Decision 88 11 050 NOV 23 1988

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of the Commission's Division of Ratepayer Advocates for Modification of Resolution No. T-12079 Re Revenue Requirement Impact of 1988 Attrition for Pacific Bell.	Application 88-05-009 (Filed May 6, 1988)
Application of GTE California Incorporated, a corporation, (U 1002 C), for authority to increase certain intrastate rates and charges for telephone services to offset 1989 financial attrition.	Application 88-07-017 (Filed July 15, 1988)
In the Matter of the Application of PACIFIC BELL (U 1001 C), a corporation, for a review of its cost of capital and capital structure.	Application 88-07-019 (Filed July 15, 1988)

OPINION RE FILING OF FINANCIAL ATTRITION APPLICATIONS BY CONTEL OF CALIFORNIA, INC., CITIZENS UTILITIES COMPANY OF CALIFORNIA, AND ROSEVILLE TELEPHONE COMPANY

Summary of Decision

This decision considers a pending request by the Division of Ratepayer Advocates (DRA) that we require the mid-sized telephone companies subject to our jurisdiction to file financial attrition rate adjustment applications on or before February 1, 1989. This decision reviews the arguments presented by DRA and the three mid-sized local exchange telephone companies (Contel of California, Inc. (Contel), Citizens Utilities Company of California (Citizens), and Roseville Telephone Company (Roseville)), and resolves these arguments by ordering the filing of financial attrition applications on or before February 1, 1989, except in the case of Contel, where we adopt, on a provisional basis, an alternative consistent with Contel's October 21, 1988 motion requesting a comprehensive adjustment of its outstanding revenue requirement adjustments.

Procedural Background

On May 6, 1988, DRA filed its application seeking certain modifications of Resolution T-12079, the Commission's 1988 order relative to Pacific Bell's 1988 attrition year revenue requirement. DRA raised several procedural issues concerning the Commission's prospective 1989 attrition reviews for Pacific Bell, General Telephone Company of California (GTE-C), and the three mid-sized local exchange telephone companies. DRA requested that we issue an order requiring the three mid-sized local exchange telephone companies to file financial attrition applications by February 1, 1989 (DRA Application Page 4).[1] As DRA notes, the last adopted test year rate cases for Roseville, Citizens, and Contel occurred in 1982, 1983, and 1985, respectively, and the three utilities have not had individual revenue requirement adjustment proceedings since

1 As noted, this was one of several issues raised in DRA's application. With the exception of the financial attrition issue for Contel, Citizens, and Roseville, we have addressed all of DRA's requests in previous decisions.

Specifically, in D.88-09-028 issued September 14, 1988, we approved a stipulation presented by DRA, Pacific Bell, GTE-C, Toward Utility Rate Normalization (TURN), and AT&T Communications of California (AT&T-C) resolving three disputed operational attrition issues. This action was designed to facilitate our review of the 1989 operational attrition advice letters of Pacific Bell and GTE-C filed October 1, 1989.

In Decision (D.) 88-06-024, issued June 8, 1988, we required the filing of financial attrition applications by Pacific Bell and GTE-C on July 15, 1988; evidentiary hearings on these consolidated financial attrition applications have been held, and a decision is anticipated at year-end 1988.

then. Roseville, Citizens, and Contel currently have authorized returns on common equity of 15%, 14.1%, and 15.5%, respectively.

After requesting and receiving extensions of time, Contel, Roseville, and Citizens formally responded to DRA's application on July 29, 1988. DRA filed a formal Reply to these responses on September 8, 1988.

The Protests of Citizens and Roseville

In its July 29th Protest, Citizens argues that the Commission's prior decision (D.85-08-093) dealing with attrition for Contel, Citizens, and Roseville provided for optional (versus mandatory) attrition filings in the two years following a test year, and that this decision is determinative of the present controversy.

Citizens also argues that DRA's request for a mandated 1989 financial attrition filing is inappropriate because DRA seeks an order mandating attrition for Citizens through the procedural vehicle of an application to modify Resolution T-12079, an order solely impacting Pacific Bell. Citizens asserts that DRA's appropriate procedural remedy was a Petition to Modify D.85-08-093.

Further, Citizens maintains that no procedure exists for it to make a 1989 attrition adjustment, and that such an adjustment would be complex and controversial because its last adopted test year was 1983. In contrast, attrition procedures are supposed to be simple and noncontroversial.

Finally, Citizens asserts that a 1989 financial attrition adjustment is inappropriate given the uncertainty of the current regulatory climate. In support of this assertion, Citizens cites a list of unresolved issues, including TRA, USOA, SNI/RID, Phases 1, 2, and 3 of I.87-11-033, the uncertain fate of attrition in the new regulatory framework, and Pacific Bell's proposal to terminate the settlements or pooling process in testimony submitted in I.87-11-033. Citizens urges us to defer changes to its attrition mechanism until the conclusion of Phase 2 of I.87-11-033.

In its July 29th Protest, Roseville argues that DRA's request to bring the mid-sized local exchange telephone companies into this proceeding is highly inappropriate. Roseville believes this proceeding is primarily structured to deal with attrition issues impacting Pacific Bell and GTE-C, using mechanisms and procedures which are well-established and rooted in the Commission's regular review of the two larger companies. Roseville maintains that DRA has neither justified its request nor analyzed the impacts of including the mid-sized telephone companies in this complex proceeding. Further, Roseville cites limiting language appearing in D.88-06-024's discussion of operational attrition issues as support for its argument that inclusion of the mid-sized companies is unwarranted.

