurring charges and 13% for nonrecurring charges, except for certain items which should have rates consistent with directly comparable items listed in other schedules. Staff agrees. General's approach is adopted, except that consistent with other CPE, we will raise recurring charges by 10%. These revised rates will generate an estimated $756,200 in 1984.

C. Returned Check Charge (Schedule D & R)

General now charges $5 for a returned check and wants to raise it to $10, which would generate an additional $610,400 in revenue. Staff thinks it should be raised to $7.50 consistent with the charge of "certain other independent telephone companies." While General did not show that a $10 charge equaled its out-of-pocket costs when receiving a bad check, there is considerable administrative time involved in rectifying things and adjusting billing records. The $10 bad check charge will, in addition to recovering costs involved, be an incentive to customers to avoid the incidence of bad checks, which can, in turn, lower overall bill collecting costs. TURN opposes an increase, stating that while it "does not support subsidies for 'deadbeats,' proper costs for services ought to underlie charges...." It notes that Pacific Bell only requested an increase from $5.25 to $6. The $10 charge, even if it exceeds General's costs, will help defray increases to residually priced basic access line service. We will approve the $10 charge.

D. Line Extension Charge (Schedule A-31)

Line extension charges apply to individual rural and suburban customers beyond exchange base rate areas who require a line extension beyond the free footage allowance. Presently General charges $50 for the first 100' or any part of the first 100', and 50¢ for each additional foot. It proposes to charge $300 and $3 respectively, a 500% increase. This would generate $1.4 million of new revenue.

Staff's witness Betts notes that the proposed $3/foot charge will recover only about 56% of General's estimated costs, but he thinks the 146% increase in costs since 1981 claimed by General is excessive and way beyond the estimated impact of inflation under assumptions used elsewhere by General to update costs. Applying General's "implicit price deflator" method Betts finds costs have increased by only 26%. His alternative is to adopt Pacific Bell's present $110/1.10 charge.

Pacific Bell's line extension charges have not been increased since 1975, and even then they were not set at its full cost. We want these one-time charges to fairly contribute to service extension costs, and we are not convinced Pacific Bell's existing charges should necessarily be applicable. They are out of date. Under these circumstances, we believe $175 and $1.75 per foot are reasonable charges. These increases will generate $594,800 in 1984 revenue.

E. Service Connection, Move and Change, and Repair Charges (Schedule A-41)

General proposes significant increase in these charges, which apply when residential and business service is ordered (different charges apply for CPE repair visits, pickup, and prewiring).

Following are proposed and adopted charges for installation of an access line (for non-key-set service):

	Present	Proposed General	Proposed Comm. Div.	Adopted
Residence				
Initial Service Order	$11.00	$ 25.00	$16.50	$ 20.00
Central Office Work	11.00	25.00	16.50	20.00
Premises Visit Charge	25.00	35.00	30.00	35.00
Premises Interior Wiring per connecting point	20.00	35.00	35.00	35.00
Total	$67.00	$120.00(79%)*	$98.00(46%)*	$110.00
Business				
Initial Service Order	$25.00	$ 50.00	$ 30.00	$ 30.00
Central Office Work	16.00	30.00	30.00	30.00
Premises Visit Charge	30.00	35.00	30.00	35.00
Premises Interior Wiring per connecting point	22.00	35.00	35.00	35.00
Total	$93.00	$150.00(61%)*	$125.00(34%)*	$130.00

*% increase over present rates

General's proposed charges were developed using the cost study procedures ordered by D.93728 in 1982. Staff recommends smaller increases to hold aggregate increases below 50% for service order and central office work. We adopt higher charges than recommended by staff to bring the charges closer to cost. Premises visit and inside wiring charges should be set at full cost, particularly since most existing structures have already been wired for phone service (new structures are usually prewired), and customers have the option of installing their own inside wiring. The premises visit has become a relative luxury in most instances, and probably accommodates a preference rather than a necessity. However, the impact on new residential customers from the initial service order, even without a premises visit, concerns us. To mitigate this economic impact we will order General to collect all initial service establishment charges for single-line residential service in equal amounts over the first three billing periods (this is conceptually consistent with Pacific Bell's Schedule 36-T). While, as an alternative, we could allow payment over three months at the customer's option with an interest charge, we think uniformly is better since all new customers may not be advised of the option. Further, as this modest extension of credit is over such a short period, it is too bothersome to select and impose a separate interest charge.

The initial service order and central office work charges shall be the same if service is established at a phone mart. However, customers picking up their instruments would, by not necessitating a premises visit by General, have a lower total charge for establishing service: $40 for a residential customer and $60 for the business customer.

General now charges $10 for a premises visit to repair a modularized single-line telephone set that it leases. It wants to raise the rate to $40. Staff thinks the rate should be $35 to cover

the cost of a premises visit. Customers who take their leased instruments to a phone mart or other central points can, of course, avoid the charge. We will authorize a $35 premises instrument repair visit. This substantially increased rate will drastically repress requests for premises repair visits, and reduce maintenance expenses by $1,365,000.

Finally, General's Schedule A-41 lists an $8 charge for installing each phone, $10 for a modular conversion, and $12 to move each instrument. These charges apply in addition to those for the premises visit and any wiring work. The installation and instrument move charges, added to other applicable charges, are excessive for single-line premises activity. For example, once the premises visit is made, the cost for simply plugging in (or installing) an instrument is de minimus. We will retain but not increase the modular conversion charge ($5 residence and $6 for business) because the incremental cost for modular conversion in connection with a premises visit, for which there is a separate charge, is small.

Other than the rates discussed above in this section, we will approve General's recommended increases. The test year revenue, including expense savings from repression, from our revised Schedule A-41 rates is $23,174,000.

F. Verification/Interrupt Charge (Schedule A-1)

These charges apply when an operator, at a customer's request, interrupts a conversation or verifies that a line is in service. In addition to increasing it from 25¢ to 75¢, General proposes amending its tariff so these charges would also apply to requests from customers at public and semi-public coin phones. Staff recommends an increase to 50¢ for both services because that is the increase it recommended for Pacific Bell. The charge for verifying that an access line is operative is waived if the operator finds the line is out of order.

In our recent Pacific Bell decision we authorized the increase for busy line verification to 50¢, but allowed a $1 charge for interrupt service. We found interrupt service is more costly to provide, and a premium service for which those requesting it should recognize as being very labor intensive and costly to provide. Accordingly, we will authorize a $1 charge for General's interrupt service, and 50¢ for verification. Also, we will approve General's proposal to make the charges for these services applicable to callers from all coin telephones. These revised rates will generate $408,500 of new revenue.

G. Directory Listing Service (Schedule D-1)

A directory listing in a customer's local directory is free. Charges apply for additional listings in other directories. For an additional business listing, for example, General proposes the existing $1 charge be raised to $1.50. Staff thinks only a 15% increase should apply as these charges are not cost based. TURN agrees with staff. The steepest increase General proposes is going from 30¢ to $1/month for "nonpublished listing service." Staff would increase this charge to 35¢. Whereas General's increases would generate $5.3 million, staff's would generate $.51 million.

Additional directory listings fall in the category of a nonessential accommodation for customers, and in the spirit of pricing nonessential services on a value of service basis to reduce pressure on basic exchange services, we will adopt General's additional listing increases.

Nonpublished service, however, warrants separate discussion. Presently about 30% of residential customers have

nonpublished directory listings.[7] General's Quaintance said the proposed $1/month charge was not cost based, but that administratively its employees had to follow different procedures in processing nonpublished service requests. He views the service as a luxury, and one that should be priced to generate revenue. Nonpublished numbers also generate calls for directory assistance and affect those overall costs. Customers can be listed and avoid the charge, yet not list their full name or address. Generally speaking, we view "complete" nonlisting, or having an unpublished number, as a relative luxury. The instance where a nonpublished number is essential is when there has been an unfortunate history of harassing calls. While in most instances a nonpublished number may be a luxury or optional preference, there are undoubtedly others where customers are nonpublished to minimize chances of harassing or obscene calls. Some may hold jobs which by their nature make them targets for harassing calls, others may have experienced harassing calls and still others, particularly those who may live alone, may gain some sense of security in having a nonpublished number. If we knew how to design criteria and an expedient administrative procedure so those who needed a nonpublished number could have it without charge, we would be inclined to price this service high as a relative luxury for the remaining customers who are nonpublished by preference and/or for convenience. But in the final analysis determining which customers need a nonpublished number comes down to a case-by-case analysis and subjective judgment. Weighing the above factors, we conclude a 60¢/month charge is reasonable, but we temper this 100% increase by requiring that General allow customers 90 days from today to convert from a nonpublished number without the usual charge for a record change.

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[7] A nonpublished number means it is both not published in a directory <u>and</u> not listed with directory assistance (DA) or 411; in contrast, an "unlisted number" is not published but is listed with DA. While there is an existing charge for a nonpublished number there is no charge for an unlisted number.

The new revenue generated by these increases in Schedule D-1 rates is $2,555,000.

H. Joint User Service (Schedule A-13)

General proposes to eliminate joint user service, which is a service allowing combined billing for a number of services. This is an antiquated service according to General, which is costly to administer. Of the 4,640 customers with joint user service, about 50% are expected to elect regular exchange access line service if joint user service is withdrawn, resulting in about $200,000 of additional revenue. Betts agrees that this service should be withdrawn because it was instituted many years ago before customers could own their own CPE. Also, given the advent of measured local business service, the joint user's monthly bill cannot allocate charges between stations and segregate which one made what calls. He thinks joint user service creates more potential administrative problems for both General and its customers than its worth.

We will allow this service to be withdrawn, but direct General to provide affected customers notice that they can regrade to regular acccess line service without the otherwise applicable charges. This free regrade is fair since it is our action and not customers' which prompts the need to regrade their service.

I. Special Billing Number and Interexchange Receiving Services (Schedules A-17 and 33)

Staff finds that General overlooked proposing increases for these optional services, and staff proposes a 25% increase for Schedule A-17 and 20% for Schedule A-33. Combined these increases will generate $17,500. We agree that these rates should be increased consistent with most other rate increases.

J. Reservation of Telephone Number (Schedule A-1)

While General proposed increasing the monthly charge for reserving a phone number from $2 to $5, it proposed the increase only

for residential customers. Staff thinks the increase should apply to business customers also. Also, staff thinks General unfairly excludes any cost savings caused by repression in calculating revenue generation. We will adopt staff's recommendations, resulting in $125,200 in new net revenue.

K. Charge for Touch Calling Service

Touch Calling service is General's corollary to Pacific Bell's touch tone. In the last rate proceeding we reduced this monthly charge from $1 for business customers and 75¢ for residential customers to a common 65¢. Now General wants to entirely eliminate the charge, which 40% of subscribers now pay, resulting in a revenue loss of about $7.3 million. Betts concludes that while the line charge for Touch Calling could eventually be eliminated, we should not consider such a step until existing uncertainty about FCC-imposed access charges is resolved. While Touch Calling results in some cost savings because switch holding times while dialing are reduced, it is nevertheless in the broader perspective a premium nonessential service that facilitates what are termed space-age enhancements for basic telephone service. TURN agrees with General's proposal to eliminate the charge, calling the existing 65¢ charge "higher basic charges under a deceptive label."

Pacific Bell's charges for this service are $1.70 for business and $1.20 for residence lines. It proposed retaining the charge, with its witness Evans pointing out in Exhibit 527 (sponsored in A.83-01-22 et al. in which General and TURN were parties), that these charges are revenue generators, well in excess of costs, which serve two purposes: to support the availability of relatively low-cost basic exchange service for those who do not need or want enhancement, and because the charges are a contribution from those who want enhanced services to partially defray the capital cost of new technology central office equipment which facilitates them. We disagree with TURN that Touch Calling is an element of "basic

service." Rather, it is the optional threshold service needed for a host of other optional enhancements and capabilities. In the present climate of the telecommunications industry and regulatory change we find Pacific Bell's rationale sound, and we think there should be a closer relationship between the Touch Calling charges of Pacific Bell and General (particularly as they serve in a contiguous major metropolitan area). Therefore we will adopt a monthly charge of $1 for residential and $1.20 for business customers with Touch Calling service. Achieving full parity with Pacific Bell's charges at this time, particularly for business rates, could result in a too drastic increase that may trigger a movement to convert back to dial instruments. This increase will result in new revenue of $6.1 million.

L. Centrex and Electronic Business System Service (EBSS) (Schedules A-3 and A-6)

General proposed no increase to Centrex and EBSS rates because it is a declining service, and an increase would accelerate migration and strand central office investment. Staff proposes increases. For example, each additional station line over the first 40 would increase from $7.20 to $11.90. The customer access line charge was imposed by the FCC, going from $2 in 1984 on existing lines to $4 in 1986. Any additional increase imposed by us on Centrex rate components other than the access line rate element would be counterproductive from many perspectives, and would not generate any meaningful or stable new revenues. We will only increase the access line components of these rates by the same percentage as other access line rates for business customers.

M. Foreign Exchange Service (Schedule A-19)

Foreign Exchange Service (FEX), along with private line services, was included for both restructuring and repricing by General. We are not, as discussed in the section or private line services, adopting General's restructure. Staff illustrates the impact of General's proposal on total monthly charges for an average FEX customer who has FEX to a contiguous exchange provided wholly by General (Exhibit 96, page 2-28). The business FEX rate would go from $32 monthly to $101 and the residential rate from $17 to $102, an increase in recurring rates of 216% and 499% for business and residential customers, respectively. Staff's Betts concludes the magnitudes of General's increases would cause repression that would decrease annual revenues by about $20 million, with this loss in revenue probably shifting to residually priced basic exchange service rates.

Betts' alternative is to increase all existing FEX rate elements the same proportional amount that basic access lines are increased, but with no increase in the mileage rate elements, and an increase in the FEX message unit from 9¢ to 10¢.

General's Quaintance testified that FEX is a physical extension of dial tone over dedicated facilities between central offices and, as such, allows circumvention of the toll network through facilities that are very costly to provide. He thinks FEX is highly subsidized and therefore a luxury the general body of ratepayers can ill afford. While he cites the present FEX rate structure as encouraging FEX subscriptions, with 31,461 FEX services as of December 1982, staff finds that from mid-1980 to May 1983 General has lost 30% of residential FEX services and 5% of its business services.

FEX is a toll bypass rate structure that has evolved over many years. It results in a "toll discount" for large calling volume

users; however, with the extension of ZUM and ongoing efforts to redraw exchange boundaries, we think FEX is a declining service. Drastic increases or restructuring at this time would be needlessly disruptive to the thousands of existing FEX customers.

The following is a listing of the present rates applicable to intra-company FEX services based on the average mileage of two 1/4-mile increments without usage charges:

Business (measured FEX)		
Local FEX access	$25.00	
Mileage (¼-mile increments)	7.00	
Residential		
Local FEX access	$ 7.75	(regular flat rate access line rate)
Increment	2.25	
Mileage (¼-mile increments)	7.00	

We accept staff's recommendation to not increase the mileage rate component, and we will, as it recommends, increase the local FEX access component by the same percentage that business and residential access line rates are increased. However, to align residential monthly FEX rates closer to those for business customers, we will increase the residential increment additive from $2.25 to $5.00. The rates for a unit of local FEX usage, where it is measured, will be raised by 1¢, as proposed by staff, from 9¢ to 10¢.

Nonrecurring charges for FEX service consist of a $100 charge for all FEX access lines, plus the applicable service connection charges in Schedule A-41. We will raise the $100 FEX connection charge to $175, which is closer to Pacific Bell's charge. Schedule A-41 charges are discussed above.

The revised Schedule A-19 rates will generate additional revenue of $3.2 million.

N. Local Directory Assistance Charge Plan

Until recently PU Code § 776 prohibited any DA charge plan that did not provide 20 free calls monthly; however, that Section had a sunset provision and it was repealed effective April 1, 1983 (1978 Statutes, Chapter 1381 p. 4574). Unlike Pacific Bell, General has not had a local DA charge program. It proposes one to be implemented throughout 1985. Its plan closely parallels Pacific Bell's initial charge plan, but customers would have a five free calls a month allowance, with a 25¢ charge for each DA call over that. The only business service not receiving a five-call allowance would be individual centrex lines which would receive one call. Those exempt from charges include:

1. Residential customers with impairments limiting their use of directories.
2. Businesses where the proprietor and all regular employees have impairments limiting directory use.
3. Lines in hospitals for patients' use.
4. Calls from coin telephones directly to DA.