Roseville also believes that a true financial attrition filing is infeasible because it has not had frequent rate cases that would provide a baseline for a true financial attrition filing. Its last general rate case was decided in 1982, and since that time, it has experienced significant change in several indicators, including number of access lines, amount of intrastate regulated revenues and intrastate rate base. Further, Roseville underscores the differences between itself and the larger companies by noting that Pacific Bell and GTE-C will use more recent rate case data (versus 1982 rate case data) as an attrition starting point.

Roseville also believes that timing considerations militate against an attrition filing at this time. It cites uncertainties associated with Pacific Bell's California Plan for Rate Stabilization (CPRS) presented in Phase 2 of I.87-11-033. For example, it believes that Commission adoption of Pacific Bell's proposals regarding elimination of the charge for touchtone service and expansion of local calling areas, and extension of these proposals to Roseville, would have serious adverse revenue impacts. Roseville also believes the types of regulatory changes the

Commission is considering in Phase 2 of I.87-11-033 may significantly increase Roseville's future business risk, thereby changing its cost of capital. Roseville argues that further uncertainties associated with changes emanating from the supplemental rate design proceedings in A.85-01-034, TRA, Inside Wire, and USOA, militate against a financial attrition filing that will only increase the likelihood of "roller coaster rates."

Roseville's Protest echos Citizens' arguments relative to D.85-08-093. Roseville believes that the procedure the Commission envisioned for mid-sized local exchange telephone companies in that decision (i.e., "that attrition could operate only if it went hand-in-hand with a record developed in rate cases concluded immediately prior to the attrition matter") is different than what DRA contemplates. Roseville believes that a new proceeding is needed, or a reopening of the proceedings culminating in D.85-08-093, as a prelude to any attrition review for the mid-sized companies.

<u>Contel's Response</u>

In its July 29th Response, Contel stated that it desired a comprehensive determination of its outstanding revenue requirements changes. Contel proposed:

1. That the 1989 cost of capital adjustment be applied to its adopted 1985 test year results of operations (adjusted for the change in the net-to-gross multiplier) to determine a percentage change in test year revenue requirement;

2. That the resulting percentage be applied to updated 1989 estimated billings to calculate the gross revenue requirement change; and

3. That the change in turn be combined with and netted against the revenue requirement changes from other pending proceedings, specifically:

- Memorandum account balances relating to federal income taxes, USOA rewrite,[2] interest synchronization, and the expected decision regarding inside wire deregulation be netted out as of December 31, 1988. As part of the calculation of this net refund, Contel proposed to deduct the 1988 partial year negative revenue requirement effect ($1.5 million) of D.88-07-022 (the PacBell rate design decision).[3] The net refund (which Contel estimated at approximately $6 million before interest) would be amortized in a surcredit on local recurring exchange billings over a 12-month billing.

- On a prospective basis, effective January 1, 1989, Contel would reduce its revenue requirement by the annualized effect of the items previously subject to memo account treatment. Contel proposed as part of this calculated reduction, to deduct the annualized negative revenue requirement effect ($4.7 million) of D.88-07-022 (Pacific Bell rate design decision) and the 1989 negative revenue requirement effect of net settlement changes which would have been the subject of an October 1, HCF advice letter filing. In addition, Contel proposed to deduct any negative revenue requirement which might result from Pacific Bell's and GTE-C's memo

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2 D.88-09-030 signed 9/14/88 in the USOA docket required Contel to make a filing on October 1, 1988. Advice Letter 846 was filed in compliance with D.88-09-030.

3 Contel indicated that its August 8, 1988 High Cost Fund (HCF) advice letter filing would show a negative revenue requirement effect associated with the rate design decision of approximately $4.7 million annually, and $1.5 million for 1988. However, according to CACD, Contel declined to make the August 8 filing, and Contel has thereby forfeited HCF relief for 1988.

account closeout pursuant to the joint commissioner's ruling in I.87-11-033.[4]

DRA's Reply

On September 8, DRA filed a formal reply. DRA argued that the Citizens and Roseville Protests do not justify relief from a February 1, 1989 financial attrition filing requirement. However, DRA maintained that Contel's suggestions have some merit. DRA agreed that to the extent a comprehensive Commission decision for Contel can be accomplished, it would merely strengthen the need for a financial attrition review for the three companies in 1989.

Contel's October 21, 1988 Motion

On October 21, 1988, Contel filed a Motion requesting that the Commission issue an order to be effective January 1, 1989, authorizing it to eliminate its current bill-and-keep 5% intraLATA toll billing surcharge and reduce the billed component of its current pooled 8.57% intraLATA toll and exchange billing surcharge to 1.43% for 1989 and 6.5% for 1990. Contel's proposal is a variation of its earlier Response to DRA's A.88-05-009, and was presented after lengthy informal discussions with DRA.

Under Contel's proposal, certain outstanding revenue requirements impacts (related to TRA and USOA memoranda accounts, interest synchronization, the California High Cost Fund, and 1989 financial attrition) would be netted together in one rate reduction. Contel's proposed adjustments to its existing billing surcharges will reduce its rates by approximately $12,327,000, while amortizing the outstanding 1987-1988 memoranda account balances over a 12-month period ending December 31, 1989.