Staff's witness Shantz urges us not to approve a DA charge plan in this proceeding, recommending instead that we direct General to file a separate application. His rationale is that General did not, with its NOI, submit all the data required by our OII 83-03-02. On this point General responds that the OII was issued after it prepared its NOI, and it subsequently supplemented its rate design showing by supplying the data Shantz found lacking. Shantz testified that he did not review General's supplemental showing, Exhibit 60, even though it was distributed several months before his rate design

report was released. The data Shantz found lacking in General's initial submittal fall under the categories of estimated revenue generation and cost savings. Further, Shantz thinks General's DA charging program should be identical to Pacific Bell's.

General noticed customers of its DA charge plan, and many attending our hearings opposed the idea. Many think DA is now free, that a five-call allowance is too small, and they expressed concern about the feasibility of getting and storing current directories covering their local calling area. TURN also opposes DA charging of any form. It thinks those few customers who "abuse" DA by extraordinarily large calling volumes can be identified and charged, without adopting a charge plan for all customers.

General estimates that in 1984 DA cost per access line will be $1.26, and 85% of DA calls will be from customers to obtain numbers within their area code. Obviously DA is not free, but customers are not aware of the cost because it is now rolled into the basic access line rate. In 1986, the first full year of DA charging, General estimates that under its proposal, the total volume of DA calls will drop to about 110 million from 1984's estimated volume of 143 million, resulting in a gross monthly cost of 67¢ per access line, compared to today's cost of about $1.26. It estimates at least $7.8 million in revenue during 1986 from the charge plan and an operator force reduction of 281. Capitalized cost to install the needed measuring equipment totals $3.2 million. The average access line makes 4.7 calls for local DA each month.

We conclude that it would be counterproductive to require further review of this matter in a separate application. DA charging is a significant means of reducing operating costs and, ultimately, minimizing rate increases. It is a fair means of placing a good portion of incremental cost for using DA on those who place a great demand on the service.

With the overall public concern about the rising cost of basic access line service, a DA charge plan should be welcomed by the fully informed average customer. Much of the customers' animosity toward DA charging comes, we think, from their misconception that DA is now "free." When publicizing the phase-in of its charge plan General should clearly point out the now "hidden" but passed on cost of local DA per access line, and explain that there will be cost savings from charging that accrue to benefit all customers. General's Quaintance testified that 20% of customers make 80% of local DA calls, and the largest users of DA tend to be business customers. This, coupled with the experience of the average access line calling for local DA about five times a month, means under General's proposed five-call allowance the vast majority of General's residential customers will usually not be charged for DA.

We will adopt the same local DA charge plan recently approved for Pacific Bell, which allows a free call monthly allowance of five for residential and two for business customers. Customers will be allowed to ask for up to three numbers during each DA call. Centrex lines will be given a one-call allowance, and General's proposed exemptions will be adopted, except we will, consistent with Pacific Bell's DA charge conditions, not exempt hospitals, motels, and hotels. Also, General's Schedule D-3 shall reflect the impact of the current LATA structure.

Directory availability within local calling areas is important to customers as directory use is one significant step customers can take to minimize DA calling; another measure they can take is to keep a list of repeatedly or periodically called numbers. Quaintance testified that it is General's practice to provide customers free copies, upon request, of any directories covering

their local calling area.[8] This seems to conflict with the experience of some customers who attended our hearings. Also, information in General's directories could be easily taken to be in conflict with Quaintance's understanding: "Directories for other cities are available by calling your Business Office and may be secured at an additional charge." General's tariffs shall reflect the free directory availability policy and the informative paragraph in directories should be changed so that it is clear additional directories covering customers' local calling area are free upon request, and can be either picked up or mailed. If experience shows that General cannot timely provide additional requested local area directories we will modify its DA charge plan to provide free unlimited DA service to customers who ask for, but cannot be provided, the local directories.

There is no test year revenue effect from the adopted DA charge plan, but in 1985 the revenue and expense savings will be at least $7.7 million and in 1986 it becomes $16.6 million.[9]

The longer term solution for DA access, particularly by heavy DA users such as some businesses, is direct access to General's computerized DA data base. Customers, for example, could have a terminal, maybe no larger than a TDD, to gain DA access. This

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[8] The local calling area is essentially the ZUM calling area, and not the customer's entire area code zone.

[9] We have computed cost savings of $3.9 and $8.8 million for 1985 and 1986, respectively by pricing out the force reduction with average wages plus a 50% loading for fringes and overheads. These amounts assumed a five free call allowance for all customers, whereas we are allowing business customers two, and are low. The incremental revenue and expense savings will be reviewed in the attrition offset filings for 1985 and 1986.

approach reduces the operator force involved with DA and is being implemented in France (Telecommunications, March 1980, p. 70). A similar system could reduce DA costs generally, reduce the charges for necessarily heavy DA users, and provide a market for a new piece of CPE. We urge our staff to pursue this concept with General and other telephone utilities as it may hold promise as the eventual DA solution from many perspectives.

O. Monthly Suburban Mileage and Special Rate Area Increments (Schedules A-1 and A-4)

General assesses monthly "mileage rates," with a charge for each 1/4 mile a customer is beyond the "base rate area" within an exchange (Schedule A-4). Presently the charge is $1.50 per 1/4 mile for single-party service and $1 for 2-party service.[10] Both rates would go to $2 under General's proposal. A related offshoot of these mileage rates are discounted mileage-based or incremental monthly charges for designated "special rate areas" (Schedule A-1). These are areas beyond the more densely populated base rate area, but where a pocket of customers live that makes the vicinity relatively more populated per square mile than where only straight mileage rates apply. A residential customer, for example, fortunate enough to be in a special rate area between 1-3/4 to 3-1/2 miles beyond the base rate boundary now pays an increment of $3 per month, whereas the customer not in a special rate area, but the same distance from the base rate boundary, pays between $9 and $21. The final refinement in this program of incremental monthly charges based on population density are a series of special rate area "zones," now in 11 exchanges, which are roughly concentric areas surrounding the base rate area line.

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[10] Pacific Bell's corresponding mileage rate increments are only 65¢ and 35¢, respectively.

Staff recommends no increases to these density rates, stating that of the major utilities having variations of these rates General's are already the highest, and that the present $1.50 per 1/4 increment (or $6/mile) is well above General's stated average cost for a local loop of $4.72/mile. Also, we note that with the present charges for General's premises visits to repair CPE there is repression in demand for such visits and, in rural areas, long drives. With the advent of changes such as customer-owned CPE, do-it-yourself inside wiring maintenance and improved outside plant technology (e.g. lower maintenance subscriber cable and improved carrier technology), all occurring since density rates were initially adopted, there is less ongoing incremental cost associated with serving these suburban-rural customers.

Some of the customers attending our hearing in Indio raised questions about General's mileage rates, including the rationale for these rates, how long they must pay them and General's population density review process. Letters from customers, primarily in the desert regions, have complained about the economic impact of existing mileage rates and General's proposed increases. They point out customers may pay $30-40 per month exclusive of any usage or CPE charges. The only way customers can avoid these monthly mileage increments is to elect four-party service, which is exempt from mileage rates; General, however, is proposing to freeze four-party service to existing customers and eventually eliminate it.

The population density criteria for administering this rate program and the procedure for determining density (e.g. who does it and how) are not in General's tariffs. The criteria were adopted in a 1969 decision, which referred to an exhibit in the proceeding. General explained the density critera as follows:

> "Where an area contiguous to an existing base rate area has exceeded a density of 100 establishments per square mile, but not exceeding 150 per square miles, the utilities <u>may</u> expand the base rate area to include such additional territory.

> "Where the density of such contiguous area exceeds 150 establishments per square mile, the utility shall promptly proceed to include such territory within the base rate area.
>
> "In portions of the exchange area remote from the existing base rate area, the utility may establish special rate areas in those portions where the density exceeds 100 establishments per square mile with a minimum of the establishments and shall do so where the density exceeds 150 establishments per square mile with a minimum of 150 establishments.
>
> "Additionally, such remote areas shall be converted to base rate areas when the density therein exceeds 300 establishments per square mile.
>
> "In lieu of the foregoing arrangements the company may elect a plan to provide urban services in zones throughout the exchange." (TR vol. 38, pp. 3858-9, emphasis added.)

The criteria leave General a lot of room for discretion. For example, if a square mile adjoining the base rate area has 99 establishments, mileage rates must apply; if there are finally found to be 100 to 150 establishments, General may elect to add it to the exchange's base rate area. Likewise, customers in a square mile not contiguous to the base rate area may be included in a special rate area if General determines there are 100 establishments and it elects to carve out a special rate area to receive lower monthly rates; but it does not have to set up a special rate area until there are 150 establishments.

General's Quaintance testified that it is General's goal to annually resurvey population density to realign the base rate area boundaries and set special rate area boundaries. This is left to local exchange managers. One apparent conflict of interest in utility initiated and conducted surveys is that an increase in population density can only trigger a reduction in rates and revenues. The methods exchange managers use to survey potentially

affected areas were not explained. It was developed from staff counsel's cross-examination that General has no tops down review or imposed schedule to ensure those surveys are methodically always done every year. Staff has computed for us that present suburban mileage and special rate area increment rates generate about $2.3 million annually. Quaintance could not quantify the incremental administrative costs associated with these rates caused by customer inquiries, complaints, and resurveys. Population density rates, he concludes, should be retained to not burden urban ratepayers with higher costs of service associated with rural areas. This is in contrast to Continental Telephone Company, which is proposing in its pending A.83-12-57 to eliminate such monthly rate increments.

These rate increments are closely akin, in structure and underlying rationale, to the density or zone monthly customer charges that once applied to electric utility customers. For example, Pacific Gas and Electric Company's monthly service rates were higher in Ukiah than in San Francisco. In the mid-1970s we eliminated such rate zones as a means of reducing customer confusion and also because, on balance, the incremental rural-to-urban fixed cost of service subsidy had become relatively small in relation to the overall cost of energy. Our thinking on this issue today, and the balance between theoretical ratemaking perfection and pragmatic considerations, is essentially the same as in 1969:

> "Rate making is never a mathematical application of a theoretical principle. In the utility field there are always customers who are served at less than cost, and, if the overall return to the utility is reasonable, there are those who are served at more than cost. No one has been able to devise and apply a practical system of cost accounting in this field to carry out the cost of service principle literally; and if it were done, it would result in such an elaborate and complicated schedule of rates that the public could not understand it and few could apply it. It may be true that any system of rate making which ignores the cost of service as a standard

> invites attack, but practically, rate making is always a compromise between what would be charged if certain principles of cost allocation were adhered to and the practical necessity that a rate structure should be easily understood and simply applied." (69 CPUC 601-682.) (Emphasis added.)

We believe the many problems inherent in General's administration of these population density based monthly rates, as well as periodically trying to accurately quantify any suburban area cost of service differential, outweigh any benefits from maintaining these rates. The revenue requirement shift is small and General will undoubtedly realize some expense savings from not attempting to administer the program. Aside from bringing needed rate simplicity, eliminating these rates can only increase the affected public's faith that rates are set on an understandable, nonarbitrary and reasonable basis. For example, several customers, in their letters, asked why they were "penalized" in rural areas through monthly telephone rates based on population criteria but not for electric service provided by Southern California Edison. Our decision to eliminate General's mileage and special rate increments in connection with basic local exchange access service is specific to this utility and the circumstances presented in this proceeding.

While we are mindful that Pacific Bell has population based zone and mileage rate increments, we note that its circumstances differ from General's. Compared to General, it serves a less densely populated service territory (with 300 customers per average square mile, compared to General's 375), and its existing mileage rate charges are significantly less than General's. General is by that measure the most urban of California's local exchange utilities, which is why the revenue shift from eliminating these monthly rate increments is relatively small. Staff suggests attempting in the next rate proceeding an extensive revamping of General's rate area increments into zone rates. But we conclude it is preferable to

eliminate population density based rate increments for this utility rather than attempt further refinements; this is because such revamping would be several years away, which given the present rate levels is too long. Also on balance, with the staggering number of pressing matters in telecommunications regulation, we think there are and will be far more critical matters for our staff to study and address. Our decision today is not intended to be a commentary on Pacific Bell's existing zone rate increment program, or Continental Telephone Company's pending proposal to eliminate its monthly population density rate increments.

General will, of course, still study and maintain its exchanges' base rate area boundaries as line extension rules and charges will still apply to customers initially ordering service in suburban areas of exchanges. We do not believe maintaining charges for a one-time customer contribution to extend service, based on area population density, is necessarily inconsistent with our decision to eliminate the recurring monthly basic exchange service rate increments. This is because an order for new service should, in connection with the preliminary engineering study, prompt a review of whether the customer wanting initial service is in a base rate area. In contrast, once customers in suburban areas have facilities installed mileage or special rate area monthly increments now continue, potentially for many years, until General conducts a survey that finally finds they should cease. The ongoing application of these monthly rate increments to present customers, and the attendant administrative dilemmas, concerns us much more than the case-by-case one-time review of the base rate area boundary in connection with periodic individual service extension orders.

Eliminating these rates (only suburban mileage and special rate area increments) will result in $2.3 million less revenue. This small revenue shift is put into perspective in view of Quaintance's general rule of thumb that for each $1 million spread on residential

access line rates they increase by about 3¢/month. The revenue shift effect on other customers' access line rates is de minimus.

Our determination on this issue directly affects our treatment of 2-party and suburban area 4-party rates, as discussed in the next section. Mileage rates and party line service have evolved to the point they are integrally related.

P. <u>General's Proposal to Withdraw or Freeze 4-party Surburban Service and to Restrict 2-party Service</u>

General now offers party line business and residential service in what are termed suburban areas, or areas within exchanges that are beyond the base rate boundary, as discussed in the preceding section. The existing services and rates are:

Los Angeles Metropolitan Extended Area Exchanges:	
Suburban business (4-party) flat rate	$14.60
Suburban residence (4-party) flat rate	6.90
Non-metropolitan Exchanges:	
Suburban business (4-party) flat rate	14.60
Residential single-party flat rate	7.75
Residential 2-party flat rate	6.90
Residential suburban (4-party) flat rate	6.90

(Note: Suburban service, with up to 4 parties, is <u>not</u> subject to monthly mileage rate increments or special rate area charges.)

Initially, General proposed to change its offerings as follows: (1) customers in base rate or special rate areas with any party line service would be converted to single line service; (2) all suburban or 4-party service would be withdrawn, and (3) customers outside the exchange base rate or a special rate area could opt for single line or 2-party service, and monthly mileage increments would apply to both. By withdrawing mileage-rate-exempt 4-party suburban service, the greatest impact on customers now having that service would be from the new imposition of mileage rates. (The structure of existing mileage rate increments are discussed above.)

However, in response to TURN's pointing out that General failed to notify these potentially affected customers of the impact of the proposed changes (e.g. the impact of mileage rates applying on customers taken off 4-party service), General modified its proposal so that 4-party service would be frozen to existing customers. Several reasons for phasing out suburban service were given by General: (1) The number has declined to ½% of total services, (2) new service offerings such as touch-calling, call-forwarding, and call-waiting, etc. are not compatible with party line service, (3) much of the new CPE available to customers will not work on party lines, and (4) 62% of 4-party line customers are now on a line by themselves. Also, customer connections and terminations on party lines cannot be made at the central office, rather they necessitate a costly premises visit, and diagnosing trouble on a party line is much more involved and costly. Staff agrees that suburban or 4-party service should be withdrawn, but suggests waiting until the next rate case where the question could be considered in conjunction with a comprehensive rate banding proposal.

The rates for 4-party and 2-party residential service are now the same in non-metropolitan areas. Undoubtedly, the driving reason motivating most customers who have selected suburban 4-party service, and who put up with a lesser grade of service from the standpoints of convenience and privacy, is to avoid the potentially high monthly mileage increments that would otherwise apply.[11] Having 4-party service is the only means for customers outside the base rate area to avoid monthly mileage or special rate area changes.

[11] For example, at present mileage rates a customer within a suburban area, and 5 miles beyond the base rate area boundary, would pay $30 monthly in addition to the monthly single-line access rate, and an additional $20 if he had 2-party service.

General offered good reasons for phasing out its party line service. Historically, in the early days of telephony, party line service was a means of extending service into rural areas while minimizing the capitalized outside plant investment per customer. However, General has reached the point where single line service can now be provided throughout most of its nonmetropolitan exchanges, with conversions made within six months, while only six exchanges would be converted as late as 1987-88. As noted above, enough cable pair capacity exists that most four-party customers are today actually on a single line receiving one-party service. In a real sense, at least for General, party line service is obsolete. Having decided to eliminate monthly mileage and special rate increments for customers beyond exchanges' base rate areas, the need to keep party line service essentially vanishes; 4-party service existed, from the customer's perspective, as a means of having telephone service, albeit a lesser grade, in exchange for their not having to pay monthly mileage rate increments. Likewise, 2-party service enabled customers who did not want the inconvenience of 4-party service, but who could pay mileage rates, a means of having lower total monthly mileage rate increments than if single line service was selected (e.g. $1.00/1/4 mile per month for 2-party service versus $1.50 for single party service). We think most 2-party customers selected that service because of monthly mileage rate considerations and not because the monthly 2-party rate, standing alone, was 85¢/month less than single line service.