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4 However, this portion of Contel's proposal is at odds with Ordering Paragraph 2 of D.88-08-024 which ordered Pacific Bell and GTE-C to file advice letters October 1, 1988 to close out existing memorandum account balances, on the basis of a "bill and keep" surcharge/surcredit mechanism.

Contel asserts that the $12,327,000 reduction in annual revenues is possible only if the Commission acts to net these various outstanding adjustments effective January 1, 1989. The components of Contel's proposal are as follows:

> **Offsetting Outstanding Memoranda Account Adjustments**
>
> Effective December 31, 1988, Contel states that its TRA and interest synchronization memoranda accounts are negative in the amounts of $12,558,000 and $275,000, respectively. The ongoing reduction in revenue requirement for 1989 is approximately $10,588,000 and $435,000, respectively. Offsetting these amounts, however, is the positive USOA revenue impact of $4,983,000 for 1988 and $4,590,000 for 1989.
>
> **1989 Financial Attrition**
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> A key part of Contel's motion is its proposal to reduce its authorized return on common equity from 15.5% to 13%, based on a capital structure consisting of 53% common equity, 3% preferred stock, and 44% debt. In addition, Contel proposes to use its estimated 1989 imbedded costs of debt and preferred stock. Contel calculates that, if authorized, its financial attrition adjustment would reduce its revenue requirement by approximately $10,290,000 on an annual basis, commencing January 1, 1989.
>
> **Withdrawal of Requests for CHCF Relief**
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> In addition, pursuant to decisions issued by this Commission in the Pacific Bell general rate case docket, Contel has been accruing a revenue requirement associated with the intraLATA SPF to SLU conversion; it has included this increase, along with the impacts of other separations changes, in an Advice Letter (No. 847) seeking CHCF relief to reflect an additional $11,067,000 revenue requirement in 1989. Contel proposes to withdraw Advice Letter 847 upon issuance of the year-end decision it seeks herein.

Contel indicates that it believes the authorization it seeks is acceptable to DRA (Contel Motion, p. 6). Pursuant to the

ALJ's Ruling, responses to Contel's Motion as amended on October 27, 1988,[5] were filed by DRA and Citizens on November 10, and 15, 1988, respectively.

Upon review of the motion and its supporting data, DRA does not oppose Contel's proposal, and believes it is in the interests of ratepayers.

In its Response, Citizens asserts that, having reviewed Contel's Motion, it believes the proposal presents an appropriate alternative to protracted proceedings, and does not oppose the Motion. Citizens states that it is reviewing the procedures followed by Contel, and accepted by DRA, to determine if a similar procedure would be appropriate for it. If so, it indicates it will file a similar motion in an effort to facilitate the conclusion of this proceeding as to Citizens.

<u>Discussion</u>

The principal issue we face is whether to require financial attrition showings of the mid-sized local exchange companies. If we decide to impose such a requirement, we must also decide what base year is an appropriate starting point for the attrition calculation and whether to couple resolution of the financial attrition issue with a decision netting out other outstanding revenue requirements issues for these companies.

In analyzing whether it is appropriate to require financial attrition filings, we first address Protestants Citizens' and Roseville's argument that D.85-08-093 is controlling. D.85-08-093 was issued subsequent to D.85-03-042, the decision adopting the attrition formula, but both decisions were issued in the same docket. In D.85-08-093 the Commission, having adopted a formula for use by Pacific Bell and GTE-C, focused its attention on

5 The Amendment substituted a new exhibit containing Contel's financial attrition calculations.

the small and mid-sized local exchange companies. The Commission directed the smaller local exchange telephone companies to attend workshops designed to determine the applicability of GO 96-A procedures to their attrition filings. It ordered the mid-sized companies (Contel, Citizens, and Roseville) to use the same operational attrition formula applicable to Pacific Bell and GTE-C pursuant to D.85-03-042, with the exception of revenues and telephone plant in service categories. D.85-08-093 made these attrition filings optional on the condition that the utilities file for both attrition years following an adopted test year if they chose to file at all. The decision also imputed a 5% productivity factor for use by Contel in its attrition filings.

Thus, D.85-08-093 dealt only with operational attrition issues and the applicabilility of the attrition formula (or "cookbook") adopted in D.85-03-042 to the small and mid-sized companies. The present attrition formula is simply a means of calculating the operational attrition adjustment from year to year, and has nothing whatsoever to do with determining financial attrition. Since DRA's request is limited to financial attrition, not operational attrition, the relevance of D.85-08-093 to the present controversy is questionable at best.

Even assuming that the references to optional operational attrition filings have some bearing on the question of mandating financial attrition filings, the Protests ignore the fact that the Commission has required operational and financial attrition filings in recent years in the interests of protecting ratepayers (e.g., D.86-12-066, D.88-06-024).

For example, in D.86-12-099 the Commission modified the operational attrition formula in response to a request by Pacific Bell, but also mandated a 1987 operational attrition filing based on the need to protect ratepayer interests during periods of declining interest rates. Prior to D.86-12-066 (and indeed at the time D.85-08-093 was issued), operational attrition filings were optional. Thus, the Protestants' citations to D.85-08-093 are of limited help in resolving the issue before us.