Eliminating the mileage and special rate area increments means customers with party line service can begin being regraded to single line service without the specter of either being subject to mileage rates for the fist time or, in the case of 2-party customers, being subject to higher mileage rates. They can have a better grade of service with only a small rate impact. In one sense all customers are bearing the cost of existing plant facilities that could be used to provide single line service because those facilities are in rate base, and by eliminating mileage rates we have removed the economic impediment to those who elected party line service which has prevented full use of General's cable facilities already in rate base. If we start the phase-out of all party line service, with no charge to customers for the regrade, the only increase is for existing 2-party customers who are within base rate areas, and not subject to mileage charges, who selected the service to save 85¢/month. Those who made this selection out of economic necessity now have rate relief through the universal telephone service program.

General's proposal to freeze 4-party service to only existing customers contemplated, of course, keeping mileage rates. But that would place us in the untenable position of approving a rate structure where "grandfathered" customers would pay either lower or no mileage charges, while new ones would pay such charges at the single line rate. That would, in short order, lead to new customers' animosity and complaints about discriminatory rates. Our similar approach for some of Continental Telephone Company's exchanges, where party line service was frozen, led us to ultimately lift the freeze (Resolution T-10811, approved March 21, 1984).

On balance, for the above reasons, we will order the phased elimination of all party line service, with no regrade charges to affected customers. We must, of course, set revised rates for both 2-and 4-party line service that will apply until customers are

regraded. The estimated increased revenue from the upgrading to single line service will be $306,000, which partially offsets the revenue shift caused by eliminating mileage and special rate area increments. We have the latitude to order these rate changes given our evidentiary record and the investigation consolidated with these proceedings, OII 83-08-02.

Q. Withdrawal of Toll Station Service in The Gaviota and HiVista Exchanges

General filed Advice Letter 4853 in February 1984, which requested authority to withdraw "toll station" and foreign exchange (FEX) service in its Gaviota exchange, and replace it with remote exchange rates. Our Communications Division tentatively proposed approval of General's proposal, but ultimately at our meeting of March 21, 1984 the proposed resolution was withdrawn from our agenda so the issue could be taken up in the April hearings. General resubmitted its proposal by Advice Letter 4862 on March 20, and also proposed comparable treatment for another exchange, HiVista. In its latest proposal General dropped its request to also withdraw FEX service in Gaviota.

The nearest large town to Gaviota is Santa Barbara (26 miles away) and for HiVista it is Lancaster (about 20 miles away). General's Quaintance thought Gaviota area customers were all invited to an informal community meeting in early 1984 where a presentation on General's proposal was made, but he was not certain. Letters were sent specifically noticing Gaviota customers of the proposal and our April 10 hearing date on March 23, and to HiVista customers on March 30. There are 119 customers in HiVista and 53 in Gaviota. While Gaviota was characterized as having primarily well-to-do customers, living on Hollister Ranch parcels, less is known about HiVista. When Quaintance testified, on April 12, we had received 7 letters of protest, most from HiVista. These customers complained of

the economic hardship General's proposal would cause. Since then 4 customers in Gaviota have objected, while one who could no longer afford optional FEX supports General's proposal because the rates would be less than for FEX.

While Gaviota is served from an existing central office that can provide local measured service, HiVista is not. Thus, General proposes a special nonoptional local measured service in Gaviota but flat rate service in HiVista. Following is General's rate structures that would replace $7.50/month toll stations:

	Gaviota	HiVista
Residential		
Single line	$ 70.00	$57.50
Two-party	N/A	23.00
Four-party	N/A	17.00
Business		
Single line	100.00	83.00
Semipublic coin station	138.50	138.50
Usage Charges	5¢ for 1st minute of local call, 2¢ each add'l. minute	N/A (flat rate)

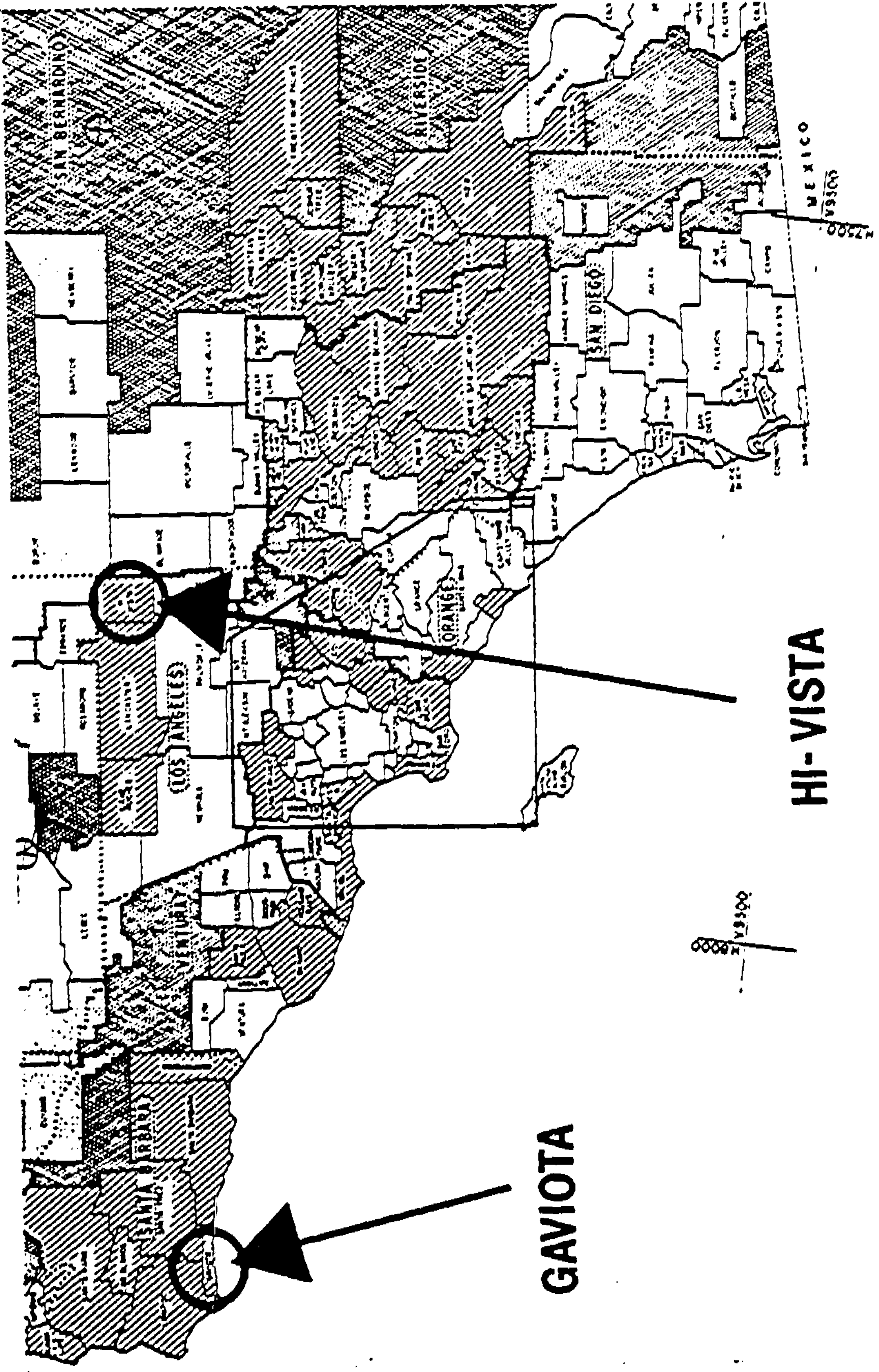
The toll station service that would be withdrawn is relatively unusual; the only other place General now offers it is in San Gabriel Canyon. No existing monthly mileage rate increments apply; however, each call (even a local exchange call) is billed at the toll rate (the 8-16 mile rate is the minimum charge per call, regardless of the call's distance). Although each toll station service call has to be manually routed through an operator, the usual "operator assisted" premium charge per call is not applied. Quaintance testified that toll station service is provided on a party line, with as many as ten customers or stations on a line. Obviously toll station service is very labor-intensive. General will save an estimated $504,000 annually if it can withdraw toll station service in connection with its traffic department's modernization and

consolidation program. If the service is retained an additional plant investment of $169,000 will be needed for trunking facilities to route these operator assisted calls from Gaviota and HiVista to the Thousand Oaks traffic office. General quantified a $504,000 annual expense savings in connection with withdrawing this toll station service in these exchanges, which results from not having to staff the Thousand Oaks traffic office with operators to handle calls originating from toll stations. There is no new incremental switching or central office investment needed to serve these areas if toll station service is withdrawn. General's rationale for the relatively high proposed monthly rates is that the remoteness of these customers results in an extraordinary outside plant investment per customer; thus the name for the proposed service: "remote exchange service."

Over the years some customers in these areas converted from toll station to FEX service, but Quaintance testified that the sharp increase in the mileage component of the FEX rate structure in 1982 has caused many to shift back to toll station service. Customers with FEX in Gaviota may pay as much as $400/month for service, but they can save on toll charges and have the convenience of single-party service. Historically, customers in most of General's remote areas received regular exchange service but have been subject to mileage rates, unless they elected 4-party service. When asked why General did not propose withdrawing toll station service and simply replacing it with the usual rate structure, where mileage rates would apply depending on the grade of service the customer elected, Quaintance said that approach was considered but rejected because of the extreme remoteness of these small "pockets" of customers. He stressed that any impact of the proposed rates on the truly needy would be mitigated by the Moore Universal Service subsidy.

Staff counsel made a statement that staff supports General's proposed withdrawal of toll station service and its replacement with special remote exchange rates. However, because staff was concerned about the potential rate impact of going from a basic monthly charge of $7.50 to $70 in Gaviota, staff recommended that Gaviota customers also have optional 2- or 4-party rates as General proposes for those in HiVista. In response Quaintance testified that the in-place Santa Barbara central office which would provide the new service, if toll station service is withdrawn, cannot provide party line service (it is too advanced).

The following page is from our exchange area map, showing the location of these exchanges.


GAVIOTA
HI-VISTA
SANTA BARBARA
VENTURA
LOS ANGELES
ORANGE
SAN DIEGO
RIVERSIDE
SAN BERNARDINO
MEXICO
SCALE IN MILES
0 10 20 30 40 50

TURN's brief states General's proposed exchange service rate increase for those customers taken off toll station service (667% in HiVista and 833% in Gaviota) is unacceptable, and that "General's assertion that the 50% subsidy provided by the Moore Bill absolves us of concerns is callous." Given the small number of customers affected, TURN believes General's proposal has only a minimal impact on overall revenues and, as such, these affected "customers deserve to be shielded from more extreme increases."

We conclude that General's proposal to eliminate toll station service in these areas is sound because substantial recurring expense savings in excess of $500,000 annually will accrue to the benefit of all ratepayers everywhere on its network. However, the replacement service, special remote exchange service rates, will not be authorized because: (1) Separate exchange service rates for these areas, with relatively few customers, creates yet more access line rate structure complexity, and goes against our policy that the structure of residential basic exchange telephone service should be kept as simple, uniform, and comprehensible as possible; (2) We do not want to establish yet another category of basic exchange rate treatment for geographic areas (see the preceding discussion on suburban service and mileage rates.); (3) Any incrementally higher cost of serving these customers will be substantially, if not entirely, offset over time by the $500,000+ recurring annual expense savings resulting from withdrawing the toll station service which has historically served these areas; (4) Finite cost of service analysis could in theory probably show actual costs to provide local exchange service which vary between all exchanges, on General's or any telephone utility's system; however, translating such cost of service variances directly into exchange rates is not in the public interest from the standpoint of having generally uniform and understandable rate structures for residential service.

General will be ordered to withdraw toll station service in these areas and offer the applicable basic exchange rates offered elsewhere on its system. The estimated test year revenue impact, not netted with recurring annual expense savings from eliminating toll station service, is between $50,000 and $70,000.[12] The $504,000 annual traffic department expense savings is presumably reflected in our adopted test year traffic expense estimate, which encompasses ongoing impacts of modernization and productivity improvements.

R. Optional Residence Telephone Service (ORTS) and Optional Calling Measured Service (OCMS) (Schedules B-4 and 5)

General states that ORTS and OCMS are "toll substitute services," and it proposes a restructuring of these rates that would result in increases of 165-274%. It would use 100% of current toll rates to calculate the call allowance, and calls exceeding the allowance would be billed at 75% of the applicable toll rate. These charges would generate, under General's estimate, $24 million in revenues. Staff notes that since General and some other utilities offer ORTS and OCMS through concurrence in Pacific Bell's tariffs, and the level of these rates affect the statewide division of intraLATA toll revenue, these rates should be uniformly set in the Pacific Bell proceeding, A.83-01-22 et al. General agrees with staff's observations, but, nevertheless, wants its recommendations adopted. TURN thinks both staff and General beg the broader question about the need for a "metropolitan rate plan" that offers, for a

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[12] The exact revenue impact has been difficult for our staff to quantify because present revenues based on toll station service includes both the monthly charge and usage charges (which are all toll calls); further the amount of overall revenue reduction depends on the level of adopted exchange service rates that replace existing toll station service.

premium flat rate charge, wider calling areas. It wants us to order Pacific Bell and General to start developing wide area calling proposals, and states that in the meantime "further erosion of existing ORTS/OCMS must be halted."

The adopted ORTS/OCMS rates in the Pacific Bell proceeding shall also apply to General. Similar points have been raised by TURN in that forum and, as an industrywide approach is needed to restructure these charges or replace them with optional wide area calling programs, we will issue any orders for studies in that proceeding.

Based on the charges for ORTS/OCMS adopted in the Pacific Bell proceeding, General will realize increased revenue, which is rolled into the message toll and ZUM revenue changes described later.

S. Farmer line Service (Schedule A-12) and Farmer Line FEX (Schedule A-20)

Farmer line service allows connection of customer-provided lines and facilities with General's network. Traditionally, these facilities were put in by customers in very rural areas as a means of obtaining affordable telephone service, hence, the name farmer line was applied. General provides this service in about 11 localities, and it is not an expanding service. While General proposed no increases, staff proposes increases of about 60% which would generate $1,500 in new annual revenue. These customers were not noticed that their rates were subject to increase in this proceeding. Still some increase should come as no suprise to them and they have been subject to the existing 21.3% surcharge resulting from our interim decision. Under these circumstances, we think it is reasonable to simply increase Farmer line rates by 21%, which will generate only $347 in new revenue.

T. Monthly Direct Inward Dialing Rates and Case 82-10-08 (Schedule A-6)

Case 82-10-08, consolidated with these proceedings, was filed by Telephone Answering Services of California (TASC), alleging General's rates for direct inward dialing (DID) service are unreasonable. By interim D.83-06-091 we denied a motion to dismiss and clarified what the scope of evidence could be.

DID service routes the last four digits of a called number directly to an end user through one of General's central offices. For example, a telephone answering service can be set up to receive calls for 100 customers or numbers over "answering lines,"[13] and DID can route the calls for 100 customers between the central office and answering service over 10 loop or trunk lines, obviating the need for 100 separate loops. This reduction in otherwise needed separate loops is an economy for all concerned. Customers that could use DID service, aside from answering services, are radio common carriers and business with large PBXs (pages 24-25 of TASC's opening brief succinctly explain how DID service operates and other applications).

[13] An answering line goes from a central office directly to an answering service; there is no line to a second location to serve the ultimate end user. The other answering service arrangement is "secretarial line" line service, where a loop goes from the central office to both the answering service and the customer. Under the secretarial line arrangement, for example, if the customer does not answer on the fourth ring the answering service can (a phone will ring at both locations).

The average holding times and frequency of calls to DID numbers determine the ratio of DID trunks or loops to numbers. The longer the holding times and more frequent the calls the more trunks are needed. The essence of TASC's contention is that present DID rates are for numbers only, whereas it should be segregated or "unbundled" so there is a number charge and a trunk termination charge, which would allow DID customers to pay for only the trunks they need and select. TASC points to unbundled DID rate structures in 12 other jurisdictions for Bell System companies, but it finds General has not done a cost study to enable us to unbundle the presently aggregated rates. As an alternative to now attempting an unbundling, TASC urges us to set DID number rates based on a cost study General prepared relating to its providing DID service to radio common carriers (RCC). That study, Exhibit 45, found different costs for different types of carriers, based on different average holding times: tone paging RCCs have an average 10-second call holding time and a DID number cost of 42¢, tone and voice RCC paging have a 30-second holding time and a $1.25 cost, and mobile voice RCCs have a 50-second holding time and a cost of $2.07. TASC and General disagree on the average holding time of TAS calls. TASC presented Exhibit 89 showing, from a national study, it is close to 30 seconds; Quaintance testified that from his personal experience of calling people with answering services that he is sometimes put on hold, often resulting in a holding time of one minute or more. Quaintance was questioned at length about his personal experience conclusion, and he conceded General did not do a study. There is now only one TAS served by General that has DID service.

General's present and proposed monthly rates for tariffed DID numbers[14] are:

Present Rates

Quantity	Charge
First 200 numbers	$330/100 numbers
Each 100 numbers over 200	57.75/100 numbers

Proposed Rates

Quantity	Charge
First 100 numbers	$330
Each 100 numbers over 100	200/100 numbers

TASC has demonstrated that the cost per number of providing DID service to a TAS was about $1.25 per month in 1982, and adjusted by the 6.5% inflation impact adjustment applied elsewhere by General the 1984 cost becomes $1.35. This means General's present rate to TAS customers for the first 100-200 numbers is too high, but the 57¢ charge for each additional number is too low. We will adopt a $135/month charge for all groups of 100 DID numbers for TAS application. However, General's proposed rates for other applications, (e.g. PBXs), where there are longer average call holding times, are reasonable. We will adopt General's proposals for nonrecurring charges relating to DID service; they were not contested. Today's solution to monthly DID number rates is interim in the sense that ultimately these rates should be unbundled, establishing a separate number and trunk charge, which would allow the customer to order and pay for the ratio of trunks to DID numbers needed for his particular use. We will direct General to propose an unbundling in the next rate proceeding.

The test year revenue generated by the revised DID rates is $285,000.

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[14] This service is extended to utility RCCs also, as discussed in interim D.83-06-091, but by intercarrier agreements and not under the tariff rate.

U. Dedicated Facility Channels/Private Line Loops; Rates and Quality of Service; (Schedules G-1 through 7, and G-13,18,22, and 26)

General proposes both increases and a broad restructuring of recurring and nonrecurring charges for these services, which include various types of private line loops. These facilities are used for alarm circuits, answering service lines, and foreign exchange service. Its proposals engendered intense opposition from the following: Sonitrol Alarm Companies and American Protection Industries (Sonitrol), Western Burglar and Fire Alarm Association (WBFA), and TASC; staff does not accept General's restructuring or the underlying cost study, but recommends that most of these rate components should be increased proportionally with increases for basic access line service, with no increase to applicable mileage rates. As an alternative to the comprehensive restructuring, our ALJ directed General to present a repricing which he thought would be based on the present rate structure. However, the alternative proposal nevertheless contained some restructuring; and since it was also premised on the same cost study which was so intensely litigated, it satisfied none of the other parties.

The stated goal of General's restructuring is "to simplify the current multitude of dedicated facility channel (e.g. private line) tariffs by charging the same rate per mile per month for each line regardless of use, with additional charges only where 'conditioning' or 'enhancing' of the facility is required by the customer" (General's opening brief, p. 151). This conceptual pricing approach, termed "a-loop is a-loop," was, as other parties point out, rejected in our recent D.83-04-012, which established private line costing methodologies. General's response is that it did not apply our pricing guidelines because its NOI was tendered before June 30, 1983 and, by our order, it did not have to use the new pricing approaches. Other parties point out that General actively

participated in our private line costing proceeding, and the "committee" meetings leading to a consensus, and it should have known better than to plunge ahead with such a radically divergent approach for this proceeding.

General selected Quaintance, who did not conduct its cost study, to sponsor its results. Because he did not conduct the cost study, the reasons for many of the study's underlying assumptions and approaches could not be cogently or convincingly explained. In summary, and to save extensive discussion, so much doubt has been cast on General's cost study that we cannot rely on it. Also, while some restructuring of these complex tariffs would be desirable, we cannot conclude General's approach would be an improvement.

Staff proposed increasing monthly rates by the same percentage that basic exchange service rates are increased, with the exception of no increase for services billed on a mileage basis; while nonrecurring charges would be increased the same percentage as service connection charges in Schedule A-41. Under these parameters, based on our adopted basic exchange and service connection charges the increases are 26% for monthly rates and 59.6% for nonrecurring charges. Although Sonitrol, WBFA, and TASC would prefer our rolling the existing 21.3% surcharge into present rates, they ultimately contend increases of over 50% would be excessive. However, no party directly took issue with staff's proposed increases, obviously because the economic impact would be far less than General's proposed rates, so we will adopt them. Foreign exchange service rates, which were included in General's restructuring, are discussed separately in this opinion.

The other alternative we have considered is to direct General to adopt the rates for these services which were just authorized for Pacific Bell. Pacific Bell did generally follow our costing methodology and the evidentiary record in that proceeding,

where all these same parties participated, is far better for purposes of setting the various components of these rates. We will not do that at this juncture, although the idea has appeal from the standpoint of consistency and as we think General's aggregate costs should be about the same. However, it is an approach we may take in the next proceeding if we are again faced with dilemmas like those posed by this evidentiary record.

There are CPE technologies marketed which use alarm-radio activated automatic dialing devices to send an alarm message over customers' regular exchange access loops, obviating the need for separate alarm loops. Although routine or daily circuit tests cannot be conducted from a central point to verify that such CPE alarm systems are operative, if alarm loop rates are priced too high such unregulated CPE, which is sure to be marketed by telephone utilities or their affiliates, could become very attractive alternatives. The migration that could result would leave General with stranded alarm loop investment. Likewise, eventual use of cable TV facilities for alarm loops could lead to stranded telephone utility loop investment. These considerations, among others, must be weighed as we review these rates in future proceedings.

Quality of Private Line Alarm Service

In October 1982 we adopted General Order (GO) 152 which set standards for private line alarm service. Service indices or measurements are held orders, met installation commitments, installation and service customer trouble reports, and repair response. Singh conducted staff's service investigation, and he found overall General has made steady progress improving all indices since 1982. He made a spot telephone survey of alarm companies and learned they all find General's repair response time too slow when trouble was reported outside normal business hours. Singh's good news was that they all believed General's response time and cooperation has "improved remarkably."

The GO 152 measured aspects of service shows General is having problems meeting, or getting above the reporting level and into the standard service range indices for keeping installation commitments and repair response time. Singh concludes General is taking steps that will improve meeting installation commitments, and will presumably get into the standard range where 90% of commitments are met. General has progressed to where it is very close to the standard range of having only 2% of repair responses take more than 48 hours, but it is not as close to meeting the standard range of 6 or fewer response hours on average per trouble report. It has moved from almost 30 to 12 hours within 9 months. Singh believes more training for General's repair force working on private lines, along with improving testing facilities, can further improve repair response time.

Singh wants us to order General to improve employee training, assign more trained repairmen to evening and weekend shifts, and to meet our GO 152 standard service ranges by the "end of 1983." The training and work force allocation issues seem to overlap. For example, better training and test facilities may result in no need for more weekend and evening employees. General has regrouped or otherwise taken encouraging steps to dramatically improve service, and while Singh's diagnosis may be correct, we think it is preferable to let General continue to decide how to meet the standard range of our service indices. Rather than now order General to meet the standard ranges for all indices by a time certain, we put General on notice that if it is still consistently falling below any of the standard ranges at the time of its next rate proceeding we will then institute a surcredit-penalty program as an incentive. That measure will hopefully not be necessary. Our staff should again report on private line alarm service in the next rate proceeding.

One of WBFA's witnesses, Willie, testified that from his alarm company's experience in 1983 he concludes General's service

remains poor and below GO 152 standards. Accordingly, WBFA urges us to consider General's service performance in deciding whether a rate increase for alarm service is justified. Willie's data is not nearly as encouraging as that summarized by staff's Singh. Willie applied GO 152 criteria to his company's experience in two exchanges from July through December 1983, but he could not recall, for example, the number of installations ordered each month upon which the percent of unmet commitments were calculated. Overall, he was not very familiar with the survey's details. Thus we will rely far more on staff's conclusions about the direction service quality is headed. Willie's testimony corroborates Singh's on the conclusion that General has further to go in improving its service to the alarm industry. Hopefully, Willie's experience is relatively isolated. If WBFA wants to challenge the adequacy of service in General's next rate proceeding it should compile more comprehensive data upon which we could rely in drawing conclusions.

V. General's Experiment with Non-optional Local Measured Service in Orange County Exchanges

General proposes an experiment with non-optional measured local service in its Huntington Beach and Westminster exchanges, both in Orange County. If approved the experiment would start in 1985, after General has installed enough central office call measuring equipment. General calls this usage sensitive service (USS), which is structured very similarly to toll and zone usage measurement (ZUM). It is now time to test the water, so to speak, and gauge public acceptance of USS, according to General, and the only means of doing so is a limited non-optional experiment. The exact impact on residential bills has not been estimated, but generally heavy uses may pay more while light or off-peak uses will pay less. Staff supports the experiment, but recommends some modifications. TURN is flatly opposed to USS, calling it part of a "grand plan", along with

ZUM, to steadily degrade flat rate service by providing residential customers less and less for higher charges. Staff is sharply criticized by TURN for accepting and, from TURN's view, being an accomplice to General's "grand plan." Almost all of the customers speaking at our public hearings that addressed the USS concept were opposed to it. Most indicated they felt unlimited local calling was a right, and that measuring and timing these calls would have a disastrous chilling effect on vital intra-community communication.

Specifics of General's USS Proposal

General's proposed USS rates are not cost-based. Rather, they were designed to give incentives encouraging off-peak local calling. Unlike ZUM rates which have three elements (length of call, distance, and time-of-occurrence), overall USS has four: a "set-up" charge per call, a duration charge, distance or zone modifiers, and time-of-occurrence. These are the proposed terms and charges:

Monthly Access Rates

Residence

Basic	$ 7.00
Suburban (1-party only)	7.00 + applicable mileage rate increments
Targeted Lifeline (Moore Bill proposal)	3.50 - $2.00 usage allowance

Business

Basic	14.00
Suburban (1-party only)	14.00 + applicable mileage rate increments

Usage Rates

Set-up and duration charges for three time periods and three distance zones:

Period A:	Weekdays	8:01 a.m. - 5:00 p.m.
Period B:	(Discount = 25%) Weekdays	5:01 p.m. - 11:00 p.m.
Period C:	(Discount = 50%) Weekdays	11:01 p.m. - 8:00 a.m. and all hours or weekends and holidays

ZONE 1 (Less Than 8 Miles)

Time Period	Completed Call Set-up	Per Minute or Fraction Duration
A	$0.030	$0.020
B	0.0225	0.015
C	0.015	0.010

ZONE 2 (More Than 8 But Less Than 12 Miles)

Time Period	Completed Call Set-up	Per Minute or Fraction Duration
A	$0.060	$0.040
B	0.045	0.030
C	0.030	0.020

ZONE 3 (More Than 12 But Less Than 16 Miles

Time Period	Completed Call Set-up	Per Minute or Fraction Duration
A	$0.090	$0.060
B	0.075	0.045
C	0.045	0.030

Certainly, an alternative to this USS rate structure would be to simply impose ZUM Zone 1 charges for all customers in these exchanges, which staff suggests. But General believes any conceptual consistency advantages from simply imposing the ZUM Zone 1 structure are outweighed by the more precise usage-cost causing rate elements of USS.

The experience of USS which General plans to study, through initial pre-USS and follow-up post-USS implementation studies, is explained by General (Exhibit 60, pp. 10-11):

> "In addition to testing the validity of usage data, customer reaction to USS can be gauged. An independent market research firm will conduct tests to measure customer acceptance of USS in the Huntington Beach and Westminster exchanges. A questionnaire will be forwarded to this select group of customers to measure the following:
>
> (1) Customer perception of the importance of the telephone;
>
> (2) Expectations of post-conversion USS telephone;
>
> (3) Estimates of local calling patterns;
>
> (4) Estimated repression or stimulation from the implementation of measured service rates;
>
> (5) Customer evaluation of the fairness of measured rates;
>
> (6) Customer preference for measured versus flat-rate charges;
>
> (7) The dollar value the customer would assign to measured versus flat-rate service;
>
> (8) Estimates of usage with respect to other households;
>
> (9) Detailed demographic information regarding the areas surveyed. The sample population utilized in this study will include, but not be limited to: (1) the elderly, (2) low income households, and (3) the handicapped.

> Approximately six months after USS has been implemented, a second survey will be conducted. This second survey is extremely important since past studies have demonstrated that customers may tend to overestimate their local usage and therefore register a negative bias toward USS prior to actual implementation of the service."

In addition to public awareness programs before USS starts in these two exchanges, General proposes "dual billing" in only one of the exchanges for two months before USS starts. The dual billing may enable customers to adapt more readily to USS; whether it does would be studied by General.

Staff's USS Proposal

Staff's Shantz testified that General's long-range goal is to implement USS throughout its system by 1991, when it is scheduled to have all electronic central offices that can facilitate one minute local call measurement. Staff thinks a USS experiment is desirable, and notes that Continental Telephone Company's limited USS program demonstrates widespread customer acceptance of USS. But according to staff General's proposed USS rate structure should more closely parallel ZUM, with comparable off-peak discounts, otherwise staff thinks there could be customer backlash and bias against USS. Staff thinks we should endorse the USS experiment, but with the following directives (Exhibit 96, pp. 2-47):

> "1. All basic exchange access lines will be offered on a measured basis with no usage allowance included in the monthly basic exchange access line rate.
>
> "2. Usage charges as set forth in Schedule Cal. P.U.C No. 6-T of The Pacific Telephone and Telegraph Company shall apply to calls originating in the trial exchanges on routes of 0 to and including 16 miles (ZUM rate structure).

"3. The basic exchange access line monthly rates applicable under USS shall be established at levels which will result in no change in aggregate customer billing in the trial exchanges for usage (local, message toll and message toll related) and access lines based on the rates for usage (local and message toll) and access lines in effect at the time of implementation of USS in the trial exchanges.

"4. No repression or stimulation in usage shall be reflected in the development of the USS exchange access line monthly rates.

"5. The basic exchange access line monthly rates to be applicable under USS shall be developed in consultation with the Commission staff based on the parameters discussed herein and shall be filed by advice letter 90 days prior to the requested effective date of such rates. Such advice letter shall be subject to authorization by the Commission by resolution action.

"6. Coincident with the filing of an advice letter requesting implementation of USS in the trial exchanges, General shall file documentation which shows the development of the basic exchange access line rates to be applicable under USS. Such documentation should be developed in consultation with the Commission staff, shall be made public, and should be provided to all parties of record in A.83-07-02.

"7. Beginning a minimum of 90 days prior to the implementation of USS, each customer in the trial exchanges shall receive monthly notice of the forthcomig USS implementation. Dual Billing should be considered as appropriate customer notice.

"8. Any request for expansion of USS beyond the trial exchanges shall be by formal application or as a part of a major rate application. The General Order No. 96-A advice letter process should not be utilized as the method for requesting expansion of USS beyond the trial exchanges.

"9. General shall collect, analyze, and report to the Commission on a semiannual basis all pertinent data gained from actual experience with the USS plan in the trial exchanges. The format and specific items to be set forth in the semiannual reports shall be developed in consultation with the Commission staff. Semiannual reports shall be filed for period ending June 30 and December 31 of each year. Such reports shall be filed within sixty days after the end of each period."

TURN's Position

TURN's witness, Richardson, thinks the proposed USS experiment is premature and would unfairly subject customers to a guinea pig trial. As General has not based USS on actual marginal costs of local calling, how, TURN asks, can we proceed with a USS trial and redistribute the revenue burden among local exchange customers? Richardson's Exhibit 107 lists a number of costing studies that should be undertaken in conjunction with demographic impact analysis before USS is seriously considered. Without such data he thinks we risk taking an ill informed and grave step, all to the detriment of affected customers.

Discussion

We will not authorize the proposed experiment with non-operational or mandatory local measured service. This is not because we do not think it would be useful to study different approaches to residential measured service, but because we think there are other and more preferable ways to analyze the probable impact on customers. For example, General may analyze customer billings, once it has the central office equipment installed in these exchanges, and compare billings under existing rates to what they would be under either USS or some other measured service rate structure. While such studies will not show how customers actually adapt under USS, or how they change calling habits, they would show the initial impact assuming no change, which in itself could be very useful

information. We believe the mandatory aspect of General's experiment, when weighed against the probable customer confusion and ill will, is undesirable.

Another consideration in our refusal to authorize an experiment leading potentially to an extension of mandatory residential measured service is the lack of any clear cost justification. For example, the need for USS as a means of shifting local calling off peak, and mitigating marginal local exchange costs, has substantially lessened in recent years. New technology digital central offices are "non-blocking" compared to older technologies; that is, whereas older switches would start blocking when 8-10% of the lines were in use, digital switches can internally handle 100%. The subscriber's local loop must be installed in any event, but reducing the growth in local on-peak traffic could minimize intercentral office trunking requirements where more than one central office serves a local exchange.