The question is whether we now should review the companies' overall costs of capital and capital structures, because several years have passed since out last reviews, and interest rates and other key financial indicators have changed significantly during this interval. We do not find the arguments against such review persuasive.

We have previously discussed and dismissed the arguments based on D.85-08-093, but Protestants Roseville and Citizens also oppose making financial attrition filings on other grounds. For example, they argue that considering financial attrition for the mid-sized companies is counter to our expressed desire to limit these 1989 attrition proceedings (e.g., Roseville Protest, p. 3, citing D.88-06-024); however, a closer reading of D.88-06-024 demonstrates that our limiting language dealt with disputed operational attrition issues, not the issue whether financial attrition filings should be required of Pacific Bell and GTE-C. Therefore, the limiting language is not dispositive of the issue at hand.

Protestants also assert that we should not require financial attrition filings of the mid-sized companies because certain matters, such as prospective TRA and USOA filings, and Phase 2 of I.87-11-033, are currently unsettled. However, we do not find this a particularly compelling justification for delaying or foregoing the filings. A significant amount of this unfinished business will be concluded as the utilities make compliance filings prior to the end of 1988, as required by decisions issued in other dockets (e.g., D.88-09-030; D.88-07-022; D.88-01-061; D.88-08-024). Obviously, I.87-11-033 is an ongoing proceeding, but we see no reason to treat the mid-sized local exchange companies differently than we treated Pacific Bell and GTE-C whose similar pleas for delay based on I.87-11-033 were rejected in D.88-06-024. We are inclined to require the filings and provide Protestants the opportunity (previously extended to Pacific Bell and GTE-C) to address the impacts of I.87-11-033 in their risk assessment testimony.

We will grant DRA's request, and require Roseville and Citizens to file financial attrition applications, including testimony and exhibits relative to 1989 cost of capital and capital structure. These filings are due on February 1, 1989.

We turn now to the issue of the approriate base year to be used in the February financial attrition filings. We will require Citizens and Roseville to track the approach suggested by Contel[6] in its July 29th Response, by using their own respective adopted test year results of operations, but otherwise mirroring Contel's suggestion. Naturally, Citizens and Roseville are free to suggest alternative approaches in their February 1, 1989 applications, and other parties are free to comment in their prepared testimony on any such alternative suggestions.

We now turn to Contel's proposal. As shown in Appendix A[7] to this opinion, Contel proposes that we authorize a $12,327,000 annual reduction in its revenues based on offsetting: (1) its 1987 and 1988 refunds due to its customers as well as its TRA, USOA, and interest synchronization memoranda accounts totaling $13,104,000, (2) against its 1989 CHCF amount, $11,067,000, (3) against ($10,290,000) derived under its proposal to reduce its

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6 Contel suggested that the 1989 cost of capital adjustment be applied to its adopted 1985 test-year results of operations (adjusted for the change in the net-to-gross multiplier) to determine the percentage change in test-year revenue requirement. The resulting percentage was to be applied to updated 1989 estimated billings to calculate the gross revenue requirement change.

7 Appendix A includes Contel's Exhibits A-1, A-2, B, and C, attached to the October 21, 1989 Motion, as amended.

authorized return on common equity from 15.5% to 13% based on a capital structure composed of 53% common equity, 3% preferred stock, and 44% debt, using Contel's estimated 1989 imbedded costs of debt and preferred stock (Exhibit B to Contel's Motion). These offsets result in a net impact of ($12,327) million. As shown in Appendix A, Contel proposes to effect this $12,327,000 reduction by eliminating its current 5% bill-and-keep surcharge on intraLATA toll revenues and reducing its pooled 8.57% surcharge[8] to 1.43% for 1989 and 6.57% for 1990.

Contel's three-part proposal, while attractive, is not problem free. Two of its components (offsetting memoranda accounts and CHCF relief) are known and verifiable quantities; however, the third component, its financial attrition proposal, is untested. Contel has provided no data, no cost of capital analysis, and no analysis of the business and/or financial risks it will face in the 1989 attrition year. We are left with a bare proposal totally lacking in underlying justification.

If the 13% ROE figure is premised on the settlement reached in Pacific Bell's 1989 financial attrition proceeding (A.88-07-019), we note that, at least in that proceeding, underlying data and testimony existed that allow for a determination of the acceptability of the settlement. Here no such data is available to us, and Contel has not presented cost of capital information to this Commission since 1984-1985.

In addition, although Contel's proposal has the overtones of a settlement with DRA, it is not presented to us as such. There is no formal "agreement between some or all of the parties...on the resolution of any issue of law or fact material to the proceeding"

8 Contel would continue to pool the surcharge as if it had continued at a level of 8.57%, so administratively the 8.57% is still applicable for pooling purposes.

(Rule 51(c)), presently before us. Also, there is no indication that the settlement rules, which ensure the due process rights of other parties, have been followed. Nonetheless, given the reaction to Contel's proposal, it is apparent that no parties oppose it (ALJ Ruling of October 26, 1988).