USS is not a means of matching actual local call cost recovery with time-of-occurrence. General has, as TURN's Richardson points out, no cost studies on the marginal costs of an on-peak local call vis-a-vis an off-peak call. Rather, it is a pricing approach which charges customers for local calls very similarly to the traditional toll schedule, which is a pricing approach many customers have accepted. Whether USS or any measured service is simply a revenue generating device as alleged by TURN, or a fair means of charging customers based on their individual usage volume as claimed by General, may ultimately boil down to point of view. However, until we are presented with clear cost justification for mandatory local measured service, we believe it is preferable for measured service to continue to be an option to flat rate service. As long as local measured service is option customers can ultimately, through their election, decide which service is the most fair given their needs.

We will order General to study the probable impact of USS in the two exchanges, through billing comparison analyses. In particular, we think some analysis of different types of USS rate structures would be very useful, and we will order General to study the following USS rate structures: (1) call measurement and timing 24 hours a day, (2) measurement and timing during the peak and semi-peak period, and (3) measurement and timing only during the peak period. We want the hybrid combined measured and flat rate studied because having unmeasured and untimed calling periods for customers may mitigate the impact of USS on those involved with local community volunteer organizations, "neighborhood watch" programs and the elderly or shut-ins who depend so heavily on the telephone network. These were the groups and individuals which spoke so strongly against USS at our public hearings. Their common theme was that there must be unmeasured and untimed local calling. Allowing unmeasured local calls in off-peak periods may strike a fair balance, and allow residential customers a reasonable opportunity to substantially avoid local timing under USS if they mostly call during off-peak periods. The potential impacts of the three USS rate structures which are to be analyzed must include.

1. The rate impact on residential customers broken down by low, moderate, and upper income, as well as by age and size of household.
2. How USS could be structured to provide low and moderate income families with effective options for reducing their telephone costs consistent with their usage needs, (e.g. periods when usage is at no extra charge).

General should work closely with our staff in devising both the hypothetical USS rate structures and the billing study methodology. The study results shall be submitted by the end of 1986.

W. Coin Telephone-Local Coin Charge (Schedules A-1 and A-21)

General wants to raise the local coin telephone call from 10¢ to 25¢, which would come far closer to covering costs. The revenue increase, combining semi-public and public coin stations, will be $8.6 million. Staff thinks the 10¢ charge should be raised, but set consistent with whatever change is adopted for Pacific Bell. TURN opposes the increase, pointing out it is an essential service for reporting emergencies and the low income population that cannot afford monthly phone service. The coin rate increase drew a mixed reaction from customers attending our hearings. General is modifying coin phones so that the operator and 911 (emergency reporting) can be reached without a coin. To avoid needless customer confusion the local coin rate should be uniform, so we accept staff's recommendation that General's rate be set the same as Pacific Bell's, which is 20¢ or, for convenience, one quarter. The new revenue generated will be $9.5 million.

X. Monthly Semi-Public Coin Telephone Rates (Schedule A-1)

General proposes increasing monthly semi-public coin telephone rates from $17.50 to $45.45, or about 150%. It unbundles the now combined monthly rate into an access line element and an instrument charge, concluding that the monthly instrument charge component should be $30. There are about 12,500 semi-public stations. Staff notes that the 6% repression in these stations that General estimates would result from a 150% monthly rate increase is not reflected as an annual expense savings, which staff quantifies a $650,000. But more importantly, staff thinks General's coin station cost study that derived the proposed $45.45 monthly rate is flawed. General did not consider coin station revenue from toll calls while assigning all costs to local coin service. Further, certainly some of the expense to these stations and lines should be assigned to

interstate in the course of costing the service. All coin stations require more ongoing labor intensive attention and maintenance than other local exchange services, but General's coin station cost study in Exhibit 60 does not clearly recognize that semi-public stations require less maintenance than public stations because they are usually enclosed within a business' premises. They are subject to less vandalism, which reduces a number of expenses relating to these stations compared to public coin stations. The relationship of semi-public station costs to those of public stations was not fully explained by General.

Staff recommends that we increase monthly rates for semi-public station by the same percentage as other exchange access line rates, but that assumes the existing difference between the business measured access line rate and the semi-public coin station rate of about $10 fairly reflects the added costs of providing semi-public coin station service. We are not fully convinced it does. As a means of ensuring this labor intensive service is not unduly subsidized, and priced closer to the cost of providing it, we will increase the semi-public coin station rate by 20% more than the increase imposed on the business measured service local exchange rate. This will result in a rate of $27.70 per month, which generates $1.6 million of additional revenue.

Y. Local Measured Rate Service-
Units of Use (Schedule A-1)

Presently, General has mandatory local measured service for business customers within Los Angeles extended area metropolitan exchanges, and optional residential measured service in these areas. These measured local services are assessed units or usage rates on local calls in increments of 5 minutes. The charge is now $.06 per unit or a fraction. General and staff both propose raising this to $.07, which we will approve.

Z. Extention of ZUM Zone 1 Capability

General's Boveri sponsored Exhibit 47, which addressed the cost of installing central office equipment to start full scale ZUM Zone 1 measurement in the extended Los Angeles area and Los Gatos during 1986. ZUM timing differs from General's existing local measured service in that ZUM times calls in one-minute increments and provides off-peak price discounts. This report was required by D.82-06-054. While General has ZUM Zone 2 and 3 capability, Zone 1 timing capability (0-8 miles) does not now exist in these areas. Boveri testified that it is logical and certainly most economical to extend ZUM Zone 1 implementation in connection with General's ongoing phased program of converting central offices to digital switches, which will be completed in 1991. Staff agrees. It would be too costly and wasteful to modify existing older switches for this timing capability when they will ultimately be replaced anyway with switches that can measure local ZUM Zone 1 calls in one-minute increments.

AA. Zone Usage Measurement (ZUM) Rates and the Extension of ZUM in Connection With Exchange Boundary Realignment

General and some other utilities join in Pacific Bell's ZUM tariff, both because ZUM rate uniformity is desirable to aid customers' understanding and to compensate for effects on interutility settlement revenue. These rates were recently adjusted in the Pacific Bell proceeding, A.83-01-22. Likewise, exchange "reapportionment" affecting General's customers was addressed in that proceeding, as General's proposed changes and the effects on overall ZUM reviews was part of an "industry proposal" made by several utilities. The following General exchanges were split into 2 to 4 new exchanges: Covina, Downey, Ontario, Pomona, and Whittier. This splitting or reapportionment was due to population growth and evolving changes in customers' "communities of interest." The incremental costs associated with General's implementing ZUM, as well

as the revenues, will primarily occur in 1985 and can be addressed in General's 1985 attrition filing.

BB. Estimated Settlement Revenue Effects From the decision for Pacific Bell in A.83-01-22

The division of revenue or settlement process among utilities covers several areas: intraLATA message toll, intraLATA private line toll, extended area service and ZUM. Adjusting rates for different utilities in a close time frame means there are literally cross-flows of settlement revenue from these services. From the rates adopted in A.83-01-22 we have calculated the following test year revenue effect for General:

IntraLATA message toll*	$38.4 million
IntraLATA private line	12.6 million
Extended area service program	11.6 million
ZUM settlement (Note: estimated ZUM settlement revenue was underestimated by $2.9 million in D.84-06-111.)	14.5 million
Total	$77.1 million

*Includes effect of revised ORTS & OCMS rates.

This revenue source reduces the new revenue revised rates must generate.

CC. Basic Exchange Service Rates

Both General and staff essentially approach these rates by residual pricing, which means they are the last rates set after all other rates have been adjusted. This section addresses exchange service rates not previously covered.

General contends basic exchange service rates are subsidized, but we have no evidence of that proposition. As much as anything, its assumption is based on intuition and conventional wisdom. We have not been presented with any detailed allocation or assignment of costs between the many service categories which would

support General's contention. Our traditional results of operations broken down by major categories of service, contained earlier in this opinion, does not support General's contention. It shows basic exchange service, compared to toll, is not subsidized.

The difference between General and staff's proposed basic exchange rates is primarily due to the revenue requirement they assumed would be spread. The rate structure for optional residential local measured service is the only area of conceptual difference, with General proposing essentially a monthly access line rate with no usage allowance, whereas staff would continue the present 30-unit allowance. General's local call measurement differs from Pacific Bell's. Whereas Pacific Bell now applies ZUM timing, in one-minute increments with the rate varying by time of occurrence and distance, General still times in 5-minute increments. The adopted charge for each 5 minutes, or any fraction of 5 minutes, is 7¢, irrespective of time of occurrence. However, when the local call distance exceeds 8 miles, or reaches into ZUM Zone 2 or 3, General applies the same ZUM rates as Pacific Bell for those zones. Until General completes its central office modernization program it will continue to time local 0-8 mile calls differently than those over 8 miles. General and Pacific Bell offer residential measured service in contiguous areas in the extended Los Angeles metropolitan area, and we think a more comparable rate structure for both can only enhance overall residential customer understanding of optional measured service. We recently continued a usage allowance as part of the monthly measured service rate for Pacific Bell, and we conclude the same structure is also suited for General's metropolitan service area. The adopted residential measured rate will include an allowance for $3 of local usage, that can apply to Zone 1 calls (billed in 5-minute increments at 7¢) as well as ZUM Zone 2 and 3 calls. This may make measured service more attractive, particularly to customers who make local calls beyond 8 miles.

General's Universal Lifeline Telephone Service (lifeline) rate will be 50% of the optional local measured service rate in areas where General can provide measured service, and 50% of the flat rate in areas where it does not provide local measured service. However, where the qualifying lifeline customer is placed on measured service, the local calling allowance will not be $3 of local calling (within ZUM Zones 1 through 3), but instead an allowance of 30 untimed local (ZUM Zone 1) calls; calls over that monthly allowance will be billed as follows: 31-40 calls at 10¢ per call, and all calls over 40 at 15¢ each. All lifeline customers will receive the 75¢ monthly credit for maintaining a telephone set and a 50% discount on multi-element service connection charges. These are the rates and terms in General's Schedule A-22, filed in compliance with our recent decision instituting lifeline. On July 1, 1984 Schedule A-22 became effective.

Presently where General offers optional residential measured service, about 2.2% of customers have elected it. With the publicity and notices about the new lifeline service, we expect more than 2.2% will elect lifeline. For General the switching of services means those on flat rate service converting to measured service lifeline will cause a decrease in revenue, but this revenue drop will be offset to some degree by the new usage charges of 10¢ and 15¢ per call when the lifeline customers exceed their 30 free call allowance. In the recent Pacific Bell decision, we did not attempt an estimated quantification of the net effect in connection with determining the revenue generation from its new rates. We felt we would be estimating in the dark with too many unknowns. We are in the same position today with General. By the time General makes its 1985 attrition advice letter filing later this year, it will have some actual experience with lifeline, and we can be in a far better position to then estimate the lifeline "take rate" and the amount of local calling the lifeline customers make over the 30 call allowance. Accordingly, we will allow General to propose an

adjustment to local service revenues in its attrition advice letter filing for any incremental net revenue charge caused by customers electing lifeline.

The following page shows the present and adopted basic exchange service rates:

Present and Adopted Basic Exchange Service Rates

Los Angeles Metropolitan Extended Area Exchanges	Base Rate	Base Rate With Existing 21.3% Surcharge Applied	Adopted	% Increase Over Base Rate
Business				
1-party measured service	$ 7.20	$ 8.73	$ 9.10	26%
PBX line-measured	7.20	8.73	9.10	26
Suburban-4-party flat rate*	14.60	17.71	18.45	26
Semi-public coin station	17.50	21.23	26.45	51
Residence**				
1-party flat rate	7.75	9.40	9.75	26
1-party measured	2.80 (includes 30 5-min. units of use)	3.30 (18.0% surcharge)	5.25 (includes $3.00 of local calling usage)	(restructured
Suburban 4-party flat rate*	6.90	8.37	8.70	26
Non-Metro Area Exchanges (without local measured service capability)				
Business				
1-party flat rate	17.20	20.86	21.70	26
PBX line-flat rate	25.95	31.48	32.70	26
Suburban 4-party flat rate*	14.60	17.71	18.45	26
Semi-public coin station	17.50	21.23	26.45	51
Residence**				
1-party flat rate	7.75	9.40	9.75	26
2-party flat rate*	6.90	8.37	8.70	26
Suburban 4-party flat rate*	6.90	8.37	8.70	26

*Party-line service will be phased out. As customers are regraded to single-line service they will be assessed monthly single-line rates.

**Lifeline service is 50% of the otherwise applicable rate. However, where measured service is offered there is a usage allowance of 30 untimed local calls, excess local calls are charged for as follows: 31-40 calls at 10¢ per call, and each call over 40 at 15¢.

Traditionally we have allowed a period after local basic exchange service rates are increased and/or restructured for customers to regrade or switch to a different basic service without the usual charge. We will direct General to allow residential customers to convert without charge over the first 90 days after today's revised rates are in effect.

DD. Settlement Effect of Today's
Rate Increase on Pacific Bell

We have calculated the effect of today's rate changes on Pacific Bell. The result is a gain for Pacific Bell in billing revenue of $11.4 million. Accordingly, as Pacific Bell is a respondent to OII 83-08-02, we will direct it to change its existing .41% negative surcharge on local exchange service to a negative 1.12% surcharge.

The effect on settlements for other smaller telephone utilities is extremely small and we will not order them to make rate adjustments.

Findings of Fact

Service

1. More than 10% of General's customers served by seven central offices have reported trouble, on an average basis, during each month over the period from July 1982 through June 1983.

2. Monthly trouble reports per 100 stations or access lines are a solid indicator of a multitude of access line service problems encountered by customers on a day-in-day-out basis.

3. Although on a total company aggregated basis General's service has improved and is improving, customers served by seven central offices, and those on the Kenwood exchange, were and may still be receiving inadequate service.

4. General's customers are not as satisfied with the telephone service they receive as customers served by other California telephone utilities.

Revenue Requirement

5. A return on General's common equity of 15.50% will afford it a reasonable opportunity to attract new capital and adequately compensate its shareholder; combined with the adopted year-end capital structure and other cost factors, the resulting 12.74% return on rate base is just and reasonable.

6. The ongoing accounting changes recommended by staff's auditors, as discussed in this opinion, will result in General's books of account being more accurate.

7. General can realize additional intrastate access charge revenue from long distance carriers other than AT&T. It is presently receiving some compensation from such carriers from ENFIA.

8. The adopted summary of earnings represents a reasonable estimated level of revenues at present rates, operating expenses and rate base.

9. General's allocation and/or assignment of advertising and commercial expense between its regulated and unregulated CPE marketing was not investigated by staff.

10. Assuming General correctly assigned all costs relating to its 28 phone marts between regulated and unregulated activities, the routing of customers needing face-to-face contact to phone marts, in lieu of using other facilities, provides valuable foot traffic for General's unregulated single-line CPE sales.

11. The ratio of year-end CWIP to gross plant additions has varied from 32.3% in 1975 to 24.9% in 1982, going as high as 64.9%. In view of such fluctuations a normal test year ratio should be developed from an average ratio over those eight years.

12. It has not been demonstrated that all General's capitalized expenditures in connection with installing GTD-5 COSE are reasonable, particularly in view of GTD-5 suitability problems and the need to colocate backup COSE.

13. About 40.11% of General's total materials and supplies will be used in connection with long-term interest bearing construction, and under these circumstances that amount of materials and supplies should not be directly included in rate base.

14. An 18% per annum late payment charge on overdue bills will encourage timely payment performance by customers.

Separate CPE Marketing Subsidiary

15. General now leases embedded CPE under regulated rates and terms, and markets unregulated new CPE (both single end multiline).

16. Attempting an allocation of expenses related to unregulated and regulated CPE marketing, installation, and maintenance, when resources are shared, is an extremely time-consuming endeavor, and it is one which is beyond the resources of this Commission to undertake in each rate proceeding for General.

17. A physical corporate segregation of unregulated CPE marketing, installation, and maintenance through a stand-alone separate subsidiary, with limited resource sharing, will, in contrast to attempted accounting separation, result in more certainty that there is not cross subsidization by ratepayers of unregulated competitive operations.

Switch Procurement

18. General ordered GTD-5 central office switches, before competitive bidding, which were not fully proven for the intended applications. General did not pursue foreseeable damages from its affiliated supplier caused by delivery delays and collocated switch augmentation.

Embedded CPE Sales

19. The average remaining life of General's station apparatus (or CPE) adopted for ratemaking is 3.57 years.

20. The net book value component of embedded CPE sales prices, for both multi and single-line CPE, will more currently reflect net book value if the average 1984 net book value is used.

21. Adjusting sales prices in 1985 and 1986 based on the CPE's average net book value in those years will result in sales prices more reflective of the remaining net book value.

22. A six-month installment payment program for sales over $1,000, applying an interest rate of 10% per annuam, can make the purchase of multiline CPE more attractive to customers.

Attrition Mechanism 1985-86

23. The following factors potentially impacting General's revenues in 1985 and 1986 are subject to significant variation: (1) Local service revenues attributable to embedded CPE, directory assistance charging and ZUM extension, (2) access charge revenue from interLATA carriers, and (3) intraLATA toll revenue from settlements. On the expense side, the incremental expense savings from local and long distance directory assistance charging has not been precisely quantified.

24. Unless adjusted, General's authorized return on rate base will fall in 1986 if it achieves the projected 47.4% equity ratio.

25. For ease of administration and fairness any adjustments in rates due to attrition filings or additional settlement revenues should be made by a uniform billing surcharge on all local exchange service rates, including usage.

Rate Design

26. Some of the rates in Schedule E-1, special assemblies, have not been adjusted for years due to General's inattention, and increases of over 50% at one time are potentially disruptive for these affected customers.

27. A returned check charge, albeit one that may exceed General's costs, is an incentive for customers to pay on time.

28. A DA charge plan will significantly reduce the volume of DA calls and operating expense, and result in heavy DA users directly bearing more of the incremental cost caused by their use.

29. The information printed in General's directories can be construed by customers to mean that additional local calling area directories are only available for an additional charge.

30. If General's DA charge plan parallels Pacific Bell's most of California's telephone subscribers will be treated equally, which can minimize customer confusion stemming from otherwise different free call allowances.

31. The estimate of revenue generation and expense reduction in 1985 and 1986 from the adopted DA charge plan has not been analyzed by staff.

32. Charging for local directory assistance calls allows those who use the service to more directly support it. The average customer on General's system makes 4.7 calls to local directory assistance each month.

33. General's existing mileage and special rate area program was adopted before many of the recent changes in the telecommunications industry, including customer ownership and maintenance of CPE and higher technology outside plant.

34. In order for customers in suburban exchanges to be properly assessed under the existing mileage and special rate area program there must be complete assurance the accurate population or "establishment" density per square mile surveys are accurate and conducted annually.

35. Eliminating monthly basic access line mileage and special rate area charges will result in a simpler basic exchange service tariff structure.

36. Party-line service, compared to single-line service, is a lesser grade of service from the standpoints of: privacy, limitations on the type of CPE that are compatible and the availability of enhanced services. In most exchanges having party-line service General has the cable pair capacity to offer single-line service.

37. Many existing party-line customers pay the slightly lower monthly rate but, given General's plant capacity, are on underfilled party-line circuits.

38. The primary motive of customers now having party-line service is to either pay lower or no monthly mileage or special rate area increments.

39. General's private-line alarm loop service has improved and by the next rate proceeding it can meet G.O. 152 service standards.

40. The average call to a TAS has a holding time of about 30 seconds, and given that holding time General's cost is about $1.35/month per DID number.

41. General's cost study underlying its proposed private-line or dedicated facilities rates did not follow the methodology adopted in D.83-04-012.

42. As a result of withdrawing toll station service in Gaviota and HiVista General can avoid a $176,000 investment in trunking lines between these areas and its Thousand Oaks traffic office, and save $504,000 annually in operator costs.

43. An experiment implementing nonoptional residential local measured service is not the only means of studying probable customer impact of different forms of measured service.

44. Pacific Bell will realize an estimated $11.1 million in additional annual revenue resulting from today's adopted revenue requirement for General, which means that Pacific Bell's existing billing surcharge should be revised to a negative 1.12%.

Conclusions of Law

1. In view of the inadequate service received by some of General's customers it is reasonable to mitigate the impact on them from the increased revenue requirement found reasonable in these proceedings.

2. General's proposed 18% per annum late payment charge is a penalty to encourage timely bill payment by customers, and is not subject to California's Usury Law. Even if the charge did violate the Usury Law this Commission, through authority delegated by the Legislature, has the plenary authority to authorize the charge.

3. If General does not form a separate corporate subsidiary for marketing unregulated CPE, as ordered below, it is reasonable to impose a .5% downward adjustment to its authorized return on equity, and assign all phone mart costs to unregulated operations, and reduce its rates.

4. TASC has demonstrated that a reasonable rate for DID service provided by General to a TAS is $1.35 per month/number.

5. The adopted attrition allowance mechanism, procedure, and rate design formula will result in just and reasonable rates in 1985 and 1986.

6. The revised rates authorized in the following order and in Appendix B are just and reasonable.

THIRD INTERIM ORDER

IT IS ORDERED that:

1. This order is final with respect to the General Telephone Company of California's (General) test year 1984 revenue requirement. While consolidated C.82-10-08 is closed by this order, A.83-07-02 and OII 83-08-02 remain open to consider: General's 1985 attrition filing, staff's recommendations on means of reducing uncollectibles, and any prospective rate adjustments in the event General's access charges for interLATA carriers are adjusted as a result of further orders in A.83-01-22 et al. (access charge proceedings).

2. The relief requested in C.82-10-08 is granted to the extent reflected in today's adopted rates; in all other respects it is denied.

3. General shall continue to be subject to Ordering Paragraphs 7, 8, and 9 of D.82-04-028. However, those paragraphs 7 and 9 are modified to read as follows:

"7. After today General shall collect data on customer trouble reports per 100 lines and dial service indices on a central-office-by-central-office basis for the following central offices: Baldwin Park, Azuza, Sierra Madre, Coachella, La Puente, Elsinore Main, Perris, Sun City, Claremont, Los Serranos, Pomona, Banning, Muscoy, San Bernardino, Sepulveda, Malibu, Zuma, Del Rey, Mar Vista, Ocean Park, Sunset, San Fernando, Santa Barbara, Bundy Santa Monica, Palisades, Santa Monica, Bel Air, Bundy, University, West Los Angeles, Westwood, Norwalk, Laguna Beach, Market, Uptown, California, Long Beach Main, El Nido, Manhattan, Redondo, Whittier South, Blossom Hill, Montebello, Mountain.

"9. A surcredit of $3.80 a line shall be imposed for each line in a central office where in two of three consecutive months the customer trouble reports per 100 lines are at least 10.0 and in two of the three months including utility-owned terminal equipment reports (not necessarily the same two months) the dial service index is less than 97.0%. General may petition the Commission staff to be relieved of the penalty in D.82-04-028, on a central office basis when measurements for both indices are within G.O. 133 reporting level for at least 6 consecutive months."

4. General may discontinue submitting to the Commission the quarterly reports required by Ordering Paragraph 3 of D.92366, which consisted of 17 indices.

5. General's customers served by the following central offices shall be refunded, by billing credit or check, 65.2% of the applicable 21.3% surcharge on their recurring basic exchange charges between January 1, 1984 and the date the new rates authorized today

are effective: Malibu, Zuma, Topanga, Ocean Park, Muscoy, Perris, and Los Alamos. These refunds shall be made within 90 days. Customers in the Kenwood exchange shall receive the same refund, and they shall not be subject to any increases in recurring rates, as authorized by this order, until 12 months from the date the revised rates authorized by this order for all other customers become effective.

6. General's Rule 10 shall be modified to provide that if a customer shows a billing postmark that is later than the bill's printed mailing date, that postmark date is controlling in determining whether the late payment charge applies. Other than that change, General's proposed 18%/annum late payment charge is authorized.

7. General's competitive bidding plan for central office switching equipment, adopted by Resolution T-10642, is modified as follows: (a) General is authorized to limit the receipt of competitive bids for central office switching equipment (COSE) to three vendors once it has purchased switches of a given technological level or family from three different vendors; and (b) a single test unit of COSE representing new technology may be purchased without seeking competitive bids.

Within six months from today General shall submit the following information to aid our staff in its investigation of COSE expenditures:

a. Copies of the cost studies or justification that existed prior to General's selecting No. 2 EAX COSE.

b. Copies of all cost studies or other economic justification for colocating new digital COSE next to No. 2 EAX switches.

c. Quantification of the full incremental capitalized costs caused by colocated COSE, broken down by each central office location.

8. General shall, within 90 days, make the following changes in its books and accounts, either directly or through the use of memoranda accounts (and staff shall follow up to ensure compliance):

a. IDC on short-term construction projects, now in memoranda accounts, shall be retired at approximately the same rate the plant itself is retired.

b. Uninvoiced receipts more than one year old shall be excluded from materials and supplies (both for bookkeeping and ratemaking).

c. Work orders in the in-progress of fabrication account that are over one year old shall be written off to extraordinary income charges (both for bookkeeping and ratemaking).

d. General shall process its payments to affiliated vendors in the same manner as those to nonaffiliated vendors, and institute a common purchase order verification system.

e. Premium refunds from General's medical insurance carriers shall be charged as a credit to the relief and pensions account; however, any portion of such refunds that can clearly be assigned to unregulated operations may be credited below the line.

f. General shall, on an ongoing basis, assign a portion of general office salaries of "managers and above" to construction.

g. General shall reclassify all embedded and new company official business telecommunications equipment to new Account 262. Its request to reclassify this equipment to other accounts and write off company-used station apparatus over five years is denied.

h. General shall cease accruing IDC on advances in aid of construction, and on an ongoing basis reduce its plant account by the balance in the advances account.

i. All plant additions related to the 1984 Olympics shall be reclassified from plant in service to the miscellaneous physical property account after the 1984 Olympics until definite plans are developed for their use.

When proposing depreciation lives for company-used communications equipment in Account 262, General shall submit a separate study which recognizes the specialized and lighter use this equipment receives, and which includes a detailed analysis on whether as an alternative to purchasing new PBXs it could have used vacant centrex capacity.

9. General and all other telephone utilities are authorized to expense minor items, going back to January 1, 1983, having a total cost of $200 or less.

10. Within six months from today General shall form a separate corporate subsidiary for marketing, installing, and maintaining all unregulated CPE, and within one year it shall have fully segregated its facilities and resources between the unregulated subsidiary and regulated operations. The only resources that can be shared between regulated operations and the unregulated subsidiary are:

a. Corporate officers and directors; including their immediate support personnel and headquarters.

b. Legal and accounting support, but for a maximum of two years.

c. Customer billing for integrated unregulated CPE billing along with network services. Billing expense can be allocated to the unregulated subsidiary until embedded CPE is deregulated, thereafter it shall be billed separately.

e. Phone mart direct expense shall be directly charged to the unregulated subsidiary, but a portion directly benefiting regulated operations may be billed to them. This arrangement shall only continue until embedded CPE is deregulated, and after that CPE sales shall not be conducted at locations where customers go for face-to-face transaction in connection with regulated services.

11. Within 30 days from today General shall file tariffs governing its sale of in-place and from inventory embedded customer premises equipment (CPE) as proposed in Exhibit 119, and implement the program on the timetable and with the terms as proposed, but with the following modifications:

a. The average net book value for the CPE shall be computed using the average 1984 remaining regulatory net book value.

b. The 43% return on sales or profit mark-up on "from-inventory" multiline CPE shall be reduced to 25%.

c. For purchases in excess of $1,000 General shall offer an optional six-month installment plan, with simple interest of 10% per annum.

12. The sales price for newer electronic PBXs (GTD-120, Rolm and Focus) shall be either the tariffed sales price or the optional purchase price according to the existing contract, whichever is lowest.

13. During June of both 1985 and 1986 General shall file revised tariffs with prices for both single and multiline CPE which reflect the incremental change from using average 1985 and 1986 net book value, respectively, for those years. No other sales price components shall be adjusted. Within 60 days from today General shall start separately itemizing on residential bills the recurring monthly charges for leased CPE.

14. General shall revise its tariffs to reflect revised sales prices for single-line CPE within 30 days, recalculating net book value based on 1984 average net book value.

15. General shall retain its complete workpapers underlying the development of all embedded CPE sales prices, as directed by this order, for five years, and the workpapers shall be available for inspection by the public.

16. In June of both 1985 and 1986 General shall file a report with the Evaluation and Compliance Division detailing the results of its embedded single and multiline CPE sales programs, including the types and quantities sold, the present "take," and the net gain or loss.

17. Within 90 days General shall make a compliance filing with the Docket Office, and give notice of the filing to all appearances,

showing the results of embedded multiline CPE sales price adjustments to customers who bought such CPE under negotiation after December 22, 1983 (see Ordering Paragraph 1 of interim D.83-12-067).

18. Within 120 days General shall include a bill insert notice to all residential customers advising them of the terms for purchasing embedded single-line CPE and the revised 1984 prices. This notice shall also clearly explain that starting in 1986 dial sets, in most localities, can be used to obtain equal access among competing long distance carriers.

19. General is authorized to implement a local directory assistance charge plan with the free call allowance and charges adopted for Pacific Bell. The adopted conditions for General's proposed Schedule D-3 shall be applicable, and customers shall be allowed to receive up to three numbers per local directory assistance call. General's tariffs shall provide that customers may, upon request, receive one copy of any additional local calling area directories. The additional copies may be either picked up or mailed, at the customer's election. General shall clarify the information printed in its directories to reflect that additional local calling area directories are available at no charge. This change shall be made over the forthcoming directory publishing cycle starting 90 days from today.

20. For the sole purpose of gathering critical information and conducting essential consumer impact studies regarding measured service, General shall study the potential impact of the three hypothetical USS rate structures as outlined in today's decision. It shall work with our staff in devising the hypothetical rates to ensure they are realistic and result in no overall revenue shift or change within the study areas. General's study shall be filed with our staff by the end of 1986, and made available to any party requesting it. Specifically, the study shall address:

a. The rate impact on residential customers broken down by low, moderate, and upper income, as well as by age and size of household.

b. How USS could be structured to provide low and moderate income families with effective options for reducing their telephone costs consistent with their usage needs.

21. Limited hearings shall be held in connection with the attrition filings for both 1985 and 1986. General shall make an advice letter filing no later than October 1 in both 1984 and 1985, to be served on all appearances, for rate adjustments based on the attrition mechanism in Appendix A, but with the following modifications:

a. In connection with the filing made for 1985, General, staff, and other parties may submit proposals on methodologies for deriving the following: (1) changes in materials, rents, and services, (2) changes in rate base, (3) changes in the normalized revenues. The adopted methodologies shall be used for the 1986 filing.

b. The annual changes in revenues shall be adjusted for: (1) quantifiable changes directly attributable to CPE revenues, (2) local directory assistance call charging, (3) intraLATA toll revenue, (4) access charge revenue from interLATA carriers, (5) net revenues from extending ZUM, and (6) net revenue change from 1 FR customers converting to MLS lifeline.

c. The annual traffic expense savings from directory assistance call repression shall be applied.

d. Adopted changes to the assessment ratios used to derive ad valorem tax shall be applied.

e. General may propose only technical updating in connection with 1985's depreciation expense, and for 1986 it may propose only changes adopted in represcription review.

f. General's authorized return on rate base for 1986 may be adjusted, based on today's adopted cost components, if it demonstrates it will achieve a higher equity ratio (up to 47.4%) in 1986; all cost factors will be held constant.

g. If General, in connection with each attrition filing, does not clearly demonstrate compliance with our order to form a separate corporate

subsidiary for marketing unregulated CPE its revenue requirement will be adjusted downward by: asigning all costs connected with phone marts to unregulated operations, and reducing the authorized return on equity by .5%.

h. The prudency of General's COSE expenditures in connection with both No. 2 EAX and GTD-5 COSE shall be reviewed and addressed by staff in hearings on General's filing for 1986.

General shall submit a draft of its proposed advice letter to the Revenue Requirements Division by September 1 of each year. The filed advice letter shall be accompanied by prepared testimony, and it shall clearly set out how results of operations components were derived consistent with this order. It shall be accompanied by a surcharge rate design consistent with the criteria adopted in today's decision. General shall serve a copy of the advice letters and prepared testimony on all appearances in these proceedings, and copies of its workpapers shall be furnished to parties requesting them. The limited hearings on General's 1985 attrition filing will be held in conjunction with those on Pacific Bell's.

22. General shall keep at least two loaner TDDs in each phone mart and convenience center to loan to customers whose TDDs must be kept for repair.

23. Before January 1, 1985, General shall file a report with this Commission stating its Female/Minority Business Enterprise goals for calendar years 1985 and 1986. Commencing in 1985, on March 1 and October 1 of each year, General shall file a report on the progress made by its F/MBE program. The March 1 report shall cover program activity from July 1 through December 31 of the previous year and the October 1 report shall cover activity from January 1 through June 30. The semiannual reports shall present F/MBE data according to the ethnic classifications used by agencies of the State of California and by contract categories in which $2 million of business or more was done in the prior year. General shall meet and confer with minority group representatives in preparing their goals and reporting procedures.