We choose to regard Contel's proposal as an unopposed offer to reduce revenues submitted to the Commission via Motion, and not a settlement of the issues, pursuant to Rule 51. If we reject this proposal, ratepayers will enjoy a slight reduction as of January 1, 1989,[9] but not the immediate benefits of a reduced ROE from 15.5% to 13.00%. For that they must wait until Contel files a formal financial attrition application (presumably on February 1, 1989, as required of Citizens and Roseville), and the Commission holds hearings, and issues its decision. On the other hand, if we accept Contel's financial attrition proposal, the benefits to ratepayers will be immediate, but the cost of capital may be too high. Reinforcing this concern is the fact that we have not reviewed Contel's cost of capital for several years; further, it is presently unclear how long a 1989 attrition authorization would be in effect, but we may be blessing a result, based on no underlying reasonableness data, that will remain in effect for some time.

Our solution is to accept Contel's proposal on a provisional basis, recognizing the immediate ratepayer benefits in the short-term, but providing a vehicle for reviewing the acceptability of Contel's proposal in the long-term. Thus, we will authorize Contel to implement the proposal reflected in its October 21 Motion, but we will also require Contel to submit

9 This reduction results from the offsets that will occur as of January 1, 1989, excluding the financial attrition component (Appendix A).

testimony in this proceeding fully justifying its cost of capital proposal as reasonable for the entire 1989 attrition year. That testimony shall be served on all parties in this Docket on or before February 1, 1989.

Pending hearings on Contel's testimony, we accept its proposed reductions on an interim basis. Any adjustments following hearing, either upward or downward depending upon the evidence, will be made prospectively.

A prehearing conference will be held on February 15, 1989 in this proceeding and in the proceedings involving Roseville and Citizens in order to schedule hearings on Contel's testimony and the Roseville and Citizens' financial attrition applications. We are particularly interested in reviewing the cost of capital showings of Roseville and Citizens given the length of time that has elapsed since our last reviews (1982 and 1983).

Findings of Fact

1. In this Application, DRA requests issuance of an order requiring the three mid-sized local exchange telephone companies, Contel of California, Inc. (Contel), Citizens Utilities Company of California (Citizens), and Roseville Telephone Company (Roseville), to file financial attrition applications by February 1, 1989.

2. Citizens and Roseville protest DRA's application on procedural grounds, asserting that D.85-08-093 is dispositive, and on the basis of uncertainty in the current regulatory climate.

3. D.85-08-093 dealt only with operational attrition issues and the applicability of the attrition formula adopted in D.85-03-042 to the small and mid-sized local exchange companies. Since DRA's request is limited to financial attrition, rather than operational attrition, the relevance of D.85-08-093 to DRA's request is questionable.

4. The Commission has required operational and financial attrition filings in recent years in the interests of protecting ratepayers (D.86-12-066, D.88-06-024).

5. There is no reason to treat the mid-sized local exchange companies differently than we treated Pacific Bell and GTE-C, whose pleas seeking delay in attrition filings based on the pendency of I.87-11-033, and other uncertainties, were rejected in D.88-06-024.

6. It is reasonable to require Roseville and Citizens to file financial attrition applications, including testimony and exhibits relative to 1989 cost of capital and capital structure, because these utilities' costs of capital have not been reviewed since 1982 and 1983, respectively, and financial indicators have changed significantly during the intervening years.

7. On October 21, 1988, Contel filed a motion proposing that the Commission offset certain pending revenue requirement effects with a reduction in ROE and overall rate of return in lieu of a February 1, 1989 financial attrition application.

8. Contel's October 21, 1988 motion is unopposed.

9. Contel's October 21, 1988 motion is not tendered to the Commission as a settlement pursuant to Rule 51 of the Rules of Practice and Procedure and none of the Rule 51 requisites were followed prior to submission of Contel's proposal.

10. In its motion, Contel proposes that we authorize a $12,327,000 annual reduction in its revenues based on offsetting: (1) its 1987 and 1988 refunds due to customers as well as its TRA, USOA, and interest synchronization memoranda accounts totalling $13,104,000, (2) its 1989 CHCF amount, $11,067,000, (3) a financial attrition reduction of $10,290,000.

11. Contel's $10,290,000 financial attrition reduction proposal is premised on a capital structure composed of 53% common equity, 3% preferred stock, and 44% debt, using Contel's estimated 1989 embedded cost of debt and preferred stock, and a reduction in return on common equity from 15.5% to 13%.

12. The net impact of Contel's comprehensive proposal, including financial attrition is a $12,327,000 reduction. Contel proposes to effect this $12,327,000 reduction by eliminating its

current 5% bill-and-keep surcharge on intraLATA toll revenues and reducing its pooled 8.57% surcharge to 1.43% for 1989 and 6.55% for 1990.

13. Contel's three-part offset proposal includes two known and verifiable items (the current memoranda accounts and CHCF amounts); however, the third component, its financial attrition proposal, is untested, since Contel has provided no data, no cost of capital analysis, and no analysis of the business and/or financial risks it will face in the 1989 attrition year.

14. If we deny Contel's motion, ratepayers will still enjoy reductions due to the memoranda account and CHCF offsets (Appendix A hereto); however, ratepayers will not enjoy the additional $10,290,000 reduction associated with Contel's financial attrition proposal, and may not enjoy the benefits of a financial attrition reduction until a decision is issued in this docket, assuming that Contel's proposal is rejected and it is required to file a formal application for financial attrition. However, if we accept Contel's financial attrition proposal without further review, the cost of capital may be set at a level which is too high during the 1989 attrition year. There is no way of knowing this without undertaking further review and requiring the submission of supporting data by Contel.