24. General may file revised tariffs, in compliance with General Order 96-A, not sooner than 15 days after this order is effective, which: (a) fully contain the rates and conditions set out in Appendix B, and (b) concurrently eliminates the existing 21.3 and 13% surcharges. The revised rates shall become effective five days after filing and shall only apply to service provided on or after their effective date. General's tariffed sales prices for multi and single-line CPE shall be effective five days after filing.

25. General's revised rates for local coin station calls, contained in General's Advice Letter No. 4886, are effective today.

26. Pacific Bell shall file revised tariffs, in compliance with General Order 96-A, to increase its negative surcharge on local exchange service rates to a negative 1.12%. It shall file its revised tariffs within 10 days after this order is effective, and they shall apply to all service rendered on or after the date General's revised rates are effective.

27. A.83-07-02 and OII 83-08-02 remain open. Consolidated C.82-10-08 is closed, with relief granted to the extent reflected in today's authorized rates.

This order is effective today.

Dated July 18, 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

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

Joseph E. Bodovitz, Executive Director

STAFF'S PROPOSED METHOD FOR 1985 and 1986 ATTRITION

Advantages of Staff's Proposed Method Over Previous Method

Redefines expense components to more properly associate expenses with escalation rates:

- Purifies the old Labor and Related Overhead component which previously included a large piece of materials only cleared on labor percentages, not labor-generated.
- Lumps all nonlabor together into Materials, Rents and Services (MR&S). The new MR&S component would include the materials portion of the previous Labor component, plus the old Materials and Other Expenses components.
- Combines the old Payroll Taxes component with Labor and Labor Overheads, since they previously took the same escalation rate anyway.

The proposed components would be consistent with those proposed for Pacific.

Incorporates base year adjustment for the Labor and Labor Overheads component. Automatically incorporates base year adjustment of the first attrition year when determining the second attrition year for all components. (Base year adjustment of 1984 nonlabor not possible as shown by exhibit 36, but is automatically included for the second attrition year).

Revises the Ad Valorem Tax component to eliminate effect of growth of the Deferred Tax Reserve.

Relates Plant-in-Service growth to growth in access lines and messages rather than a trended growth in gross construction expenditures.

Relates growth of to-be-expensed portion of Materials and Supplies to escalation of the MR&S component rather than the gross construction expenditures, consistent with the decision to remove the M&S related to construction.

Deletes the working cash component. Working cash is too unpredictable and the method too complex for simple escalation; some expense increases tend to increase working cash, while others tend to decrease it, for example.

Calculates the Deferred Tax Reserve component bottoms-up using figures consistent with the other attrition components. This is the most reliable way to determine this important component.

Uses a normalized growth in access lines rather than an economic forecast, and is thus more consistent with other components. (This feature is easily changed if the Commission determines that an economic forecast is preferred).

Uses consistently the latest 5 years' data for projections and incorporates updating of data through latest available at time of advice letter filing (under the previous method, GTC used 1977-1981 data which gave undue consideration to a highly inflationary period, and missed the effects of recent trends).

Revenues

[1985 attrition due to revenues] = [Adopted 1984 intrastate revenues at authorized rates] x [- Product of - growth in total revenues per access line (1) - times - growth in access lines (2)] x [Uncollectibles factor]

[1986 attrition due to revenues] = [Adopted 1985 intrastate revenues at authorized rates] x [-Product of - Growth in total revenues per access line (3) - times - Growth in access lines (4)] x [Uncollectibles factor]

(1) Using latest 60 months 12 MMT/12MMA trend. Revenues adjusted to remove effects of rate changes.

(2) Using latest 60 months 12MMA trend applied to latest data point.

(3) Growth = $\frac{\text{projected (a) 1986}}{\text{projected (b) 1985}}$

(a) As projected at time of 1986 attrition advice letter filing using latest 60 months 12MMT/12MMA trend applied to latest data point. Revenue component adjusted to remove effects of rate changes.

(b) As projected in 1985 attrition advice letter filing.

(4) Growth = $\frac{\text{Projected (c) 1986}}{\text{projected (d) 1985}}$

(c) As projected at time of 1986 attrition advice letter filing using latest 60 months 12MMA trend applied to latest data point.

(d) As projected in 1985 attrition advice letter filing.

Labor and Labor Overheads

$$\begin{bmatrix}\text{1985 attrition} \\ \text{due to} \\ \text{labor}\end{bmatrix} = \begin{bmatrix}\text{Adopted 1984}^{(1)} \\ \text{labor and} \\ \text{labor overheads}\end{bmatrix} \times \begin{bmatrix}\text{- Product of -} \\ \text{Growth in access lines}^{(2)} \\ \text{- times -} \\ \text{Growth in composite salaries and wages}^{(3)} \\ \text{- reduced by -} \\ \text{Productivity factor}^{(4)}\end{bmatrix} \times \begin{bmatrix}\% \\ \text{intrastate}\end{bmatrix} \times \begin{bmatrix}\text{Uncollectible} \\ \text{factor}\end{bmatrix}$$

$$\begin{bmatrix}\text{1986 attrition} \\ \text{due to} \\ \text{labor}\end{bmatrix} = \begin{bmatrix}\text{Adopted 1985} \\ \text{labor and} \\ \text{labor overheads}\end{bmatrix} \times \begin{bmatrix}\text{- Product of -} \\ \text{Growth in access lines}^{(2)} \\ \text{- times -} \\ \text{Growth in composite salaries and wages}^{(5)} \\ \text{- reduced by -} \\ \text{Productivity factor}^{(4)}\end{bmatrix} \times \begin{bmatrix}\% \\ \text{intrastate}\end{bmatrix} \times \begin{bmatrix}\text{Uncollectible} \\ \text{factor}\end{bmatrix}$$

(1) Adjusted for latest view versus decision-adopted 1984 over 1983 labor escalation rates ("base year adjustment").

(2) Same as access line growth used in revenue component.

(3) Using labor contract for hourly employees and the latest labor escalation factor (as issued by the Economics Unit of Revenue Requirements Division) for salaried employees. Growth to be calculated on a weighted, year-over-year basis.

(4) Productivity factor to be 5% year-over-year improvement.

(5) Growth = $\dfrac{\text{projected}^{(a)}\ 1986}{\text{projected}^{(b)}\ 1985}$

(a) As projected using labor contract increases through contract expiration for hourly employees, and the latest labor escalation factor (as issued by the Economics Unit of Revenue Requirements Division) for the remainder of 1986 for hourly employees and for the entire year for salaried employees. Growth to be calculated on a weighted, year-over-year basis.

(b) As projected in 1985 attrition advice letter filing.

Material, Rents and Services

[1985 Attrition due to MR&S] = [Adopted 1984 MR&S] x [Product of – growth in MR&S per access line (1) – times – growth in access lines (2)] x [% intrastate] x [Uncollectible factor]

[1986 Attrition due to MR&S] = [Adopted 1985 MR&S] x [Product of – growth in MR&S (3) per access line – times – growth in access lines (2)] x [% intrastate] x [Uncollectible factor]

(1) Using latest 60 months 12MMT/12MMA trend applied to latest data point.

(2) Same as access line growth used in revenue component.

(3) Growth = $\frac{\text{projected}^{(a)}\ 1986}{\text{projected}^{(b)}\ 1985}$

(a) As projected at time of 1986 advice letter filing using latest 60 months 12MMT/12MMA trend applied to latest data point.

(b) As projected in 1985 attrition advice letter filing.

Ad Valorem Tax

[1985 attrition due to ad valorem tax] = [Adopted 1984 ad valorem tax] x [Growth in total rate base less working cash and deferred tax reserve (1)] x [intrastate] x [Uncollectibl factor]

[1986 attrition due to ad valorem tax] = [Adopted 1985 ad valorem tax] x [Growth in total rate base less working cash and deferred tax reserve (2)] x [intrastate] x [Uncollectibl factor]

(1) Growth in total rate base less working cash and deferred tax reserve to be consistent with other attrition year figures.

(2) $\text{Growth} = \frac{\text{projected 1986 (a)}}{\text{projected 1985 (b)}}$

(a) Consistent with other components of 1986 attrition year filing.

(b) As projected in 1985 attrition year advice letter filing.

Depreciation Expense

[1985 attrition due to depreciation expense] = [Adopted 1984 composite depreciation rate (1)] x [[1985 weighted average plant in service (2)] - [Adopted 1984 weighted average plant in service (2)]] x [% intra-state] x [Uncollectible factor]

[1986 attrition due to depreciation expense] = [Adopted 1984 composite depreciation rate (1)] x [[1986 weighted average plant in service (2)] - [Adopted 1985 weighted average plant in service (2)]] x [% intra-state] x [Uncollectible factor]

(1) Adopted composite depreciation rate to be the adopted depreciation expense (Account 608) divided by the adopted weighted average plant in service.

(2) Weighted average plant in service to be consistent with the plant in service component.

ITC Amortized

$$\left[\begin{array}{c}\text{1985 attrition}\\ \text{due to}\\ \text{ITC amortized}\end{array}\right] = (-1) \times \left[\left[\begin{array}{c}\text{1985 additions}\\ \text{to plant in}\\ \text{service}_{(1)}\end{array}\right] \times \left[\begin{array}{c}\text{Adopted 1984}\\ \text{effective}\\ \text{ITC rate}\end{array}\right] \times \left[\begin{array}{c}\text{ITC}\\ \text{Amortization}\\ \text{rate}\end{array}\right] \times \tfrac{1}{2} + \left[\begin{array}{c}\text{Adopted ITC}\\ \text{amortization}\\ \text{on 1984}\\ \text{additions}\end{array}\right] \times \tfrac{1}{2} - \left[\begin{array}{c}\text{Historical}\\ \text{ITC}\\ \text{fully}\\ \text{amortized}\end{array}\right]\right] \times \left[\begin{array}{c}\%\\ \text{intrastate}\end{array}\right] \times \left[\begin{array}{c}\text{Test Year}\\ \text{NTG}\\ \text{mult.}\end{array}\right]$$

$$\left[\begin{array}{c}\text{1986 attrition}\\ \text{due to}\\ \text{ITC amortized}\end{array}\right] = (-1) \times \left[\left[\begin{array}{c}\text{1986 additions}\\ \text{to plant in}\\ \text{service}_{(1)}\end{array}\right] \times \left[\begin{array}{c}\text{Adopted 1984}\\ \text{effective}\\ \text{ITC rate}\end{array}\right] \times \left[\begin{array}{c}\text{ITC}\\ \text{Amortization}\\ \text{rate}\end{array}\right] \times \tfrac{1}{2} + \left[\begin{array}{c}\text{Adopted ITC}\\ \text{amortization}\\ \text{on 1985}\\ \text{additions}\end{array}\right] \times \tfrac{1}{2} - \left[\begin{array}{c}\text{Historical}\\ \text{ITC}\\ \text{fully}\\ \text{amortized}\end{array}\right]\right] \times \left[\begin{array}{c}\%\\ \text{intrastate}\end{array}\right] \times \left[\begin{array}{c}\text{Test Year}\\ \text{NTG mult.}\end{array}\right]$$

(1) Additions to plant in service to be consistent with plant in service component.

Plant in Service

[1985 attrition due to plant in service] = [Adopted 1984 weighted average plant in service] x [[—Product of— Growth in plant in service per access line (1) — times — Growth in access lines (2) — times — Fraction of plant in service (3) associated with access lines] + [— Product of — Growth in plant in service per (4) message — times — Growth in messages (5) — times — Fraction of plant in service associated with messages (3)]]

x [% intrastate] x [Authorized rate of return] x [Attrition year NTG multiplier]

[1986 attrition due to plant in service] = [Adopted 1985 weighted average plant in service] x [[— Product of — Growth in plant in service per access line (6) — times — Growth in access lines (2) — times — Fraction of plant in service (3) associated with access lines] + [— Product of — Growth in plant in service per (7) message — times — Growth in messages (8) — times — Fraction of plant in service (3) associated with messages]]

x [% intrastate] x [Authorized rate of return] x [Attrition year NTG multiplier]

(1) Using latest 60 months 12MMA/12MMA trend applied to latest data point.

(2) Same as access line growth in revenue component.

(3) Use same fraction as 1984 adopted year.

(4) Using latest 60 months 12MMA/12MMT trend applied to latest data point.

(5) Using latest 60 months 12MMT trend applied to latest data point.

(6) Growth = $\frac{\text{projected 1986 (a)}}{\text{projected 1985 (b)}}$

(a) As projected at time of 1986 advice letter filing using latest 60 month 12MMA/12MMA trend applied to latest data point.

(b) As projected in 1985 advice letter filing.

(7) Same as note 6, but 12MMA/12MMT.

(8) Same as note 6, but 12MMT.

Materials and Supplies

[1985 attrition due to materials and supplies] = [Adopted 1984 materials and supplies] x [—Product of — Growth in materials rents and services per access line (1) — times — Growth in access lines (2)] x [% intra-state] x [Authorized rate of return] x [Attrition year NTG multiplier]

[1986 attrition due to materials and supplies] = [Adopted 1985 materials and supplies] x [—Product of— Growth in materials, rents and services per access line (1) —times — Growth in access lines (2)] x [% intra-state] x [Authorized rate of return] x [Attrition year NTG multiplier]

(1) Using same growth figures as in Materials, Rents and Services attrition component.

(2) Same as access line growth in revenue component.

Working Cash Allowance

No attrition change for working cash.

Depreciation Reserve

$$\left[\text{1985 attrition due to depreciation reserve}\right] = (-1) \times \left[\left[\text{Adopted 1984 EOY depreciation reserve}\right] + \left[\text{1985 weighted average plant}\right] \times \left[\frac{\text{Adopted 1984 weighted average adds to depreciation reserve}}{\text{Adopted 1984 weighted average plant}}\right] - \left[\text{Adopted 1984 weighted average depreciation reserve}\right]\right] \times \left[\text{\% intrastate}\right] \times \left[\text{Authorized rate of return}\right] \times \left[\text{Attrition year NTG multiplier}\right]$$

$$\left[\text{1986 attrition due to depreciation reserve}\right] = (-1) \times \left[\left[\text{Adopted 1985 EOY depreciation reserve}\right] + \left[\text{1986 weighted average plant}\right] \times \left[\frac{\text{Adopted 1985 weighted average adds to depreciation reserve}}{\text{Adopted 1985 weighted average plant}}\right] - \left[\text{Adopted 1985 weighted average depreciation reserve}\right]\right] \times \left[\text{\% intrastate}\right] \times \left[\text{Authorized rate of return}\right] \times \left[\text{Attrition year NTG multiplier}\right]$$

(1) Consistent with plant in service component

Deferred Tax Reserve

$$\left[\begin{array}{l}\text{1985 attrition}\\ \text{due to}\\ \text{deferred tax}\\ \text{reserve}\end{array}\right] = (-1) \times \left[\left[\begin{array}{l}\text{Adopted 1984}\\ \text{EOY deferred}\\ \text{tax reserve}\end{array}\right] + \left[\begin{array}{l}\text{1985 tax less}\\ \text{book depreciation}\\ \text{associated with}\\ \text{adopted 1984}\\ \text{plant}\end{array}\right] + \left[\begin{array}{l}\text{1985 tax less}\\ \text{book depreciation}\\ \text{associated with}\\ \text{1985 plant charge}\end{array}\right]\right.$$

$$\left. \times \left[\begin{array}{l}\text{FIT}\\ \text{rate}\end{array}\right] \times \tfrac{1}{2} - \left[\begin{array}{l}\text{Adopted 1984}\\ \text{average deferred}\\ \text{tax reserve}\end{array}\right]\right] \times \left[\begin{array}{l}\text{\%}\\ \text{intra-}\\ \text{state}\end{array}\right] \times \left[\begin{array}{l}\text{Authorized}\\ \text{rate of}\\ \text{return}\end{array}\right] \times \left[\begin{array}{l}\text{Attrition}\\ \text{year NTG}\\ \text{multiplier}\end{array}\right]$$

$$\left[\begin{array}{l}\text{1986 attrition}\\ \text{due to}\\ \text{deferred tax}\\ \text{reserve}\end{array}\right] = (-1) \times \left[\left[\begin{array}{l}\text{Adopted 1985}\\ \text{EOY deferred}\\ \text{tax reserve}\end{array}\right] + \left[\begin{array}{l}\text{1986 tax less}\\ \text{book depreciation}\\ \text{associated with}\\ \text{adopted 1985}\\ \text{plant}\end{array}\right] + \left[\begin{array}{l}\text{1986 tax less}\\ \text{book deprecia-}\\ \text{tion associated}\\ \text{with 1986 plant}\\ \text{change}\end{array}\right]\right.$$

$$\left. \times \left[\begin{array}{l}\text{FIT}\\ \text{rate}\end{array}\right] \times \tfrac{1}{2} - \left[\begin{array}{l}\text{Adopted 1985}\\ \text{average deferred}\\ \text{tax reserve}\end{array}\right]\right] \times \left[\begin{array}{l}\text{\%}\\ \text{intra-}\\ \text{state}\end{array}\right] \times \left[\begin{array}{l}\text{Authorized}\\ \text{rate of}\\ \text{return}\end{array}\right] \times \left[\begin{array}{l}\text{Attrition}\\ \text{year NTG}\\ \text{multiplier}\end{array}\right]$$

General Notes

1. "Adopted 1985" means figures or terms adopted by the Commission in the 1985 attrition award.