15. In order to provide immediate benefits to ratepayers, it is appropriate to accept Contel's three-part proposal on an interim basis, however, and to require Contel to submit testimony supporting its financial attrition proposal in this docket. Other parties, including DRA, may also submit testimony in accordance with a schedule to be developed by the ALJ.

Conclusions of Law

1. DRA's request that the Commission issue an order requiring Roseville and Citizens to file financial attrition applications for attrition year 1989 should be granted.

2. Contel's October 21, 1988 motion is not presented to us as a settlement within the parameters of Rule 51 of the Rules of Practice and Procedure, but is more appropriately considered an unopposed offer to reduce revenues in conjunction with offsetting other outstanding revenue requirements issues for the 1989 attrition year.

3. It is impossible to tell whether Contel's proposal for a financial attrition reduction of $10,290,000 is reasonable as applicable to the entire 1989 attrition year, in the absence of underlying data and an analysis of cost of capital and the business and financial risks confronting Contel in 1989.

4. Given the fact that Contel's proposal will result in a revenue reduction, it should be accepted on an interim basis, subject to further hearings. Any adjustments following hearing, either upward or downward, depending on the evidence, should be made prospectively.

INTERIM ORDER

IT IS ORDERED that:

1. On or before February 1, 1989, Roseville Telephone Company (Roseville) shall file an application, testimony, and exhibits, constituting its affirmative showing for capital structure and cost of capital review for attrition year 1989. Roseville's 1989 cost of capital adjustment shall be applied to its most recent test-year results of operations (adjusted for the change in the net-to-gross multiplier) to determine the percentage change in test-year revenue requirement. The resulting percentage shall be applied to updated 1989 estimated billings to calculate the gross revenue requirement change. In accordance with the preceeding discussion, Roseville is free to suggest alternative approaches to this base-year question in its application.

Roseville's application shall be served on all parties in this docket at the time of filing.

2. On or before February 1, 1989, Citizens Utilities Company of California (Citizens) shall file an application, testimony, and exhibits, constituting its affirmative showing for capital structure and cost of capital review for attrition year 1989. Citizens' 1989 cost of capital adjustment shall be applied to its most recent test-year results of operations (adjusted for the change in the net-to-gross multiplier) to determine the percentage change in test-year revenue requirement. The resulting percentage shall be applied to updated 1989 estimated billings to calculate the gross revenue requirement change. In accordance with the preceeding discussion, Citizens is free to suggest alternative approaches to this base-year question in its application. Citizens' application shall be served on all parties in this docket at the time of filing.

3. The proposal contained in Contel's October 21, 1988 motion is accepted, except that the financial attrition proposal included in Contel's comprehensive proposal is accepted on an interim basis, subject to further hearing. On or before February 1, 1989, Contel shall submit testimony and exhibits in this docket, supporting a continuation of the interim financial attrition adjustment for the 1989 attrition year. Any adjustments following hearing, either upward or downward, depending upon the evidence, shall be made prospectively.

4. On or before December 22, 1988, Contel shall file revised tariff sheets to reflect the incremental change in billing surcharge/surcredit adopted in this decision, as consistent with its proposal to eliminate its current 5% bill-and-keep surcharge on intraLATA toll revenues and reduce its pooled 8.57% surcharge. The effective date of the ordered revisions shall be January 1, 1989. Such filing shall comply with General Order Series 96-A.

5. Given the acceptance of Contel's proposal, its request to withdraw Advice Letters 846 and 847 are granted.

6. A prehearing conference (PHC) will be held on Wednesday, February 15, 1989, at 10:00 a.m. in the Commission Courtroom, 505 Van Ness Avenue, San Francisco, California, to consider further scheduling issues in connection with hearing Contel's testimony; this PHC will be consolidated with prehearing conferences to be held to consider Roseville's and Citizens' February 1, 1989 financial attrition applications.

This order is effective today.

Dated NOV 23 1988, at San Francisco, California.

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

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

Victor Weisser, Executive Director

APPENDIX A
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CONTEL OF CALIFORNIA, INC.
CURRENT REGULATORY PROCEEDINGS
($000)

	1987 & 1988	1989 IMPACTS	TOTAL
1987 & 1988 Refund Due Customers	($6,671)		($6,671)
Balancing Accounts			
Tax	--	($10,588)	($10,588)
USOAR	--	4,590	4,590
I/W	--	--	-0-
Interest Synch	--	(435)	(435)
Subtotal	--	($6,433)	($6,433)
CHCF			
1988	--	$4,663	$4,663
1989	--	6,404	6,404
Subtotal	--	$11,067	$11,067
Attrition	--	($10,290)	($10,290)
Net Impact	($6,671)	($5,656)	($12,327)
Rate Design			
5% Surcharge Elimination			($2,865)
Reduction to 8.57% Surcharge			($9,462)
Total Net Refund			($12,327)

EXHIBIT A-1

APPENDIX A
Page 2

CONTEL OF CALIFORNIA, INC.
CURRENT REGULATORY PROCEEDINGS
($000)

	1987	1988	TOTAL
TAX	($2,870)	($9,688)	($12,558)
USOAR	--	4,796	4,796
I/W	--	--	-0-
INTRA SPF TO SLU	--	404	404
CHCF	--	1,495	1,495
INTEREST SYNCH	--	(275)	(275)
	($2,870)	($3,268)	($6,138)
INTEREST			(533)
TOTAL REFUND			($6,671)

EXHIBIT A-2

CONTEL OF CALIFORNIA, INC. FINANCIAL ATTRITION CALCULATIONS:

..SS-UP FACTOR:	FACTOR
Total Gross Revenue	1.000
LESS: Uncollectibles	0.007
Net Revenues	0.993
State Income Tax base	0.993
State Income Tax @ 4.8%	0.048
Federal Income Tax base	0.945
Federal Income Tax @ 34%	0.321
Net Operating Income	0.624
Net-To-Gross Multiplier	1.603

CONTEL ADOPTED CAPITAL STRUCTURE WITH REVISED CAPITAL COSTS

	RATIO	COST	WTD. COST
DEBT	44.00%	8.36%	3.68%
PREF.	3.00%	5.54%	0.17%
EQUITY	53.00%	13.00%	6.89%
	100.00%		10.74%

.EVENUE REQUIREMENT IMPACT NET OF TAX EFFECT ON FIXED CHARGES

.HANGE IN DEBT * RATE BASE * GROSS-UP FACTOR (1.007) =	($2,354)
CHANGE IN PREFERRED * RATE BASE * GROSS-UP FACTOR (1.603) =	(131)
CHANGE IN COMMON EQUITY * RATE BASE * GROSS-UP FACTOR (1.603) =	(4,748)
NET REVENUE REQUIREMENT	($7,233)

REVENUE REQUIREMENT ADJUSTMENT:	(000'S)
ADD. REV. REQ / '85 ADOPTED INTRALATA BILLING BASE OF $40,264	-17.96%
PROJECTED 1989 INTRALATA BILLING BASE	$57,293
TOTAL REVENUE REQUIREMENT IMPACT	($10,290)

EXHIBIT B

CONTEL OF CALIFORNIA, INC.
CURRENT REGULATORY PROCEEDINGS

Contel 8.57% Surcharge 1988

January	876,441.91
February	$1,113,573.93
March	707,077.01
April	972,972.18
May	950,416.26
June	855,667.95
July	700,454.83
August	928,737.30
September	971,073.37
Total	$8,076,414.74
Annualized	10,768,553
Surcharge %	8.57%
1988 Billing Base	125,654,061

	1989	1990
Growth	105.50%	105.50%
Base	132,565	139,856
Refund	(9,462)	(2,791)
Percentage	-7.14%	-2.00%
Current Surcharge	8.57%	8.57%
Surcharge	1.43%	6.57%

EHXIBIT C

(END OF APPENDIX A)

Contel asserts that the $12,327,000 reduction in annual revenues is possible only if the Commission acts to net these various outstanding adjustments effective January 1, 1989. The components of Contel's proposal are as follows:

Offsetting Outstanding Memoranda Account Adjustments

Effective December 31, 1988, Contel states that its TRA and interest synchronization memoranda accounts are negative in the amounts of $12,588,000 and $275,000, respectively. The ongoing reduction in revenue requirement for 1989 is approximately $10,588,000 and $435,000, respectively. Offsetting these amounts, however, is the positive USOA revenue impact of $4,983,000 for 1988 and $4,590,000 for 1989.

1989 Financial Attrition

A key part of Contel's motion is its proposal to reduce its authorized return on common equity from 15.5% to 13%, based on a capital structure consisting of 53% common equity, 3% preferred stock, and 44% debt. In addition, Contel proposes to use its estimated 1989 imbedded costs of debt and preferred stock. Contel calculates that, if authorized, its financial attrition adjustment would reduce its revenue requirement by approximately $10,290,000 on an annual basis, commencing January 1, 1989.

Withdrawal of Requests for CHCF Relief

In addition, pursuant to decisions issued by this Commission in the Pacific Bell general rate case docket, Contel has been accruing a revenue requirement associated with the intraLATA SPF to SLU conversion; it has included this increase, along with the impacts of other separations changes, in an Advice Letter (No. 847) seeking CHCF relief to reflect an additional $11,067,000 revenue requirement in 1989. Contel proposes to withdraw Advice Letter 847 upon issuance of the year-end decision it seeks herein.

Contel indicates that it believes the authorization it seeks is acceptable to DRA (Contel Motion, p. 6). Pursuant to the inclined to require the filings and provide Protestants the opportunity (previously extended to Pacific Bell and GTE-C) to address the impacts of I.87-11-033 in their risk assessment testimony.

We will grant DRA's request, and require Roseville and Citizens to file financial attrition applications, including testimony and exhibits relative to 1989 cost of capital and capital structure. These filings are due on February 1, 1989.

We turn now to the issue of the approriate base year to be used in the February financial attrition filings. We will require Citizens and Roseville to track the approach suggested by Contel[6] in its July 29th Response, by using their own respective adopted test year results of operations, but otherwise mirroring Contel's suggestion. Naturally, Citizens and Roseville are free to suggest alternative approaches in their February 1, 1989 applications, and other parties are free to comment in their prepared testimony on any such alternative suggestions.

We now turn to Contel's proposal. As shown in Appendix A[7] to this opinion, Contel proposes that we authorize a $12,327,000 annual reduction in its revenues based on offsetting: (1) its 1987 and 1988 refunds due to its customers as well as its TRA, USOA, and interest synchronization memoranda accounts totaling ($12,104,000), (2) against its 1989 CHCF amount, $11,067,000, (3) against ($10,290,000) derived under its proposal to reduce its

6 Contel suggested that the 1989 cost of capital adjustment be applied to its adopted 1985 test-year results of operations (adjusted for the change in the net-to-gross multiplier) to determine the percentage change in test-year revenue requirement. The resulting percentage was to be applied to updated 1989 estimated billings to calculate the gross revenue requirement change.

7 Appendix A includes Contel's Exhibits A-1, A-2, B, and C, attached to the October 21, 1989 Motion, as amended.

authorized return on common equity from 15.5% to 13% based on a capital structure composed of 53% common equity, 3% preferred stock, and 44% debt, using Contel's estimated 1989 imbedded costs of debt and preferred stock (Exhibit B to Contel's Motion). These offsets result in a net impact of ($12,327) million. As shown in Appendix A, Contel proposes to effect this $12,327,000 reduction by eliminating its current 5% bill-and-keep surcharge on intraLATA toll revenues and reducing its pooled 8.57% surcharge[8] to 1.43% for 1989 and 6.55% for 1990.

Contel's three-part proposal, while attractive, is not problem free. Two of its components (offsetting memoranda accounts and CHCF relief) are known and verifiable quantities; however, the third component, its financial attrition proposal, is untested. Contel has provided no data, no cost of capital analysis, and no analysis of the business and/or financial risks it will face in the 1989 attrition year. We are left with a bare proposal totally lacking in underlying justification.

If the 13% ROE figure is premised on the settlement reached in Pacific Bell's 1989 financial attrition proceeding (A.88-07-019), we note that, at least in that proceeding, underlying data and testimony existed that allow for a determination of the acceptability of the settlement. Here no such data is available to us, and Contel has not presented cost of capital information to this Commission since 1984-1985.

In addition, although Contel's proposal has the overtones of a settlement with DRA, it is not presented to us as such. There is no formal "agreement between some or all of the parties...on the resolution of any issue of law or fact material to the proceeding"

8 Contel would continue to pool the surcharge as if it had continued at a level of 8.57%, so administratively the 8.57% is still applicable for pooling purposes.

5. There is no reason to treat the mid-sized local exchange companies differently than we treated Pacific Bell and GTE-C, whose pleas seeking delay in attrition filings based on the pendency of I.87-11-033, and other uncertainties, were rejected in D.88-06-024.

6. It is reasonable to require Roseville and Citizens to file financial attrition applications, including testimony and exhibits relative to 1989 cost of capital and capital structure, because these utilities' costs of capital have not been reviewed since 1982 and 1983, respectively, and financial indicators have changed significantly during the intervening years.

7. On October 21, 1988, Contel filed a motion proposing that the Commission offset certain pending revenue requirement effects with a reduction in ROE and overall rate of return in lieu of a February 1, 1989 financial attrition application.

8. Contel's October 21, 1988 motion is unopposed.

9. Contel's October 21, 1988 motion is not tendered to the Commission as a settlement pursuant to Rule 51 of the Rules of Practice and Procedure and none of the Rule 51 requisites were followed prior to submission of Contel's proposal.

10. In its motion, Contel proposes that we authorize a $12,327,000 annual reduction in its revenues based on offsetting: (1) its 1987 and 1988 refunds due to customers as well as its TRA, USOA, and interest synchronization memoranda accounts totalling $12,104,000, (2) its 1989 CHCF amount, $11,067,000, (3) a financial attrition reduction ($10,290,000).

11. Contel's $10,290,000 financial attrition reduction proposal is premised on a capital structure composed of 53% common equity, 3% preferred stock, and 44% debt, using Contel's estimated 1989 embedded cost of debt and preferred stock, and a reduction in return on common equity from 15.5% to 13%.

12. The net impact of Contel's comprehensive proposal, including financial attrition is a $12,327,000 reduction. Contel proposes to effect this $12,327,000 reduction by eliminating its

2. Contel's October 21, 1988 motion is not presented to us as a settlement within the parameters of Rule 51 of the Rules of Practice and Procedure, but is more appropriately considered an unopposed offer to reduce revenues in conjunction with offsetting other outstanding revenue requirements issues for the 1989 attrition year.

3. It is impossible to tell whether Contel's proposal for a financial attrition reduction of $10,290,000 is reasonable as applicable to the entire 1989 attrition year, in the absence of underlying data and an analysis of cost of capital and the business and financial risks confronting Contel in 1989.

4. Given the fact that Contel's proposal will result in a revenue reduction, it should be accepted on an interim basis, subject to further hearings. Any adjustments following hearing, either upward or downward, depending on the evidence, should be made prospectively.

ORDER

IT IS ORDERED that:

1. On or before February 1, 1989, Roseville Telephone Company (Roseville) shall file an application, testimony, and exhibits, constituting its affirmative showing for capital structure and cost of capital review for attrition year 1989. Roseville's 1989 cost of capital adjustment shall be applied to its most recent test-year results of operations (adjusted for the change in the net-to-gross multiplier) to determine the percentage change in test-year revenue requirement. The resulting percentage shall be applied to updated 1989 estimated billings to calculate the gross revenue requirement change. In accordance with the preceeding discussion, Roseville is free to suggest alternative approaches to this base-year question in its application.