2. Where an adopted figure is called for and the item mentioned has not been specified in the decision or attrition resolution, "adopted" means the figure used in the derivation of, or the figure consistent with, the figure specifically adopted by the decision or attrition resolution.

3. Test year NTG multiplier = 1.917 on both staff and company bases. Attrition year NTG multiplier = 1.52 (staff basis) or 1.53 (company basis) for 1985. For 1986, the attrition year NTG multiplier may require adjustment if capital structure revised by the Commission.

4. 1986 components assume no change in rate of return. Any rate of return change will require appropriate overall adjustment.

5. Both 1985 and 1986 components assume no change in depreciation rates. Any depreciation rate changes will require appropriate adjustments.

(END OF APPENDIX A)

APPENDIX B
SHEET 1 OF 18
RATES AND CHARGES

The rates, charges, rules and conditions of General Telephone Company of California are changed as set forth in this appendix.

Schedule Cal. P.U.C. No. A-1, Individual Line, Party Line, and Private Branch Exchange Trunk Line Service

The following rates, charges and revisions are authorized:

Class and Grade of Service	Monthly Rates *
Los Angeles Metropolitan Extended Area Service Exchanges (1)	
Business	
1MB	$ 9.10
SPCB	26.45
PBX-MTK	9.10
Sub. B	18.45
Residence	
1FR	9.75
1MR	5.25 ($3.00)**
Sub. R	8.70
Non-Metropolitan Exchanges (2)	
Business	
1FB	21.70
SPCB	26.45
PBX-FTK	32.70
Sub. B	18.45
Residence	
1FR	9.75
2FR	8.70
Sub. R	8.70

(1) Includes: Covina, Downey, Etiwanda, Huntington Beach, Long Beach, Malibu, Monrovia, Ontario, Pomona, Redondo, San Fernando, Santa Monica, Sierra Madre, Sunland-Tujunga, West Los Angeles, Westminster and Whittier.

(2) All other exchanges including the Gaviota and Hi Vista exchanges.

* Extended area service increments apply in addition to the rates shown.

** The monthly rate for an individual line residence measured rate service includes a usage allowance of $3.00.

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THIRD INTERIM ORDER

I. SUMMARY OF DECISION

By our interim decision in December 1983 we authorized the General Telephone Company of California (General) increased surcharge rates to realize additional annual revenue of $150.5 million. Today's decision, issued after hearings on General's test year 1984 revenue requirement have been completed, finds General has justified another $4.3 million. Thus, the total rate increase authorized in this rate proceeding is $154.8 million. General originally requested a rate increase of $348 million, but following our staff's analysis General reduced its request to $208 million. Our decision reallocates the existing 21.3% billing surcharge on local exchange service rates, and the 13% surcharge on local calling area toll rates, into set rates for telephone services. Following is a comparison of monthly local exchange service rates showing the base rate before the surcharges imposed in 1983 and 1984, the rates with the 21.3% surcharge imposed starting January 1, 1984, and the final rates adopted today:

The intrastate summary of earnings requires adjustment because of certain divestiture effects, which is done in the following table. First, the adopted level of access charge revenue from interLATA carriers is broken out (this is discussed more in the following section on revenues). Second, intrastate results of operations are adjusted for the additional expense General has because starting in 1984 it must pay AT&T or other carriers for its interLATA calls; prior to divestiture General did not pay for company business or "official toll" calls. The adopted increase in gross revenues is $153,388,000, which includes a reduction of $7,449,000 because we are not convinced that General's expenditures for central office switching equipment (COSE) are reasonable.

leased CPE; (2) division of intraLATA toll revenue uncertainty; and (3) outstanding questions on access charge revenue from interLATA carriers. General recommends an annual reassessment of revenue growth.

General's situation differs from Pacific Bell's in that in 1985 General will have a new local directory assistance charge plan in place and it still has embedded CPE, which we are encouraging it to sell. These factors, plus the relative uncertainty surrounding its access charge revenue, mean we must allow for a current consideration of these forces on revenues in 1985 and 1986. The fairest and most open way to do this is to hold limited hearings in connection with the advice letter attrition filings. We will allow a more current view of some revenue factors:

1. Changes in local service revenues directly attributed to CPE, local directory assistance charging, ZUM extension, and lifeline service.
2. Changes in toll revenue attributable to the final intraLATA toll settlements agreement.
3. Access charge revenue from interLATA carriers.

We will also review the means of estimating system growth and overall changes in revenues.

While we will apply expense savings from directory assistance charging of at least the amounts quantified in the section of this opinion on that subject, we will allow parties to make showings on whether there will be incremental traffic expense reductions exceeding that estimated by General; this is because as discussed later, staff has not reviewed or analyzed General's estimated 1985-86 expense savings from local directory assistance charging. Also, the advent of end-user directory assistance charges for interstate and intrastate long distance calls will undoubtedly further repress directory assistance calling and expenses. Our

adopted approach affords General some flexibility with respect to revenue uncertainty each year, but in exchange for using more current revenue growth data.

Ad Valorem Tax

Rather than use adopted 1984 ratios of assessed valuation to the net book value of assets, General thinks it is fair to incorporate any changed assessment ratios adopted by the State Board of Equalization. Ordinarily this is known each May, and the ratio has changed over 1981-83. Any such change can be easily quantified in the attrition filing, so we will adopt General's recommendation.

Materials, Rents, and Services and Rate Base

After hearings concluded in these proceedings we analyzed, in the recent Pacific Bell decision, D.84-06-111, staff's proposed method of deriving attrition year changes in materials, rents, and services, and rate base (among other categories). We are concerned about the validity of staff's methodologies for these items (see D.84-06-111, pp. 55-58). We will be holding hearings this fall in connection with the attrition mechanism for Pacific Bell, and we think it is logical to simultaneously consider these matters as they apply to General's 1985 and 1986 attrition filings. Accordingly, we will hold joint hearings on attrition for Pacific Bell and General although the scope of issues to consider vary to some extent between the two utilities.

Depreciation Expense/Reserve

General believes McVicar's methodology must allow for reflecting any Commission approved depreciation represcription in attrition year revenue requirement. McVicar said he would not object to this, so long as the depreciation changes had been properly ratified by this Commission.

General's Bush also proposed that what he terms "technical updates" be reflected in the attrition filings. This would be, from

Calvo alt

Add this paragraph on p. 105 at the end of the "Materials, Rents, and Services and Rate Base" section:

In these further hearings, parties should not present any attrition calculations based on trends using monetary data unadjusted for inflationary factors. While we recognize that industry characteristics may warrant somewhat different attrition mechanisms for telephone utilities compared to energy utilities, parties should consider the consistency of their attrition proposals for General and Pacific Bell with the attrition methodologies we have adopted for energy utilities.

We should establish now how General's rates in 1985 and 1986 will be adjusted so all parties can plan accordingly, and questions on rate design do not arise either in connection with the attrition filings or from a potential inflow of settlement revenue from the next Pacific Bell rate proceeding, which could have a decision in late 1985 based on a 1986 test year. Our goal is to have a straightforward approach that is easy to explain, while also fairly apportioning revenue requirement changes. Any rate increases resulting in a cumulative change in revenue requirement for 1985 and/or 1986, from that adopted today, which do not exceed $50 million shall be made through a uniform surcharge on all local exchange service rates, excluding only ZUM, directory advertising, and coin station calls paid by coin. Likewise, any reductions occurring before the cumulative revenue requirement has increased by $50 million will be made by a surcredit on these rates. When, at any time, the cumulative revenue increase exceeds $50 million the total cumulative surcharge revenue requirement shall be respread and the new surcharge applied equally on the above exchange services and on a bill-and-keep basis to General's rates for: intraLATA toll calls, ZUM and inter-utility provided private line service, Bill-and-keep means the surcharge on toll calls will be retained by General and not submitted for revenue division with other utilities. Thereafter, any reduction will be made uniformly to the uniform surcharge on essentially all intrastate services.

F. Attrition Advice Letter Filing and Processing Procedure

General shall file its attrition advice letter filing no later than October 1 in 1984 and 1985, complete with prepared testimony. Simultaneously the filing shall be served on all appearances in this proceeding. It shall submit a draft filing to the Revenue Requirements Division by September 1. The filed advice letter shall clearly show how each results of operations component

Summary of Net Revenue Generated by Adopted Rates
($000 omitted)
(Bracketed numbers are negative)

General's Tariff Schedule	Description	Dollar Increase	% Revenue Change on Billings
A-1	Basic Exchange Service		
	Residence	$ 40,696.8	26.3%
	Business	16,639.4	26.3
	Semi-Public Coin (monthly rate)	1,383.5	51.1
	Measured Local Service Units		
	Increase from 6¢ to 7¢.	6,989.0	16.7
	Touch Calling Service		
	Increase charge.	6,110.0	63.2
	Reservation of Telephone Number		
	Increase charge.	125.2	150.2
	Verification/Interrupt Service		
	Increase charges.	408.5	219.0
	Increments for Special Rate Areas and Zones		
	Eliminated.	(242.1)	(100.0)
A-2	Datatel Service		
	Increase rates.	370.0	10.3
A-3	Electronic Business System Service		
	Increase access line rate.	300.4	26.4
A-4	Mileage Rates - except dedicated facilities and FEX		
	Eliminated.	(2,019.2)	(100.0)
A-5	Services for the Handicapped		
	Increase charge.	12.5	10.0
A-6	PBX Service		
	Direct inward dialing service rate charges.	285.1	39.0
	Centrex - increase access line rate.	119.7	26.0

General's Tariff Schedule	Description	Dollar Increase	% Revenue Change on Billings
A-12	Farmer Line Service and FEX Rates increased 21%.	$ 0.3	21.0%
A-13	Joint User Service Discontinue - move to A-1.	109.1	105.0
A-15 and 15a	Supplemental Services (CPE) Increase monthly rates and certain non-recurring charges.	3,182.5	25.2
A-16 and 23	Emergency Reporting Service Increase rates.	8.4	10.0
A-17 and 33	Special Billing Number and Interexchange Receiving Increase rates.	17.5	24.4
A-19	Foreign Exchange Service Increase certain rates and measured unit rate.	3,182.5	25.2
A-21	Coin Station Service Increase local call to 20¢.	9,546.0	72.2
A-24	Telephone Answering Service Increase rates.	179.8	10.0
A-31	Line Extension Increase rate to $1.75/foot.	594.8	250.0
A-34	Push-button or Key-set Telephone Service Increase certain rates.	2,218.0	10.0
A-38	Billing Surcharge from 1983 Eliminated. (post settlements basis)	(45,870.2)	(100.0)
A-41	Service Connection, Move and Change, and Repair Visit Charges Increase rates.	23,174.1	59.6
B-4 and B-5	ORTS/OCMS Increases adopted in D.84-06-111.	(Included below under D.84-06-111 settlement revenue)	

We will order General to study the probable impact of USS in the two exchanges, through billing comparison analyses. In particular, we think some analysis of different types of USS rate structures would be very useful, and we will order General to essentially divide the exchanges, by central offices, into roughly three study groups and apply the following USS rate structures: (1) call measurement and timing 24 hours a day, (2) measurement and timing during the peak and semi-peak period, and (3) measurement and timing only during the peak period. We want the hybrid combined measured and flat rate studied because having unmeasured and untimed calling periods for customers may mitigate the impact of USS on those involved with local community volunteer organizations, "neighborhood watch" programs and the elderly or shut-ins who depend so heavily on the telephone network. These were the groups and individuals which spoke so strongly against USS at our public hearings. Their common theme was that there must be unmeasured and untimed local calling. Allowing unmeasured local calls in off-peak periods may strike a fair balance, and allow residential customers a reasonable opportunity to substantially avoid local timing under USS if they mostly call during off-peak periods. The potential impacts of the three USS rate structures which are to be analyzed must include.

1. The rate impact on residential customers broken down by low, moderate, and upper income, as well as by age and size of household.
2. How USS could be structured to provide low and moderate income families with effective options for reducing their telephone costs consistent with their usage needs, (e.g. periods when usage is at no extra charge).

General should work closely with our staff in devising both the hypothetical USS rate structures and the billing study methodology. The study results shall be submitted by the end of 1986.

35. Eliminating monthly basic access line mileage and special rate area charges will result in a simpler basic exchange service tariff structure.

36. Party-line service, compared to single-line service, is a lesser grade of service from the standpoints of: privacy, limitations on the type of CPE that are compatible and the availability of enhanced services. In most exchanges having party-line service General has the cable pair capacity to offer single-line service.

37. Many existing party-line customers pay the slightly lower monthly rate but, given General's plant capacity, are on underfilled party-line circuits.

38. The primary motive of customers now having party-line service is to either pay lower or no monthly mileage or special rate area increments.

39. General's private-line alarm loop service has improved and by the next rate proceeding it can meet G.O. 152 service standards.

40. The average call to a TAS has a holding time of about 30 seconds, and given that holding time General's cost is about $1.35/month per DID number.

41. General's cost study underlying its proposed private-line or dedicated facilities rates did not follow the methodology adopted in D.83-04-012.

42. As a result of withdrawing toll station service in Gaviota and HiVista General can avoid a $176,000 investment in trunking lines between these areas and its Thousand Oaks traffic office, and save $504,000 annually in operator costs.

43. An experiment implementing nonoptional residential local measured service is not the only means of studying probable customer impact of different forms of measured service.

44. Pacific Bell will realize an estimated $________ million in additional annual revenue resulting from today's adopted revenue requirement for General, which means that Pacific Bell's existing billing surcharge should be revised to a negative ____%.

Conclusions of Law

1. In view of the inadequate service received by some of General's customers it is reasonable to mitigate the impact on them from the increased revenue requirement found reasonable in these proceedings.

2. General's proposed 18% per annum late payment charge is a penalty to encourage timely bill payment by customers, and is not subject to California's Usury Law. Even if the charge did violate the Usury Law this Commission, through authority delegated by the Legislature, has the plenary authority to authorize the charge.

3. If General does not form a separate corporate subsidiary for marketing unregulated CPE, as ordered below, it is reasonable to impose a .5% downward adjustment to its authorized return on equity, and assign all phone mart costs to unregulated operations, and reduce its rates.

4. TASC has demonstrated that a reasonable rate for DID service provided by General to a TAS is $1.35 per month/number.

5. The adopted attrition allowance mechanism, procedure, and rate design formula will result in just and reasonable rates in 1985 and 1986.

6. The revised rates authorized in the following order and in Appendix B are just and reasonable.

IT IS ORDERED that: THIRD INTERIM ORDER

1. This order is final with respect to the General Telephone Company of California's (General) test year 1984 revenue requirement. While consolidated C.82-10-08 is closed by this order, A.83-07-02 and OII 83-08-02 remain open to consider: General's 1985 attrition filing, staff's recommendations on means of reducing uncollectibles, and any prospective rate adjustments in the event General's access charges for interLATA carriers are adjusted as a result of further orders in A.83-01-22 et al. (access charge proceedings).

p. 202 - Add ¢ per effective rates for coin tel serv.

24. General may file revised tariffs, in compliance with General Order 96-A, not sooner than 10 days after this order is effective, which: (a) fully contain the rates and conditions set out in Appendix B, and (b) concurrently eliminates the existing 21.3 and 13% surcharges. The revised rates shall become effective five days after filing and shall only apply to service provided on or after their effective date. General's tariffed sales prices for multi and single-line CPE shall be effective five days after filing.

25. Pacific Bell shall file revised tariffs, in compliance with General Order 96-A, to increase its negative surcharge on local exchange service rates to a negative 1.12%. It shall file its revised tariffs within 10 days after this order is effective, and they shall apply to all service rendered on or after the date General's revised rates are effective.

26. A.83-07-02 and OII 83-08-02 remain open. Consolidated C.82-10-08 is closed, with relief granted to the extent reflected in today's authorized rates.

This order becomes effective five days from today.

Dated JUL 18 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners