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ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of CONTINENTAL TELEPHONE COMPANY OF CALIFORNIA, a corporation, for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California.	Application 82-01-01 (Filed January 4, 1982)

Orrick, Herrington & Sutcliffe, by Robert J. Gloistein and Samuel B. Casey, Attorneys at Law, and Richard Pfeifer, for applicant.
William L. Knecht, Attorney at Law, for Interconnect Association, interested party.
Brian T. Cragg, Attorney at Law, Louis G. Andrego, and Robert L. Howard, for the Commission staff.

O P I N I O N

I. Introduction

On January 4, 1982, Continental Telephone Company of California (Continental) filed this application to increase intrastate rates to produce additional gross revenues of $31,082,000 in 1983 for telephone services furnished within California.

Public witness hearings were held on March 24 and 25, 1982 in Victorville and Barstow, respectively. Statements and testimony by over 60 members of the public and petitions bearing several thousand signatures were received.

Seventeen days of hearing were held in San Francisco between April 5, 1982 and May 20, 1982 at which Continental and the Commission staff (staff) presented evidence. The presentation of evidence concerning depreciation expense and reserve, and the effect of deregulation of terminal equipment, was deferred until the last week in July 1982 because Continental and the staff thought that evidence concerning these two issues could be affected by decisions that would be rendered in other proceedings. Evidence concerning the impact of deregulation of terminal equipment was not presented because the Commission decisions that could have affected this issue were not rendered as of the last day of hearing, which was July 28, 1982.

On May 10, 1982 Continental filed a motion to transfer certain portions of Application (A.) 59936, A.59849/OII 81, and A.60602 Order Instituting Investigation (OII) 84 to this proceeding. In those proceedings the Commission established a balancing account for certain toll and Extended Area Service (EAS) settlement revenues which Continental could receive as a result of the rate increases granted to The Pacific Telephone and Telegraph Company (Pacific) in D. 93367. The motion was granted by the assigned administrative law judge (ALJ) on July 26, 1982.

Opening and reply briefs were filed by Continental and the staff on July 1 and 23, 1982, respectively, covering all issues except the two deferred issues. The matter was submitted with the receipt of late-filed Exhibit 83 on August 23, 1982.

On October 19, 1982 counsel for Continental and the staff filed a stipulation to set aside submission of this matter for the purpose of receiving Exhibits 86, 87, and 88. The stipulation was received as Exhibit 89. The assigned ALJ so ruled on October 20, 1982. The stipulation was received as Exhibit 89.

II. Summary of Decision

This decision grants Continental rate relief in the amount of $16.73 million or 11.8% based on test year 1983. Of the $16.73 million in rate relief, $12.73 million will be derived from rates authorized herein, while the balance of $4 million will be realized from the balancing account pursuant to D.93655. Continental originally requested $31,082,000. The increase authorizes Continental to earn 12.91% on rate base which results in a return on equity of 16.00%. An attrition methodology is adopted which requires a final determination of various cost elements before a specific attrition allowance is granted for 1984. Interest from balancing account monies will be applied to partially offset any computed attrition. Both Continental and staff proposed a specific attrition award of $4.31 million without further review.

The most significant rate changes to produce the adopted 1983 revenue requirement are in basic exchange access rates, as follows:

	Business Rates		Residence Rates	
Type of Service	Present Rates	Authorized Herein	Present Rates	Authorized Herein
One-Party	$17.50	$24.50	$ 7.00	$ 9.15
Two-Party	15.00	19.75	5.90	7.70
Four-Party	15.00	19.75	5.90	7.70
Multi-Party	13.50	17.80	5.40	7.10
Multi-Line	29.00	35.95	12.00	15.75
Key Line	29.00	35.95	12.00	15.75
PBX Trunk	29.00	35.95	* N/A	* N/A
Semi-Public	17.50	24.50	* N/A	* N/A

*Not Available

The decision provides that basic rates for customers served by Apple Valley Central Office shall remain at present levels until such time as service conforms to General Order (G.O.) 133 indices for a period of three consecutive months. The decision also provides for the implementation of nonoptional business measured exchange access service and optional residence measured exchange access service in certain of Continental's exchanges.

III. Continental's Present Operations

Continental is a subsidiary of Continental Telephone Corporation (CTC). It owns and operates a total of 110 central offices, 100 of which are scattered throughout California.

Continental does not provide service in metropolitan areas. Continental serves approximately 14 telephones per square mile, and 87% of its central offices serve 5,000 stations or less. As a result, Continental's investment and operating expenses per station are higher than those of telephone companies which provide service in metropolitan areas. In contrast, Pacific serves over 300 telephones per square mile and General serves 375 telephones per square mile. Continental's largest exchange is Victorville with 32,087 main stations as of June 30, 1981. As of that same date, Continental provided service to 291,829 telephones in areas totaling approximately 19,860 square miles in 25 of California's 58 counties. Continental's average lines per central office total 1,956.

The application alleges the requested increases are essential to provide Continental with the financial strength to obtain the capital required for its extensive construction program and to allow it to earn a reasonable return. Because of its financing requirements, Continental expects its embedded cost of debt in test year 1983 to increase to 10.55% from 9.12% in test year 1981. In addition, Continental asserts that accounting and operating changes taking place in the telephone industry and recent federal tax law changes will substantially increase its revenue requirement. Without substantial rate relief, Continental believes its interest coverage will decline and its return on common equity will be significantly eroded. In 1979, Continental's bond rating was upgraded from Baa to A, and timely rate relief in 1981 enabled it to maintain that rating. Continental states that its requested rate increases are necessary to maintain its financial health and interest coverage and to assure a continued A-bond rating. High bond ratings produce lower interest costs for the benefit of Continental's customers.

Finally, Continental states the rate increases requested are necessary to allow it to continue to accommodate customer growth and to improve the quality of service to all its customers.

IV. Public Witness Statements and Testimony

On March 24 and 25, 1982, public witness hearings were held in Victorville and Barstow, respectively. The hearings provide Continental's customers with an opportunity to comment on the rate increase application. A total of 68 people testified or made statements at the two locations. All were opposed to the rate increase. Most of them spoke of service problems which can be summarized as follows:

Unable to get dial tone at times.

Unable to get operator because of constant busy signal.

Inability to dial long-distance direct.

Noise or dial tone on line during conversations.

Incorrect billing of long-distance calls.

Inoperative telephone.

Difficulty getting repair service.

Phone installation delays.

Telephone employees' attitude to customers.

Interrupted service in middle of call.

A number of petitions, bearing several thousand signatures from residents of the area were received in evidence. The petitions expressed opposition to the increase and dismay about the quality of Continental's service.

Correspondence opposing the application was received from customers of Continental in the San Miguel and Bishop areas.

During July 1982 petitions bearing many signatures were received from both residential and business customers of Continental opposing the increase requested as being excessive.

Subsequent to the public hearings in Victorville and Barstow, the staff investigated the service problems noted at the hearings. The investigation discloses that the service at Barstow and Victorville has improved because of corrective action taken by Continental. Generally the service now conforms to G.O. 133 requirements. The only exception is the quality of service to subscribers served by the Apple Valley central office. Staff's investigation revealed that the service at Apple Valley continues to be poor. We referred to these problems in Continental's last rate increase decision (D.92804-A.59936). Accordingly, we will not authorize an increase in monthly base rates of customers served by the Apple Valley central office until the service meets the standards set forth in G.O. 133.

V. Results of Operations

Tables 1 and 2 set forth Continental's and the staff's estimated 1983 test year operations excluding the effects of the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 based upon present rates for total California and intrastate service, respectively, as follows:

TABLE 1
Page 1

Total California Operations
Test Year 1983
(000's)

Description	Continental	Staff	Continental Exceeds Staff
Operating Revenues			
Local Service	$ 45,445	$ 45,445	
Toll.	133,992	132,672	$1,320
Miscellaneous	5,573	5,573	
Uncollectibles	(1,530)	(1,530)	
Amt.Exp.Sta. Conn.	3,189	3,265	(76)
Total	$186,669	$185,425	$1,244
Operating Expenses and Taxes			
Maintenance	$ 36,679	$ 36,679	
Depreciation	34,198	33,711	$ 487
Traffic	16,707	16,707	
Commercial	10,666	10,666	
General Office	10,955	10,955	
Other Expenses	14,268	13,435	833
Federal Income Tax	15,257	13,871	1,386
Calif.Corp. Fed.Tax	3,700	3,644	56
Other Taxes	7,213	7,213	
Amt.Exp.Sta.Conn.	4,296	4,093	203
Total	$153,939	$150,974	$2,965
Net Operating Revenue	$ 32,730	$ 34,451	$(1,721)

(Red Figure)

(Table 1 Continued on Next Page)

TABLE 1
Page 2

Total California Operations
Test Year 1983
(000's)

	Continental	Staff	Continental Exceeds Staff
Rate Base			
Plant in Serv.	$456,875	$451,421	$5,454
CWIP	14,219	14,000	219
Deprec. Reserve	(115,889)	(115,889)	
Net Plant	355,205	349,532	5,673
Common Plant Amt.	(1,286)	(1,286)	
Materials & Supp.	3,436	100	3,336
Working Cash Allowance			
Avg.Amt. to Pay Exp. before coll. rev.	9,468	6,735	2,733
Other Oper.Csh. reqs.	248	232	16
Amt.w/h employees	(805)	(1,046)	241
Excise Taxes	(213)	(213)	
Deferred Credits	(924)	(1,500)	576
Credit from supplies	(891)	(600)	(291)
Lag Pay Cap Items	-	(400)	400
Normalization	(9,352)	(9,352)	
Interstate Deficency	(424)	-	(424)
Adjustments			
Exp.Stat. Conn.	(8,507)	(4,315)	(4,192)
IDC for CWIP	3,900	3,900	
IDC Disallowed	(302)	(302)	
Unsupported Plant	(542)	(542)	
Affiliated Interest	-	(2,250)	2,250
Total Rate Base	$349,011	$338,693	$10,318
Rate of Return Present Rates	9.38%	10.17%	

(Red Figure)

TABLE 2
Page 1

Intrastate Results of Operations
Test Year 1983
(000's)

Description	Continental	Staff	Continental Exceeds Staff
Operating Revenues			
Local Service	$ 45,445	$ 45,445	
Toll.	90,486	89,674	$ 812
Miscellaneous	5,033	5,033	
Uncollectibles	(1,154)	(1,154)	
Amt.Exp.Sta. Conn.	2,672	2,593	79
Total	$142,482	$141,591	$ 891
Operating Expenses and Taxes			
Maintenance	$ 28,214	$ 28,214	
Depreciation	26,382	26,006	$ 376
Traffic	13,020	13,020	
Commercial	9,276	9,276	
General Office	8,600	8,600	
Other Expenses	11,265	10,607	658
Federal Income Tax	10,549	9,378	1,171
Calif.Corp. Fed.Tax	2,770	2,748	22
Other Taxes	5,632	5,632	
Amt.Exp.Sta.Conn.	3,298	3,126	172
Total	$119,006	$116,607	$2,399
Net Operating Revenue	$ 23,476	$ 24,984	$(1,508)

(Red Figure)

(Table 2 Continued on Next Page)

TABLE 2
Page 2

Intrastate Results of Operations
Test Year 1983
(000's)

	Continental	Staff	Continental Exceeds Staff
Rate Base			
Plant in Serv.	$352,753	$348,542	$4,211
CWIP	11,054	10,884	170
Deprec. Reserve	(89,699)	(89,699)	
Net Plant	274,108	269,727	4,381
Common Plant Amt.	(306)	(306)	
Materials & Supp.	2,620	76	2,544
Working Cash Allowance			
Avg.Amt. to Pay Exp. before coll. rev.	7,493	5,330	2,163
Other Oper.Csh. reqs.	196	183	13
Amt.w/h employees	(637)	(828)	191
Excise Taxes	(168)	(168)	
Deferred Credits	(731)	(1,187)	456
Credit from supplies	(705)	(475)	(230)
Lag Pay Cap Items	-	(316)	316
Normalization	(7,220)	(7,220)	
Interstate Deficency	(424)	-	(424)
Adjustments			
Exp.Stat. Conn.	(6,568)	(3,332)	(3,236)
IDC for CWIP	3,032	3,032	
IDC Disallowed	(235)	(235)	
Unsupported Plant	(418)	(418)	
Affiliated Interest		(1,737)	1,737
Total Rate Base	$270,037	$262,126	$7,911
Rate of Return			
Present Rates	8.69%	9.53%	

(Red Figure)

A. Differences Between Continental and Staff

The only significant differences between Continental's figures and the staff's figures exist in the following categories:

1. Other expenses.
2. Plant in Service.
3. Material and Supplies.
4. Working cash allowances (all categories).
5. Interstate deficiency, and
6. Affiliated Interest Adjustment.

Continental and the staff applied identical formulas to arrive at their estimates. However, in the above six categories there are differences in the variables included in the formulas. For example, the staff and Continental use the same formula to arrive at the federal income tax figure. Their estimates differ because of a disagreement on the appropriate level of net income to be applied to the formula.

The following describes the differences between Continental and the staff's figures and our adopted amounts to be included in accounts for other expenses, plant in service, materials and supplies, working cash allowances, the interstate deficiency, and the affiliated interest adjustment.

1. Other Expenses

Staff's estimate is $833,000 lower than Continental's in Account 674, General Service and Licenses.

Continental estimated its test year 1983 Account 674 expense to be $3,271,000, by trending 12-month moving average totals for the period January 1978 through April 1981. This figure contains no ratemaking adjustments, and includes an amount for return on investment. In projecting the expense Continental assumed a composite growth rate of 36.6% for the years 1981, 1982, and 1983 which the staff accepts as reasonable.

The staff figure of $2,438,000 for this account was calculated by removing from the Continental estimate the 1983 return on investment of $72,000 (which was arrived at by increasing the $52,358 1980 recorded return on investment by the composite growth rate of 36.6%) for a resultant figure of $3,199,000. From this the staff disallowed $807,000 and added a return on investment of $46,000.

The $807,000 staff-recommended disallowance is detailed in Table No. 2-C of Exhibit 48 as follows:

	($000)
Nonutility Property	21
Aircraft	81
Dues, Donations, Contributions	5
Investor Interest Expenses	453
Former Owners, Former Officers, etc.	54
Annual Management Meeting	4
Unregulated Operations	108
House Services & Other Taxes	81
	807

Although Continental disputes the disallowance of each of the above recommended disallowances, it only cross-examined the staff witness concerning the investor interest expenses which include trustee fees, transfer agent fees, registrar fees, New York franchise taxes, Delaware franchise taxes, audit fees, annual report costs, director fees, and public relation costs.

Continental takes the position that the investor interest expenses allocated to it by CTC are reasonable surrogates for expenses that would be incurred by Continental if it were a publicly held company.

The staff argues that Continental failed to show that its investor interest expenses are just and reasonable or that California ratepayers would receive any benefit from these expenses. The staff therefore urges the Commission to adopt staff's recommendation for disallowance of investor interest expense and the other expenses in Account 674 as set forth above. We concur with the staff and will adopt its position.

2. Plant in Service

Telephone plant in service is estimated for the test year by adding the estimated total of the beginning of year balances in the various telephone plant in service accounts to the estimated weighted average additions to telephone plant in service during the test year. That portion of common telephone plant not allocable to California operations is subtracted from that amount.

Continental and the staff began their analysis with Continental's Planned Construction Budget (PCB) of May 5, 1981.

The only adjustments staff made to Continental's estimates were for station equipment items. For apparatus and stations, staff reduced Continental's estimates to reflect staff's expectation of lower growth in customer demand in the test year. For large PBX, staff reduced Continental's estimates under the assumption that a softening of the economy will reduce demand for large PBX equipment.

To obtain an estimate of the effect of lesser growth in customer demand, staff looked to its estimates of main station gain. Main station gain was employed as an index of customer demand because, in the judgment of staff witness Mangold, it has been a good indicator of more general changes in customer demand.

The staff's adjustment to the large PBX item reflects its belief that economic recession will influence business demand in the test year more keenly than other types of customer demand. Staff argued that many of the factors that affect business demand for large PBX are unpredictible. Those factors include the extent and duration of the recession, the number of business closings, the extent to which the local economies of Continental's service areas echo national economic trends. As a result, staff argued, forecasting from historical patterns in this area is a meaningless exercise. For this reason, the amount of the staff adjustment was a matter of judgment.

Continental contends that the staff's downward adjustment for station equipment resulted from three errors: (1) mistaken assumptions used in allocating construction expenditures to station equipment, particularly large PBX; (2) the failure to recognize that estimates of station apparatus and station connection expenditures must take into account the cost of serving all of Continental's customers, not just new customers; and (3) the failure to recognize that Continental's estimates of large PBX expenditures had already projected downward economic conditions.

In Exhibit 45, Chapter 13, Paragraph 8, the staff purported to compare the construction expenditures for 1982 and 1983 as estimated by Continental and the staff. It was shown on cross-examination and rebuttal that the Continental columns for 1982 and 1983 construction expenditures were not taken from the PCB, but were developed by the staff based on its assumptions on the allocation of expenditures set forth as follows:

Item	1982 Cont'l	1982 Engr. Anal.	1982 Cont'l Exceeds Engr.Anal.	1983 Cont'l	1983 Engr. Anal.	1983 Cont'l Exceeds Engr.Anal.
	($ Millions)					
Station Equipment						
Apparatus	$ 4.0	$ 2.8	$1.2	$ 4.2	$ 3.7	$0.5
Connections	8.2	5.6	2.6	9.5	8.2	1.3
Large PBX	2.5	1.5	1.0	2.8	1.8	1.0
Subtotal	14.7	9.9	4.8	16.5	13.7	2.8
Land and Buildings	3.7	3.7	-	6.4	6.4	-
COE	21.3	21.3	-	26.7	26.7	-
Outside Plant & General Equipment	16.1	16.1	-	15.7	15.7	-
Total	55.8	51.0	4.8	65.3	62.5	2.8

The staff conceded that if its assumptions are incorrect, its calculation of the breakdown of construction expenditures in the PCB would change (Mangold, RT 1032-1033, 1128-1129, 1134-1140). Continental argued that staff used erroneous assumptions to calculate its breakdown of construction expenditures from the PCB (Exhibit 67, pages 4-5; Pfeifer, RT 1435-1474).

The correct breakdown is set forth in the "Cont'l" column of Table 2 to Exhibit 67 and compared with the staff breakdown. This table shows that the staff erred on the breakdown, and on the total 1982 and 1983 station equipment construction expenditures. The staff miscalculated the total station equipment construction expenditures because it determined "California only" construction expenditures from the total company summary in the PCB using an estimated allocation factor. In contrast, Continental summed the specific construction jobs attributable to Arizona and Nevada projects, and then subtracted those from total company operations to arrive at a California only figure. The staff incorrectly categorized as large Private Automatic Branch Exchange Service (PABX) expenditures, expenditures which should have been allocated either to station connection or station apparatus expenditures.

The correct numbers, as shown in Table 2 of Exhibit 67, which should have appeared for Continental in Exhibit 45, Chapter 13, Paragraph 8, are:

<u>1982</u>	
Station Apparatus	$ 4,067,000
Station Connections	8,230,000
Large PABX	478,000
Subtotal-Station Equipment	$12,775,000
<u>1983</u>	
Station Apparatus	$ 4,400,000
Station Connections	9,134,000
Large PABX	451,000
Subtotal-Station Equipment	$13,985,000

The staff also reduced Continental's estimate of 1982 and 1983 construction expenditures, based on its downward adjustment of Continental's estimates for station equipment expenditures. The staff downward adjustment of $4.8 million in 1982 and $1.8 million in 1983 is based on two factors. For the apparatus and station connection portions of estimated station equipment expenditures, the staff based the adjustment on its lower estimate of "main station gain" for 1982 and 1983. For the large PBX portion of the estimated station equipment expenditures, the staff contended that the $1 million reduction in both 1982 and 1983 is a "judgment amount" based upon a "softening of the economy."

The staff agreed that main station gain is equated with the "addition of new customers", and does not include construction expenditures incurred to service "customer movement and the addition of extension telephones".

The staff recognized that when Continental customers move within an exchange, or lease a replacement phone, or add an extension telephone, there would be station equipment expenditures, but no main station gain.

The staff also agreed that the relationship between main station gain and station connection or apparatus expenditures is not necessarily proportional. For example, Continental may experience a main station gain of ten with an inward movement of 110 customers and an outward movement of 100 customers or an inward movement of ten and outward movement of 0, but incurs far larger station connection and apparatus expenditures in the former case than in the latter. The staff also agreed that the estimates for station equipment construction expenditures must take into account the cost of serving all of Continental's customers, not just new customers.

Staff witness Mangold used main station gain as an index of customer demand based on his experience that main station gain had been a good indicator of more general growth in customer demand. Continental submits that the staff cannot argue that "main station gain alone is a sufficient indication of what is happening to be able to predict the level of construction expenditures". To properly adjust these expenditures to reflect the staff's lower forecasts for new main stations, which Continental accepts, Continental asserts it is only necessary to take the percentage difference between these forecasts for 1982 and 1983 times the station connection and station apparatus expenditures for these years, respectively, as shown in Table 1 of Exhibit 67.

We agree with Continental that the use of "main station gain" as a proxy for estimating other station equipment expenditures has some shortcomings because the customer growth rate may not match the changes in other types of customer activity. However, all estimating techniques require assuming some unknowns. Continental failed to disprove the existence of an historic correlation between main station gain and the growth rate in demand for services resulting from customer movement and the addition of extension telephones. In contrast, staff's analysis was based on past experience.

We agree with staff that demand resulting from customer movement and the addition of extension telephones is likely to taper off in a weak economy. In addition, we note that station equipment expenditures are likely to decrease if an increasing number of customers purchase their telephone equipment, rather than lease it from the company. Accordingly, we will adopt staff's estimates.

3. Materials and Supplies (M&S)

Continental maintains a constant inventory of M&S, which is recorded in the balance sheet asset Account 122. When a particular item is withdrawn from inventory it is replaced immediately by purchase. As a result the M&S inventory does not significantly fluctuate from month to month. The M&S are available for capitalized projects as well as for the operation, repair, and maintenance of telephone plant in service. During 1980 and 1981, approximately 97.6% of the expenditures flowing through Account 122 were capitalized.

The reason for an M&S allowance in rate base is to compensate investors for inventory necessary for the efficient operation and maintenance of telephone plant in service. M&S for the construction of telephone plant is not included because they are accounted for in the estimate of construction expenditures.

Continental's estimate is the average ratio for the three-year period 1978 through 1980 of the end-of-year balance in Account 122 to the year's construction expenditures multiplied by its estimate of test year 1983 construction expenditures. No adjustment was made for capitalized M&S.

The staff estimates a reasonable M&S allowance to be 2.4% of Continental's estimate because that amount was expensed during 1980 and 1981. Staff argued that when M&S are drawn for Construction Work in Progress (CWIP), they are capitalized, and that estimates of the rate base include M&S for the test year.

Continental does not dispute staff's estimate of that portion of the M&S account which is expensed. Continental believes, however, that it will not earn a return on the remainder of the M&S expenditures under staff's proposal because Continental replaces inventory shortly after it is drawn down.

Staff's assertion that the utility recovers the carrying costs of M&S inventory devoted to construction through inclusion of CWIP in rate base overlooks the fact that M&S items are held in inventory for some time before being assigned to a particular use, and thus before being assigned to a CWIP account. Whether a particular inventory item ultimately is devoted to construction (and so capitalized) or to maintenance (and so expensed), the item will previously rest in M&S inventory for a period of time and be replaced promptly upon its removal from inventory. The carrying costs of maintaining that item in inventory, until it either enters the CWIP account or is expensed, are a proper element of Continental's revenue requirement.

Staff witness Mangold did not contend that the total amount allocated by Continental for M&S inventory was unreasonable or excessive; nor did he advocate that Continental's M&S inventory be reduced to the staff figure of $100,000. Nor does staff deny that Continental replaces inventory items promptly upon their being put to use. Yet staff would permit inclusion in rate base of only $100,000 of Continental's $3,436,000 allocation for M&S inventory.

Staff's position is consistent with past Commission decisions. As long ago as 1923 the Commission clearly stated that an allowance for materials and supplies in inventory "should cover only those supplies kept on hand for inventory and not those held for construction work." Coast Valleys Gas & Electric Co., (1923) 24 CRC 53, 57; see also Pacific Gas & Electric Co., (1921) 19 CRC 925; Midland Counties Public Service Corp., (1924) 24 CRC 544. This policy was most recently applied in General Telephone Co. of Calif., D.82-04-028, issued April 6, 1982 (mimeo, at 82-83).

Exclusion from rate base of inventory destined for use in construction is consistent with this Commission's general policy rejecting rate base treatment of non-operative CWIP. On the other hand, it is inconsistent for staff to recognize the reasonableness of Continental's inventory levels while seeking to deny any recovery of the associated carrying costs. It would be appropriate to permit Continental to establish a new account for M&S construction inventory to accrue interest at the same rate as a CWIP account. Such accrued interest ultimately will be eligible for inclusion in rate base on the same terms as interest on CWIP accounts. To recognize the probable lag between acquisition of inventory and payment therefor by Continental, interest on construction inventory should accrue only from the date of payment for inventory items, subject to reasonable averaging for purposes of accounting convenience.

Staff and Continental are requested to address this issue in depth in the next rate proceeding.

4. Working Cash Allowance

a. Average Amount to Pay Expenses Before Collection of Revenue

The working cash allowance is included in rate base so that the utility's investors may be compensated for capital which they have supplied to enable the utility to operate efficiently and economically and for which it would not otherwise be compensated. Southern California Edison Co. (1978) 84 CPUC 734, 794. The allowance compensates Continental's investors for funds provided to pay the operating expense of the business in advance of receiving offsetting revenues and to fund other operational cash requirements needed for efficient operations. Both Continental and the staff followed the lead-lag approach set forth in CPUC Standard Practice U-16, Determination of Working Cash Allowance, September 13, 1968.

Continental and the staff are in agreement on the average lag in collection of revenues. They differ on the lag day estimates for several items included in the calculation of average lag in payment of certain expenses and losses.

Staff adjusted its estimates to reflect a possible "float" to Continental's affiliate, CTC. Staff argued that such a float is a subsidy paid by Continental's ratepayers to its affiliate.

We agree with staff's assessment of appropriate lag day estimates for those items in dispute, except for its estimate of lag days applicable to payments for directory expenses. Those payments do not appear to provide a float to Continental's affiliate.

b. <u>Other Operating Cash Requirements</u>

The difference of $16,000 between Continental and the staff was not addressed in the briefs of either party. We will adopt Continental's figure.

c. <u>Deduction From Operating Cash Requirements</u>

(1) <u>Amount Withheld From Employees</u>

Continental's recommendation of $805,000 for this item is the unadjusted 1980 balance. Continental's witness acknowledged that he expects payroll and the amount withheld from employees to increase in 1983 as compared with 1980. No adjustment for this expected increase, however, was submitted by the company.

Staff's recommended $1,046,000 adjustment anticipates a 30% increase in this item over the 1980 amount. Staff's approach, as Continental's witness agreed, is reasonable and should be adopted.

(2) <u>Deferred Credits</u>

The staff's estimate of $1,500,000 is not disputed by Continental and will be adopted.

(3) <u>Credit From Supplies</u>

Continental accepted the staff's recommendation of a $600,000 adjustment. We will adopt the staff's recommendation.

(4) Lag In Payment of Capitalized Items

Continental disputes staff's consideration of funds available from lag in payment of capitalized items. Continental states that most of these items are capitalized payroll items which are not booked to CWIP until the end of the month. Thus, the company states that it does not earn interest during construction until after the funds have been distributed to the employee.

A simple example presented during cross-examination demonstrates the fallacy of Continental's argument. Capitalized payroll is frequently associated with construction expenditures that begin producing revenues--resulting from rates that include Continental's return on investment--immediately upon completion, even though the payment to employees would not be made until weeks later. Staff's estimates recognize this delay in payment and will be adopted.

5. Interstate Deficiency

Continental points out that in the past it has been required to flow through the benefits of accelerated depreciation. Continental did not record deferred taxes, nor did the Commission set rates, to cover federal income taxes which would come due in later years. Flow-through theory assumed that these taxes would be paid from the benefits of future accelerated depreciation flowed-through. The Economic Recovery Tax Act of 1981 (ERTA) has ended this source of repayment. All flow through California utilities must now recover these deferred taxes in current revenue requirement.

Continental alleges that its recovery of past flow-through is uniquely complicated by the fact that the separations process will allocate to interstate business a portion of the recovery of future tax liability resulting from past flowed-through tax benefits. In fact, however, revenues from interstate business in the past were calculated in effect to cover deferred tax liability (despite the fact that this Commission required Continental to flow the revenues attributable to deferred taxes through the net income); and interstate toll revenues will not cover these taxes a second time. This is what has been referred to in the record as the "interstate shortfall."

It is Continental's position that because of the manner in which the interstate shortfall benefited California local ratepayers in the past, recovery of that shortfall is a proper component of the intrastate revenue requirement.

The staff points out that two questions must be considered in the analysis of Continental's position concerning the deficiency as follows:

1. Does the interstate deficiency exist?
2. And, if it does, should the added expense be borne by the ratepayer or the shareholders?

The staff does not believe the deficiency exists; however, assuming that it does, we will consider the second question posed by the staff.

Staff points out that intrastate rates should not be a vehicle through which interstate revenue deficiencies should be recovered. Continental concedes that it never expressly recognized in previous rate increase proceedings the income it now asserts it received in interstate operations because the deficiency did not come to light until Continental was required to use normalization accounting.

Based upon this admission we consider it inappropriate to allow the interstate deficiency adjustment proposed by Continental.

6. Affiliated Interest Adjustments

The staff's adjustment of $2,250,000 is the result of a reduction to plant in service equal to the aggregate surviving excess profit (that profit of Continental's affiliate Continental Telephone Service Corporation which is over and above the authorized rate of return of Continental). The purpose of the affiliated interest adjustment is to ensure that ratepayers, in connection with purchases of property dedicated to the use of ratepayers, do not contribute to a profit for the utility's unregulated affiliate that is greater than the rate of return which the Commission finds reasonable for the utility's operation. As the Commission has stated, "The earnings on the investment required in...service type corporations should not be any greater than the earnings would have been had the service functions and the related investment thereon remained in the utility corporate structure." (Continental Telephone Co. (1973) 75 CPUC 573 at 584).

The potential for dealings among affiliated companies that would result in excessive expenses for ratepayers requires the approach applied by the staff and the Commission. We see no reason to alter our longstanding policy on this issue. We will adopt the staff's adjustment.

VI. Adopted Results of Operations

Based on the foregoing discussion our adopted results of operations for Total California Operations and Intrastate operations which includes the effects of TEFRA are set forth in Tables 3 and 4 as follows:

TABLE 3
Page 1

Adopted Results of Operations
Test Year 1983
(000's)

Description	Total Company	Intrastate
Operating Revenues		
Local Service	$ 45,445	$ 45,445
Toll.	132,672	89,935
Miscellaneous	5,573	5,033
Uncollectibles	(1,530)	(1,154)
Amt.Exp.Sta. Conn.	3,265	2,496
Total	$185,425	$141,755
Operating Expenses and Taxes		
Maintenance	$ 36,679	$ 28,213
Depreciation	33,711	26,008
Traffic	16,707	13,020
Commercial	10,666	9,276
General Office	10,955	8,600
Other Expenses	13,435	10,607
Federal Income Tax	14,199	9,800
Calif.Corp. Fed.Tax	4,039	2,850
Other Taxes	7,213	5,632
Amt.Exp.Sta.Conn.	3,284	2,611
Total	$150,888	$116,617
Net Operating Revenue	34,537	25,138

(Table 3 Continued on Next Page)

TABLE 3
Page 2

Adopted Results of Operations
Test Year 1983
(000's)

	Total Company	Intrastate
Rate Base		
Plant in Serv.	$451,421	$348,542
CWIP	14,000	10,884
Deprec. Reserve	(115,889)	(89,698)
Net Plant	349,532	269,728
Common Plant Amt.	(1,286)	(306)
Materials & Supp.	100	76
Working Cash Allowance		
Avg.Amt. to Pay Exp. before coll. rev.	7,604	6,017
Other Oper.Csh. reqs.	248	196
Amt.w/h employees	(1,046)	(828)
Excise Taxes	(213)	(168)
Deferred Credits	(1,500)	(1,187)
Credit from supplies	(600)	(475)
Lag Pay Cap Items	(400)	(316)
Normalization	(9,308)	(7,187)
Interstate Deficency	0	0
Adjustments		
Exp.Stat. Conn.	(4,315)	(3,332)
IDC for CWIP	3,900	3,032
IDC Disallowed	(302)	(235)
Unsupported Plant	(542)	(418)
Affiliated Interest	(2,250)	(1,737)
Total Rate Base	339,622	262,860
Rate of Return		
Present Rates	10.17%	9.56%

(Red Figure)

VII. Rate of Return

The following tables compare Continental's requested rate of return with the rate of return recommended by the staff together with the respective capital component costs:

Continental's Requested Rate of Return

Component	Capitalization Ratios	Cost	Weighted Cost
Long-term Debt	50.0%	10.55%	5.28
Preferred Stock	3.0	6.65	.20
Common Equity	47.0	18.0-19.0	8.46-8.93
Total	100.0%		13.93-14.40%

Staff's Recommended Rate of Return

Long-Term Debt	49.7%	10.33%	5.13%
Preferred Stock	3.3%	6.65	.22
Common Equity	47.0%	16.25-16.75	7.64-7.87
Total	100.0%		12.99-13.22%

The differences in capital structure proposed by Continental and the staff are minimal. The staff projects a lower interest rate for long-term debt and recommends a lower return on common equity than Continental. Continental estimates interest rates to be 15.5% and 15% compared to the staff's estimates of 15% and 14% for 1982 and 1983, respectively.

A. Long-Term Debt

In arriving at its estimates of 15.5% for 1982 and 15.0% for 1983, Continental used various data from Moody's showing bond interest rate trends for Aaa, Aa, A, and Baa utility bonds from 1946 through 1980. The data disclose that up until 1966 the yield on all utility bonds regardless of rating was less than 5%. During the 1970s the range of yield for Aaa bonds varied from a low in 1972 of 7.46% and a high in 1979 of 9.86%. In 1980 and 1981 the yield was 12.30% and 14.64%, respectively.

At the time of filing the application, Continental expected to issue bonds in the amount of $22,000,000 in 1982 and $23,000,000 in 1983. It estimated its embedded cost of debt would be 10.55%. During the course of the hearing Continental increased the estimate for both years by a total of $8,000,000 ($6,000,000 in 1982 and $2,000,000 in 1983) but did not revise its capital structure to reflect the impact of this increased debt financing, leaving its embedded cost of debt at 10.55%

The staff derived its estimates of 15% for 1982 and 14% for 1983 by using historical interest rate data from Irving Trust Company Weekly Interest Rates Listings, Moody's Bond Survey and Federal Reserve Bulletins. The staff also used interest rate forecasts of Data Resources, Inc. The staff concurred with the amounts to be issued set forth by Continental at the time of filing the application.

The staff cost of capital and rate of return witness, stated:

> "While I believe my interest rate projections are the best available at this time, I would recommend that the Commission recognize any recorded financing costs which Continental incurs prior to a decision in this case. This recommendation is necessitated by the volatility which the bond market has exhibited in the recent past and acts to protect both the utility and its customers."

On August 3, 1982 Continental advised that on July 29, 1982, it sold $10,000,000 of first mortgage bonds at an interest rate of 15-1/4% for delivery the latter part of January 1983. The maturity is 15 years with a 10-1/2 year average life. The issue is noncallable for 7-1/2 years, and thereafter nonrefundable at a lesser cost until 1992. A 10% sinking fund payment begins in the sixth year and continues each year after. The issue was purchased by Teachers Insurance and Annuities, the same company that purchased Series S.

We concur with the staff witness that recorded financing costs incurred prior to decision in this matter should be recognized. As a result of the July 29, 1982 sale the staff-recommended return is increased to a range of 13.03% to 13.26% on account of increased cost factor of debt of 10.4% and a weighted cost of 5.17%.

Continental used recorded data only whereas the staff used forecasts of a reliable source in addition to the recorded data. The staff estimates will be adopted.

B. Preferred Stock

There is no appreciable difference between Continental and the staff concerning preferred stock and therefore the slight difference of .3% in the capitalization ratio need not be discussed as it would have little or no bearing in the final outcome.

C. Common Equity

The witnesses of Continental and the staff agree that a fair return on equity should allow the utility to attract new capital, maintain its financial integrity, and provide shareholders a return comparable to other investments with similar risks.

The rates of return on equity recommended by Continental (18.0% to 19.0%) and the staff (16.25% to 16.75%) differ by 1.75% at the low end to 2.25% at the high end of each recommendation. The low end of Continental's recommendation exceeds the high end of the staff recommendation by 1.25%.

In arriving at the recommended return on common equity both Continental and the staff used financial data pertaining to CTC rather than to Continental because over 99% of Continental's common stock is owned by CTC and is not traded on the open market.

Both staff and Continental used a discounted cash flow (DCF) method to arrive at their recommendations, although staff also relied on an equity risk premium analysis and a comparative earnings test.

The theory behind the DCF method is that an investor in common stock expects a return on investment in the form of future dividends plus a growth in dividend resulting from increased company earnings. A common stockholder expects to receive some of the earnings of the company in which he or she invests. A part of those earnings are usually paid out in dividends with the remainder reinvested in the business. The additional investment generates additional earnings that should produce higher dividends. Generally DCF estimates the return on equity by adding historic dividend yields to an estimate of future dividend growth.

Continental's witness derived the dividend yield by dividing the November 1981 dividend level of $1.56 per share by the average market price per share of $15.75 for the 2-year period ending November 30, 1981, a yield of 9.9%. The growth was determined by averaging the dividend growth for the years 1978 (6.85%), 1979 (8.54%), and 1980 (6.58%), an average growth of 7.3%. The witness believes that a reasonable growth range of 7.3% (3-year average) to 8.5% (the 3-year high) is reasonable. The yield plus growth equals 17.2% to 18.4% (9.90% + (7.3% to 8.5%)). The witness then adjusted the dividend yield upward by 10% to account for market pressure, market price drop, and flotation costs. The witness testified that the adjustment is necessary because:

> "When new equity shares are sold, several things can happen. First, abnormal supply and demand pressures occur due to the introduction of the additional shares. Normally, the market cannot absorb the entire supply of new stock at the 'asking' or spot price. By underpricing, or lowering the offering price of the shares, the demand for the stock is increased until the supply is

> fully absorbed. Second, there is the risk of a market break or downturn at the time of a new financing. A market break softens the market price and decreases the net proceeds to the company from the stock issue. Flotation costs including legal, accounting, printing, and mailing charges are a third consideration." (Exhibit 29, p. 14/11-23.)

This adjustment results in a yield of 10.89% (9.9% x .10) and a return on equity of 18.19 to 19.39% (10.89% + (7.3% to 8.5%).

The witness checked the validity of his return on equity by comparing it to companies with A-rated bonds each of which was listed on the New York Stock Exchange and had at least one bond outstanding with a senior rating of A, was represented either directly or indirectly or through a parent company in Standard and Poor's issues of 500 companies, and was included in Managment Services Compustat Tapes. These companies were not necessarily public utilities. In 1980 the companies included in the studies achieved median and high returns on common equity that ranged from 14.8% to 31.5%, respectively.

The staff witness arrived at a dividend yield of 8.5% to 9.0% based upon the average yield for the year 1981 which is 8.62% as set forth in Table 23 of Exhibit 52. He assumed that interest rates would decrease from the level existing at the time of hearings. Table 24 of Exhibit 23 sets forth the historical growth rate of dividends between 1971 and 1981. The exhibit shows that over the 10-year period the growth rate was 6.27%; however, over the latter 5-year period the growth rate was 7.17% over the same period the earnings per share increased by 7.94%. The witness testified that he chose the latter 5-year period as being indicative of what the investor expects and thus assumed that a a growth rate of 7% to 8% is reasonable.

Using his DCF analysis the staff arrived at a return on equity of 15.5% to 17.0% (8.5% to 9.0% + (7.0% to 8%)).

The staff witness also used a DCF analysis on comparable companies which produced returns ranging from 15.06% to 17.81%. He concludes that his recommended return on equity of 16.25% to 16.75% compares with what investors expect for comparable companies. The midpoint of the staff recommendation produces an after tax coverage of 2.56 times which is an improvement over prior decisions where the after tax coverage averaged 2.46 times.

We note that since the time the company and staff testimony was presented, interest rates have dropped significantly. Yields on long-term U.S. government bonds were 12.68% for the last month recorded in the staff exhibit. U.S. government long-term bond yields now average around 11%. The last recorded three month Treasury bills were 10.86% in staff testimony. Now these rates are around 8.5%. As a result of declining interest rates, common equity has become more attractive, and the equity return requirements are commensurately lower.

As noted above, the staff witness employed several methodologies in developing his recommended return on equity, including DCF, risk premium analysis, and a comparable earnings test. In view of the declining market rates, we believe a 16.00% return on equity is reasonable and fairly balances the interests of ratepayers and shareholders. That rate of return falls well within the ranges of reasonable returns developed by the staff witness according to each of the above methods of analysis. The 16.00% authorized rate of return on equity will allow Continental to earn a 12.91% rate of return on rate base and to achieve a times interest coverage of 2.50.

VII. Balancing Account Relating to Certain Toll and EAS Settlement Revenues

The evidence indicates that certain adjustments should be made to the balancing account. The evidence also indicates that a final decision regarding the balancing account cannot be made at this time.

First, Continental and the staff agree that the toll settlement ratio to be used to calculate the revenue Continental receives as a result of D.93367 is 7.65% and that the local exchange revenues to be reserved for the balancing account are overstated by $2,771,000 (i.e., revenues of $2,559,000 and accrued interest of $212,000). Secondly, Continental and the staff agree that the amount to be deducted from the balancing account under D.93728, as modified by D.82-01-100, is $420,000. This amount represents the aggregate revenue deficiency from the accounting changes authorized in D.93728 ($250,000 relating to expensing the inside wiring portion of Account 232 and $170,000 relating to the depreciation rate change for the outside wiring portion of Account 232). It does not include any revenues associated with normalization of Account 232 discussed below.

Continental expressed concern that the revenue increases authorized in D.93728, as modified by D.82-01-100, may require normalization under ERTA with respect to a portion of Account 232 in 1982. Continental estimated the revenue requirement associated with such normalization is $452,000 annually. The staff believes that normalization is not required by ERTA. Neither § 209 of ERTA nor IRS Announcement No. 82-37 (interpreting § 209) lends itself to easy interpretation. Thus, although the Commission is inclined to agree with the staff that normalization should not be required for the type of offset revenue increase involved in D.93728, as modified by D.82-01-100, if the Internal Revenue Service (IRS) disagreed, Continental would incur a severe penalty in the transition from a flow-through company to a normalized company. Continental has offered to consult with the staff and submit to the IRS a request for a private letter ruling to resolve the issue. The Commission agrees that this is a reasonable approach and will include it in the procedure specified in this decision.

Continental also requested that the Commission implement increases in its depreciation rates coincident with the effective date of such increases with the Federal Communications Commission (FCC). Continental assumed the effective date of FCC increases to be in 1982. As with Account 232, Continental is concerned that such implementation could require normalization under ERTA, effective with the depreciation rate changes. The staff recommends that depreciation rate changes be implemented January 1, 1983. Determination of this issue could be affected by the ruling requested referred to above and thus should await the outcome of FCC action and IRS response. As to our jurisdiction, we will not authorize depreciation rate increases for the year 1982.

Exhibits 80 and 82 (updated by Exh. 84) set out the revenue requirements effects of various balancing account issues under various assumptions. Of these issues we will adopt the utility-staff mutually agreed toll settlement adjustment ($2,771,000) and the station connection revenue shortfall ($420,000) due to the effects of D.93728 (OII 84). The remaining three issues are the authorization of depreciation rate increases for 1982 ($363,000), minimum normalization (1982) for station connections ($452,000), and minimum normalization (1982) for all other accounts ($727,000).

As the test year before the Commission is the year 1983 we will not provide for a 1982 depreciation rate increase and commensurate revenue requirement. Also such a rate change would increase the possibility of IRS action with regard to normalization starting during the year 1982, thus further increasing revenue requirements.

Pending final rulings by the IRS on the two minimum normalization issues we will hold $1,179,000 in the balancing account. Upon resolution of the normalization issues Continental shall inform the Commission, to allow final disposition of the matter. In any event it is the intent of the Commission to dispose of the deferred amount no later than December 31, 1984. Interest will accrue on the deferred amount in the same manner as previously calculated. The amount available for rate reduction is about $8,087,000 plus interest over a period of time as set out subsequently.

There being no need for further accruals to this account we will order termination of accruals to the account as of December 31, 1982.

Adopted Treatment for Balancing Account
$(1,000)

Revenue Reserved (Est. 12/31/82)		$12,457
Adj. for Toll Settlement Ratio		(2,771)
Balancing Account		9,686
Adj. for (OII 84) Shortfall		(420)
Adjusted Balancing Account		9,266
Deferred Amounts		
Min. Norm. for Sta. Conn. (1982)	452	
Min. Norm. for All Other Accts. (12/1/82)	727	
		1,179
Amount for rate reduction		8,087*

(Red Figure)

*Subject to adjustment reflecting actual final entries and accrued interest.

IX. Revenue Requirement

A. Net-To-Gross Multiplier

Staff and Continental differ on the proper net-to-gross multiplier to be applied to additional revenues granted as a result of this proceeding. Staff advocates a multiplier of 1.90; Continental's corresponding recommendation is 2.0591. The parties differ slightly on the proper rate for uncollectibles. The chief dispute, however, is over the appropriate rate for California Corporation Franchise Tax to be incorporated in the calculation of the multiplier. Continental applied the statutory rate of 9.6%. Staff used CTC's effective rate of 1.7267%.

CTC, as Continental's parent, files a combined report on the operations of the Continental system. For state tax purposes, the

California portion of the system's operations is derived by application of a formula which considers revenues, wages, and property. Continental asserts that the Commission should assume that the wages, property, and revenue in the entire Continental system will grow in the same proportion as any increase in California revenues resulting from this case.

The staff asserts that Continental's position contains many defects. One of the most apparent is that the three elements of the unitary formula grow at different rates. Thus, while property and wages may be expected to grow gradually, California revenues normally increase suddenly and substantially after completion of the biennial general rate case. Also, productivity gains which should be expected from Continental would tend to decrease wages in proportion to property. Finally, Continental's California revenue requirement will increase considerably because of the provisions of ERTA. No proportionate increase may reasonably be expected in the system's property and wages.

The staff further asserts that Continental misconceives the purpose of the net-to-gross multiplier. The multiplier is employed to determine the gross revenues that Continental requires to receive a specified addition in net revenues. Since the focus is on the increment in revenues, the effective tax rate on that increment, and not the statutory rate, is properly incorporated in the calculation of the multiplier. An additional dollar in revenue from California will not result in an increase in California taxes of CTC of 9.6¢; by application of the unitary formula, the incremental tax will be much lower than the statutory rate. When the Commission grants an increase in revenues, it does not simultaneously increase the Continental system's property and wages. Thus, consideration of only the incremental tax effect of an increase in revenues is correct.

The staff's use of the incremental CCFT rate is supported by the Commission's decision in the last general rate case for Continental, D.92804 (March 17, 1981). In that decision, the Commission observed:

> "For determination of the additional CCFT liability which results when increased rates are granted to Continental, the 9.6 percent [statutory] rate developed is not appropriate. Since only one of the three factors changes, namely, the revenue factor, the impact of any increase only affects that one factor, not all three, and further, only Continental's California intrastate revenues are affected by rate increases granted by this Commission...[Staff's] development of the incremental tax rate is reasonable and consistent with past Commission policy." (D.92804, mimeo. p. 45. Emphasis in original.)

Thus, staff's approach reflects present Commission policy. As Continental points out in its reply brief, this matter is currently under review in OII 24.

Prior to a final decision being issued in OII 24 it would be inappropriate to change our policy in this regard. Staff's net-to-gross multiplier should therefore be adopted.

B. Increased Gross Revenue Requirement

Subtracting the 9.56% rate of return shown on Table 3 for the intrastate results of operations from the 12.91% adopted rate of return produces 3.35%. 3.35% times the adopted intrastate rate base of $262,860,000 produces a net revenue requirement of $8,806,000. $8,806,000 times the adopted net-to-gross multiplier of 1.9 produces an additional gross revenue requirement of $16,731,000.

As previously discussed in our treatment of the balancing account we have provided for a rate reduction of about $8 million plus interest. To minimize the substantial rate increases which would otherwise be required we will offset the $16.73 million revenue requirement by $4 million per year for the years 1983 and 1984. Our rate design will establish rates to meet the additional net revenue requirement of $12.73 million of those years. Accrued interest will be estimated for years 1983 and 1984 and be imputed as an offset to any attrition filing on October 3, 1983. Any residual interest would be returned through an appropriate surcredit.

At the end of year 1984 the $8 million revenue offset, except for interest, will have been drawn to zero. In the event Continental is not before us for 1985 rate relief we will provide a rate design for a $16.73 million increase over present revenue requirement, to take effect January 1, 1985. Any surcharge or surcredit continuing into year 1985 should be readjusted to reflect the higher base rates authorized for year 1985.

X. Rate Design

The Continental-proposed, staff-proposed, and adopted rate designs are shown on Table 4. Continental and the staff are essentially in agreement on the major aspects of rate design. At the conclusion of the hearings there were six areas of disagreement. These six areas, which will be discussed below, concern the subjects of measured service, foreign exchange service, service connection charges, custom calling service, contracts and deviations, and obsolete services. Also, as will be discussed below, we will utilize increases in basic exchange access line rates to achieve the necessary revenues to balance the adopted rate design with the revenue requirement. Except for the six areas of disagreement and basic exchange access line rates, we believe that the rates and charges proposed by the staff as shown on Table 4 and concurred in by Continental are reasonable and will be adopted. At the conclusion of the hearings the six areas of disagreement were:

A. Measured Service

In Ordering Paragraph 3 of D.92804 the Commission ordered:

> "In its next general rate application, Continental shall file a time schedule and

> the revenue requirement for implementing measured local service within its service areas which have or will have electronic switching during a normal five-year planning period." (Mimeo. p. 84.)

On October 19, 1982, Continental and staff submitted a late-filed exhibit (Exhibit 87) which proposes that measured rate service be implemented in Continental's exchanges as central office equipment and software are installed to provide this capability. To provide continuity and stability of local service revenues, measured service rates are designed to provide approximately the same local service revenues that would be produced by flat rate service rates. The exhibit proposes that measured-rate service be mandatory for business customers and optional for residence customers. Since measured rate service cannot be provided on party lines, business party-line services would be upgraded to one-party service upon conversion of each exchange to measured-rate service.

The only areas of disagreement between Continental and the staff are as follows:

1. Staff advocates that an EAS increment charge be added to measured-rate access line rates. Continental advocates that no EAS increment be added.

   Staff's position is based on established Commission policy. Continental believes that usage charges for EAS calls eliminate the need for EAS increments for measured-rate service.

2. Staff advocates a 30% discount on measured-rate usage charges for 5:00 p.m. to 11:00 p.m., Monday through Friday. Continental advocates no discount for usage charges for this time period.

> Staff wants Continental's measured-rate usage discounts to conform to Pacific's ZUM tariff. Continental wants the usage discounts to reflect Continental's local calling patterns. These calling patterns show high residential volumes in weekday evening hours and high business volumes in the 10:00 a.m. to 2:00 p.m. period on weekdays.

We concur with the staff that EAS increment charges be added to measured-rate access line rates. We also believe that it is appropriate to adopt a 30% discount on local measured-rate usage charges for the 5:00 p.m. to 11:00 p.m., Monday through Friday period. A discount in this evening period is consistent with present message toll rates and ZUM rates.

In Exhibit 24 Continental sets forth a schedule for the implementation of measured service in certain of its exchanges. Continental indicates that this implementation schedule is hypothetical and is subject to change. We believe it is appropriate to allow flexibility for the utility to modify such an implementation schedule. However, since customers will become aware of pending implementation of measured service based on the schedule set forth in Exhibit 24, we must insure that any changes by the utility in this implementation schedule are made in connjunction with notice to the affected customers. We will therefore order Continental to implement measured service in the exchanges and on the implementation schedule set forth in Exhibit 24. We will provide for changes to be made in this measured service implementation schedule subject to authorization of such changes by the Commission by resolution.In its request for any changes in the measured service implementation schedule Continental must set forth its basis for

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B. Foreign Exchange Service

Continental proposes, (1) to convert all contiguous foreign exchange (FEX) service mileage charges to a rate-center-to-rate-center basis, (2) to establish a channel termination charge of $18.60 per month, and (3) to increase mileage charges to $4.55 per mile per month. FEX is presently priced approximately 570% below cost. Continental's proposal would price FEX service closer to full cost.

The Commission staff is opposed to such a dramatic increase. The staff points out that FEX may be the only service available to some customers and for others the proposed conversion may make phone service prohibitively expensive.

Staff proposes that if such increases are justified by the cost of providing the service, the increase should be spread over several years at a maximum rate of 50% in any single year.

We concur with the staff. Further, Continental's proposal to convert FEX mileage charges to a rate-center-to-rate-center basis does not contain any data concerning what effect such a change would have on individual customers with respect to increased costs. It is possible that for some customers FEX may be the only service available and for others the proposed conversion may make phone service prohibitively expensive. Nonetheless, in recognition of the clear underpricing of FEX service in the past, we must authorize 50% increases in such charges for 1983, and we must indicate our intention to further increase such charges in future years. Accordingly we will increase the mileage charges effective in 1985, to more closely approximate cost. Our adopted FEX mileage rates will sustain the present method of mileage measurement and provide for recovery of a greater portion ot the costs associated with providing FEX services in the 1983 and 1985 adopted rates.

C. Service Connection Charges

Continental proposed increases in service connection charges from $71.25 for residential service and $81.25 for business service to $136.75 for each service. The staff proposed increases to $81.00 for residential service and $89.00 for business service. A comparison of the proposals of Continental and the staff are set forth below:

SERVICE CONNECTION CHARGES
Residential Service

	Rates		
	Present	Proposed	
		Continental	Staff
Elements			
Central Office Service Order Activities			
Initial Order	$10.00	$ 16.00	$11.00
Line Access	15.00	49.25	16.00
Premises Work			
Visit	17.00	25.75	28.50
Wiring	16.25	25.50	25.50
Telephone set	13.00	20.25	0
Total	$71.25	$136.75	$81.00

Business Service

	Rates		
	Present	Proposed	
		Continental	Staff
Elements			
Central Office Service Order Activities			
Initial Order	$15.00	$ 16.00	$15.00
Line Access	20.00	49.25	20.00
Premises Work			
Visit	17.00	25.75	28.50
Wiring	16.25	25.50	25.50
Telephone set	13.00	20.25	0
Total	$81.25	$136.75	$89.00

The largest discrepancy in the proposals of Continental and the staff is in the line access charge. The study upon which Continental relies for the increase in the line access charge is a study prepared in 1978, which was brought up to date for this application. Cross-examination of the witness left much of Continental's data unexplained.

The other major difference between Continental and the staff concerns the charge for the telephone set. This charge would be applicable only when the telephone instrument is delivered by the installer rather than picked up by the customers at the phone store. The staff acknowledged that it costs Continental at least $5.00 more to deliver a telephone than to have the customer pick it up at a phone store. For the sake of customers' understanding, however, staff believes the cost should be rolled into the premise charge. We do not believe this approach is reasonable.

Our adopted rate design for Service Connection Charges is as follows:

SERVICE CONNECTION CHARGES
Residential and Business Service

	Adopted Rates	
	Residential	Business
Elements		
Central Office Service Order Activities		
Initial Order	$15.00	$ 16.00
Line Access	22.50	30.00
Premises Work		
Visit	25.75	25.75
Wiring	25.50	25.50
Telephone Set	7.50	13.50
Total	$96.25	$110.25

There are occasions when delivery of a telephone instrument is necessary when premises work is not necessary, such as replacement of a faulty instrument. This type of delivery can be accomplished by common carrier and Continental will be directed to file an advice letter providing for such charge in its tariff.

D. Custom Calling Services

Continental does not propose to increase the rates for custom calling service (CCS) because of the price elasticity of this service. The staff agreed that the service is elastic.

Staff recommended that rates for CCS should contribute to any increased revenue granted in this proceeding. Continental did not directly dispute staff's proposal. Rates for CCS have not increased since 1979. Staff's proposal that customers using these services should bear a portion of the increased revenue requirement is reasonable. This decision will provide for a 20% increase in rates for CCS.

E. Contract Deviations

Continental and the staff agree that rates for services provided under contracts and deviations should be increased. The staff recommends that Continental convert its contract deviation offerings to specific tariff items, based on the theory that the maintenance of these contracts and their associated files places an administrative burden on both the utility and the Commission.

Continental opposes this recommendation because of the administrative burden which would be created by having to make the conversions rather than the present file maintenance.

Continental presently has approximately 60 such contracts which is a very small number when compared to its total service area. We concur with Continental and will not order the conversion recommended by the staff. However, Continental should bear in mind that should the number of such contracts increase it may be appropriate in the future to order the conversion recommended by the staff.

The staff's proposed increases in rates for services provided under contract or deviation as set forth in Exhibit 56 are reasonable and will be adopted. These increases will result in an increase in customer billing of $96,700 in the test year.

F. Obsolete Service

The staff proposed that the so-called "obsolete services and equipment" category receive only a 7% increase compared with a 30% proposed increase for currently tariffed terminal equipment (i.e. primarily single-line telephones and key telephones). The basis of staff's recommendation is that Continental will incur lower costs in connection with this equipment compared to non-obsolete equipment and services. The 7% level was chosen to reflect increases in administrative and maintenance expenses. Staff points out that "obsolete" is a misnomer. This category of equipment includes equipment no longer offered on a lease-tariff basis and manufacturer-discontinued items. The basis of the creation of the so-called "obsolete" category in the tariffs was a move by Continental to discontinue lease-tariff and institute sale of this type of equipment.

Continental alleges that there are three basic flaws in the staff's proposal. First, the 7% is calculated only with reference to increases in maintenance and administrative expenses. It did not take into account any other cost increases. Specifically, it did not include the increases in rate of return and associated taxes which obviously constitute a large portion of the 30% increase applied to other equipment. Continental believes that staff's calculation unfairly understates the allocation of revenue increase to the so-called "obsolete" category.

Second, since both Continental and the staff residually price basic exchange access line service ("BEALS"), the staff's proposal would result in $633,666 additional revenue requirement which must be derived from BEALS or about $3.04 per main station annually.

Finally, Continental asserted that the higher 30% increase might cause customers to migrate to other services. It argued migration may be in the best interest of Continental and customers, since the decision to migrate would make that customer available for an in-place sale.

The staff also suggested that portions of Continental's tariff Schedule No. X-2 be returned to the active tariffs, arguing that the present Schedule No. X-2 causes confusion. Continental argues that the impact of this proposal would be to produce, not reduce, confusion. If the staff proposal were implemented, Continental would have to move Schedule No. X-2 items and intermix them with various portions of its other active schedules and in each instance indicate that the item is not offered to new customers or new installations. Continental submits that this would cause a greater risk of confusion than leaving these items collectively in one schedule clearly designated obsolete. It would serve no useful purpose to direct a customer's attention to an obsolete item of equipment in Schedule No. A-10, for example, and then have to point out that the service is really not available.

Continental's proposal with respect to the increase in rates is reasonable and will be adopted. The staff suggestion with respect to the movement of Schedule No. X-2 to the active tariff is unreasonable and will not be adopted. However we will direct Continental to provide an appropriate index for those services offered under this schedule.

G. Recommended Program of Services For Handicapped Persons

Continental agreed to the recommendations contained in the staff's report "Recommended Program of Services for Handicapped Customers" (Exhibit 51). The exhibit recommends an initial allowance of $43,800 per year to restore the shortfall in billing which results from the 50% discount allowed certified handicapped customers on specialized terminal equipment. Appendix A includes this provision in rate design. We will adopt this figure and direct Continental to file tariffs consistent with the recommendations contained in Exhibit 51. We will also order Continental to publicize the program, track the response, and report the financial impact semiannually to the Commission until further order.

Basic Exchange Access

Both Continental and the staff proposed increases in basic exchange access monthly rates and have based such proposed increases in rates on the amount of increase necessary to meet the overall increase in revenue requirement after consideration of other recommended increases. This residual pricing concept is reasonable and will be adopted.

On July 26, 1982, a late-filed exhibit (Exhibit 79) was filed by Continental with staff's concurrence which proposed zone realignments in the Victorville exchange and a requirement that Continental provide in its next rate application, the results of a study that will include recommendations covering base rate exchange area type realignments based on the criteria set forth in Exhibit 79. The study will include all areas where there are 25 or more establishments for base area expansions and areas where there are 50 or more establishments for special rate area expansions.

We believe this zone realignment is reasonable and in the best interest of both the customers and Continental. We will also adopt the boundary expansion studies as recommended in Exhibit 79.

Tabulated below are the present basic exchange access rates together with those proposed by Continental and the staff and our adopted rates.

Class and Grade Of Service	Present	Proposed: Staff Alt. Rate Design II	Proposed: Continental	Adopted 1983	Adopted 1985
Business					
B1	17.50	$20.35	$43.05	$24.50	$28.35
B2	15.00	17.00	35.90	19.75	22.10
B4	15.00	17.00	35.90	19.75	22.10
Multiparty	13.50	15.65	13.50	17.80	19.90
Multiline	29.00	29.60	50.30	35.95	39.85
Key	29.00	29.60	50.30	35.95	39.85
PBX	29.00	35.15	59.50	35.95	39.85
Semipublic	17.50	20.35	43.05	24.50	28.35
Residence					
R1	7.00	9.25	14.40	9.15	10.35
R2	5.90	7.75	12.10	7.70	8.65
R4	5.90	7.75	12.10	7.70	8.65
Multiparty	5.40	7.10	5.40	7.10	7.95
Multiline	12.00	15.80	24.55	15.75	17.70
Key	12.00	15.80	24.55	15.75	17.70

The above basic access line increases for 1983 reflect the effect of applying a 31% increase to the residence class and a like percent increase to the business class. In the case of business services the adopted rates tend to converge in anticipation of a future shift toward measured service. The increase above present rates for the 1985 access line rates is 48%. These basic exchange access line increases are those necessary to have the total rate increase for all rates equal the revenue requirements for each year after consideration of the rates adopted elsewhere in this decision.

The following table reflects the rate design proposed by Continental, the staff's Alternate Rate Design II, and the rate designs for 1983 and 1985 adopted in this decision.

TABLE 4

Sheet 1 of 2

Continental Telephone Company of California

Annual Customer Billing Increase

Item	Continental	Staff's Alt. Rate Design II
	(000's Omitted)	
Terminal Equipment		
Telephone Sets	$ 862.6	$ 955.5
Telephone Answering Service	29.2	48.0
Key Telephone Systems	1,500.5	1,832.0
Supplemental Equipment	19.0	46.7
Fire Reporting Systems	1.5	2.8
Private Line and Channel Service	62.1	44.1
Miscellaneous Private Line Services & Equipment	1.7	3.1
Utility-Provided Music Access System	.2	.4
Obsolete Service or Equipment	454.2	192.9
Contracts & Deviations - Terminal Equipment	-	96.7
Service Connection & Move & Change Charges	2,880.0	597.2
Directory Listing	-	39.8
Custom Calling Service	-	2.3
Pocket Paging Service & Personal Signaling Service System	17.2	26.7
Rotary Hunting Service	30.7	30.7
Interexchange Receiving Service/Special Billing Number Service/Joint User Service/Special Dial Trunk Line Service/Customer Transfer Service/Toll Service-Station Service/Customer-Owned Private Telephone Lines Connected to Utility-Owned Private Branch Exchange Systems	-	36.8
Vacation Rates Service	-	30.5
Foreign Exchange Service	130.8[1/]	233.1
Mileage Rates (Outside Plant Facilities)	491.4	246.7
Extended Area Service	223.0	78.1
Special Rate Areas & Zone Areas	-	233.8
Victorville Zone Realignment	-	-
Basic Exchange Access Line Service	25,204.8	5,364.1
Service for the Handicapped	-	(43.8)
Billing Surcharge	-	1,411.8
Total	$31,908.9	$11,500.0
Less Settlements	-	345.0
	$31,908.9	$11,155.0

(Red Figure)

1/ Understated by $1,439.1

TABLE 4

Sheet 2 of 2

Continental Telephone Company of California

California Operations

Annual Customer Billing Increase

Item	1983 Adopted	1985 Adopted
	(000's Omitted)	
Terminal Equipment		
Telephone Sets	$ 955.5	$ 955.5
Telephone Answering Service	48.0	48.0
Key Telephone Systems	1,832.0	1,832.0
Supplemental Equipment	46.7	46.7
Fire Reporting Systems	2.8	2.8
Private Line and Channel Service	44.1	44.1
Miscellaneous Private Line Service & Equipment	3.1	3.1
Utility-Provided Music Access System	.4	.4
Obsolete Service or Equipment	837.0	837.0
Contracts & Deviations - Terminal Equipment	96.7	96.7
Service Connection & Move & Change Charges	1,203.1	1,203.1
Directory Listing	39.8	39.8
Custom Calling Service	2.3	2.3
Pocket Paging Service & Personal Signaling Service System	26.7	26.7
Rotary Hunting Service	30.7	30.7
Interexchange Receiving Service/Special Billing Number Service/Joint User Service/Special Dial Trunk Line Service/Customer Transfer Service/Toll Service-Station Service/Customer-Owned Private Telephone Lines Connected to Utility-Owned Private Branch Exchange Systems	36.8	36.8
Vacation Rates Service	30.6	30.6
Foreign Exchange Service	342.8	342.8
Mileage Rates (Outside Plant Facilities	246.7	246.7
Extended Area Service	78.1	78.1
Special Rate Areas & Zone Areas	233.8	233.8
Victorville Zone Realignment	(304.2)	(304.2)
Basic Exchange Access Line Service	7,334.0	11,400.3
Service for the Handicapped	(43.8)	(43.8)
Billing Surcharge	-	-
Total	$13,123.7	$17,247.4
Less Settlements	393.7	517.4
	$12,730.0	$16,730.0

(Red Figure)

XI. Allowance for Attrition

Continental requests an additional $4,308,000 for 1984 due to operational attrition, as set forth in Exhibit 73, as revised by Exhibit 88. No request is made for financial attrition. The staff does not dispute this figure.

Attrition may be defined as erosion in a utility's earnings when its operating and financial expenses increase at a more rapid rate than its revenues and productivity gains. The two main components of attrition are financial attrition and operational attrition. Neither Continental nor the staff have proposed a financial attrition allowance. The effect of attrition for the year after a general rate increase is to preclude the utility from earning its authorized rate of return during that year. Both Continental and the Commission staff agree that an allowance should be provided through a rate increase to compensate the utility for attrition expected to occur in the year following the test year.

The method of computing the 1984 attrition allowance was presented by the staff in Exhibit 59 with subsequent final revisions set out in Exhibit 88. Continental took no exception to the staff showing. We will adopt the staff's methodology but will not authorize a specific attrition allowance until a more precise determination can be made of labor escalation, nonlabor escalation, payroll taxes escalation, and revenue growth at a later date. The Commission will also consider changes in 1983 base figures which include an 8% wage escalation and a 9.4% nonlabor escalation. The parameters and methodology to be used are as follows:

TABLE 5

CALCULATION OF ESTIMATED OPERATIONAL ATTRITION
FOR CONTINENTAL TELEPHONE COMPANY OF CALLFORNIA

Year 1984 (Dollars in Thousands)

Item	Additional Increment (Total Co.) A	Intrastate Factor B	Intrastate Increment C	Revenue Requirement D
Expenses				
Labor & Related Overhead	*	0.7883	*	*
Nonlabor Expenses	*	0.7883	*	*
Payroll Taxes	*	0.7896	*	*
Ad Valorem Taxes	222	0.7721	171	171
Depreciation Expenses	3474	0.7715	2680	2680
Expensing Station Conn.	(1472)	0.7953	(1171)	(1171)
Deferred Invest.Tax Cr.	352	0.7719	272	(517)**
Deferred Tax Expenses	3332	0.7719	2572	4887**
Erosion of 1980 & prior flow-through tax depreciation	282	0.7719	218	414**
Total Expenses	*		*	*
Rate Base				
Plant-in-Service	45700	0.7721	35285	
Operative CWIP	2300	0.7774	1788	
Depreciation Reserve	(18397)	0.7740	(14239)	
Deferred Tax Reserve	(8966)	0.7721	(6923)	
Materials & Supplies	-	0.7600	-	
Affiliated Purchases	(372)	0.7720	(287)	
Interest During Construction	532	0.7774	414	
Expensing Station Con.	(1924)	0.7722	(1486)	
IDC Disallowed	24	0.7781	19	
Working Cash	300	0.7916	237	
Total Rate Base	19197		14808	#
Total Revenue Requirement				
Operating Revenues				
Revenue Growth	*		*	
Expensing Sta. Conn.	(776)		(504)	
Net Revenue Growth	*		*	*
Net Operational Attrition (Total Rev. Requirement less net rev.growth)				*

(Red Figure)

Footnotes:

* To be determined upon review.

** Col C x 1.90 (net-to-gross multiplier)

\# Col C x Adopted Rate of Return x 1.55 (net-to-gross adjusted for interest deduction)

TABLE 6

CALCULATION OF LABOR, NONLABOR, AND PAYROLL TAX OPERATIONAL ATTRITION

Year 1984 - Total Company
(Dollars in Thousands)

Item	Base 1983 A	Factor or Method Used to Estimate 1984 Increments B
Labor & Related Overhead	$55,095	Column A x Factor L
Nonlabor expenses	33,331	Column A x Factor NL
Payroll Taxes	3,598	1984 Wage Escalation & Payroll Tax Rate

Footnotes:

Factor L = (* - 0.025#) x 1.054** - 1

Factor NL = Ø x 1.054** - 1

* Est. Percent wage escalation (DRI: US-U CPI)

2.5% estimated productivity growth

** 5.4% estimated customer growth

Ø Est. Percent nonlabor escalation (DRI: Mod. WPI)

XII. IDC Computation Method

The staff recommended in Exhibit 46 that the fixed formula method for computing IDC* be adopted for Continental. The advantage of the IDC fixed formula is that it takes into account the unique operating conditions of the individual utility and its present financial condition. It further recognizes the costs of construction capital in a predetermined sequence from internal generation to external financing.

Under the present procedure there is no adjustment mechanism to reflect on a timely basis major changes in construction fund requirements or money market conditions. The present procedure also fails to consider short-term money as a major source of construction funds.

*Interest during construction

We concur and adopt the staff's recommendation that Continental be required to use the fixed formula method for computing IDC.

XIII. Findings and Conclusions

A. Findings of Fact

1. Continental requests additional revenues for test year 1983 in the amount of $31,082,000.

2. The adopted results of operations set forth in Table 3 reasonably indicate Continental's operations for test year 1983 at present rates.

3. The staff's recommended net-to-gross multiplier of 1.9 is reasonable.

4. A rate of return on rate base of 12.91% designed to produce a return on common equity of 16.00% based on capital ratios of 47% common equity, 49.7% long-term debt, and 3.3% preferred stock is reasonable. Such a rate of return would produce an approximate times interest coverage of 2.50 times.

5. Based upon our adopted rate of return of 12.91%, intrastate rate base of $262,860,000, and the net-to-gross multiplier of 1.9, Continental's increased gross revenue requirement is $16,731,000.

6. The measured service rate plan set forth in Exhibit 87 is reasonable and should be implemented based on the implementation on schedule set forth in Exhibit 24. Any changes in such implementation should be subject to Commission resolution action after customer notice by Continental of Continental's request to change the implementation schedule.

7. Continental should file an advice letter to implement its measured service rate and should notify its customers by bill insert 60 days prior to implementation.

8. The staff's recommended program of services for the handicapped is reasonable and should be adopted.

9. Continental should file tariffs which provide a program of services for handicapped customers consistent with the recommendations set forth in Exhibit 51. The program should be publicized by bill inserts immediately following the effective date of the tariffs.

10. Adoption of the rate design set forth in Table 4 is reasonable.

11. The Victorville Zone changes as set forth in Exhibit 79 are reasonable and will be ordered.

12. Continental should include as a part of its next major rate application a study of boundaries as recommended in Exhibit 79.

13. Continental's overall quality of service is adequate, however, the quality of service provided to customers served by the Apple Valley central office has not shown any significant improvement since Continental's last rate increase application at which time service problems were disclosed.

14. Because there is an immediate need for the rate relief authorized this decision should become effective today.

15. The cost of service adopted is based on conventional normalization methods as mandated by ERTA consistent with Commission D.93848 dated December 15, 1981 in OII 24.

16. Continental should seek private letter rulings to resolve the deferred normalization issues. Upon resolution of the issues Continental shall inform the Commission for disposition by resolution of the deferred amount in the balancing account.

17. Eight million dollars of the balancing account should be applied to offset revenue requirements over the years 1983 and 1984. Interest accruals should be used to offset attrition and/or applied as a surcredit to customer billings.

18. A change in the method for determining the IDC rate for Continental is necessary. The staff's recommended fixed formula method for computing IDC is reasonable and should be adopted.

19. Continental should be authorized to establish a memorandum account to identify capitalized M&S inventory to be used for construction purposes and to capitalize interest thereon at the rate of interest accrued on the corresponding CWIP account.

20. Continental's proposal for a predetermined attrition allowance for 1984 is premature since more precise data for computation of the allowance will be available at a later date. The method adopted in this decision for making that computation is reasonable.

21. ERTA requires normalization of the tax benefits of ACRS depreciation and related components if Continental is to be eligible to use these tax benefits. The effect of meeting ERTA requirements is to increase intrastate revenue requirements by about $6.1 million.

B. Conclusions of Law

1. The Commission concludes that the application should be granted to the extent set forth in the following order.

2. The rates authorized in Appendix A are just and reasonable. Any other rates applied after the rates in Appendix A are in effect are unjust and unreasonable.

3. Continental should file, within 30 days, an advice letter to establish charges for telephone deliveries that are not coincident with premises work.

4. Basic rates for customers served by the Apple Valley central office should remain at present levels until the service conforms to G.O. 133 indices for three consecutive months after which time Continental should file an advice letter requesting increases for Apple Valley central office customers to the rates authorized for all other customers by this decision.

5. Continental should be authorized to file an advice letter on October 3, 1983 to establish a surcharge on local access customer billing to yield an increase in customer billing for 1984 to match the 1984 attrition allowance. The attrition allowance should be based on the methodology set out in Tables 5 and 6, updated to reflect the latest estimates of labor escalation, nonlabor escalation, payroll taxes, and revenue growth. Accrued interest on the balancing account amounts, including the deferred amounts, for years 1983 and 1984 will be applied as an offset to the calculated attrition allowance. Such advice letter filing should not become effective prior to January 1, 1984 and shall be subject to authorization by Commission resolution.

6. Continental should terminate on December 31, 1982 the negative billing surcharge established by D.93367 as modified by D.93655 to provide a balancing account. An amount of $1,179,000 is to be held in the account pending disposition of minimum normalization issues. The balance $8,087,000 (adjusted for final entries and accrued interest) shall be refunded as provided herein.

7. In the event Continental does not file for an attrition allowance for 1984 or the interest accruals and released deferred amounts, if any, exceed the attrition to be allowed then a surcredit on local access customer billing is appropriate.

O R D E R

IT IS ORDERED that:

1. Five days after the effective date of this order Continental Telephone Company of California (Continental) is authorized to file revised rate schedules attached to this order as Appendix A and concurrently to cancel the presently effective schedules. Such filing shall comply with G.O. 96-A. The effective date of the revised schedules shall be not before January 1, 1983 nor less than five days after the date of filing. The revised schedules shall apply only to service rendered on and after their effective date.

2. Continental shall file with the Commission, 15 days after the effective date of this order, in conformity with the provisions of G.O. 96-A, tariffs providing a program of service for handicapped customers consistent with Exhibit 51. The tariffs shall be effective 5 days after the date of filing. The program shall be publicized by bill inserts immediately following the effective date. Continental shall track the response to the program of handicapped services and its financial impact, and shall report to the Commission semiannually beginning six months after the effective date of the tariffs establishing the program until further order.

3. Continental shall file with the Commission, within 30 days of the effective date of this order, an advice letter to establish charges for telephone deliveries that are not coincident with premises work.

4. Continental is authorized to request through an advice letter filing increases in basic rates for customers served by the Apple Valley central office when service to those customers conforms to G.O. 133 indices for a period of three consecutive months. The increase sought shall not exceed the increases authorized for customers served by central offices other than Apple Valley.

5. Continental shall terminate, effective January 1, 1983, balancing account accruals provided for in D.93655. Interest on the balances including deferred amounts in the account shall be computed at the Commercial Paper Rate (3-month prime) compounded monthly and subject to review by the staff.

6. For each of the years 1983 and 1984 the balancing account shall be written down at the rate of $4 million per year on a monthly basis. The amount of the writedown shall accrue as revenues to Continental. Interest, as provided herein, shall accrue on all balances in the account. In the event Continental elects not to file for an attrition allowance for 1984, Continental shall file for an access line surcredit rate reduction for the estimated accrued interest for years 1983 and 1984 and balancing account released deferred amounts, if any. The surcredit filing shall be made not later than October 1, 1984 and shall apply to the year 1985.

7. Continental shall use the fixed formula method for determining the IDC net rate as set forth in Appendix C to this order. The initial application of the revised method will be January 1, 1983 based on actual financial data from the preceding 12 months using the level of return on equity authorized in this decision.

8. Continental shall review the IDC rate on a quarterly basis to ensure that the rate is still applicable; should there be a change of 25 basis points or more, a new net rate shall be used. The Commission shall be notified each time the rate is changed.

9. Continental shall use the monthly compounded net IDC rate for accounting and intrastate ratemaking purposes; the rate should be limited to a ceiling of one-half of one percent less than the latest rate of return authorized by the Commission for its California operations.

10. Continental shall implement measured exchange access service at the rates set forth in Appendices A and B, on the schedule stated on page 2 of Exhibit 24 as modified in Appendix A. Any revisions in the measured service implementation schedule shall be subject to Commission authorization by resolution. All affected customers must be provided notice of any revisions in the measured service implementation schedule. Such notice shall be provided coincident with the filing by Continental of a request for revision of such implementation schedule.

11. Continental, as part of its next major rate application shall include a study regarding base rate area and special rate area expansions which meet the density requirements as set forth in Exhibit 79.

12. Continental is authorized to file not later than October 3, 1983 an advice letter for an attrition allowance to be effective January 1, 1984 subject to Commission authorization by resolution. Such attrition allowance shall be based on the methodology set out in Tables 5 and 6 updated to reflect the latest estimates of labor escalation, nonlabor escalation, payroll taxes, and revenue growth. Accrued interest on the balancing account estimated for years 1983 and 1984 and deferred amounts, if any, will be applied as an

offset to the calculated attrition allowance. The attrition allowance for 1984 shall be implemented by the establishment of a local access customer billing surcharge. Continental's advice letter filing for a 1984 attrition allowance shall include, as an attachment, a showing of the development of the local access billing surcharge.

13. Continental is authorized to file the revised rate schedule attached to this order as Appendix B and concurrently to cancel the presently effective schedule. Such filing shall comply with G.O. 96-A. The effective date of this revised schedule shall not be before January 1, 1985. The first bills rendered after the effective date of such revised rates shall include a customer notice of such rates.

14. Continental is authorized to establish a memorandum account to identify capitalized materials and supplies inventory to be used for construction purposes, and to capitalize interest thereon at the rate of interest accrued on the corresponding CWIP account.

15. Continental shall, concurrently upon implementation of rates authorized in Appendix A, notify customers that of the authorized increase in revenues, approximately $6.1 million is the result of ERTA requirements.

This order is effective today.

Dated DEC 8 1982, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

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

Joseph E. Bodovitz, Executive Director

RATES AND CHARGES

The rates, charges and conditions of Continental Telephone Company of California are changed as set forth below:

Schedule Cal. P.U.C. No. A-1, Network Access Line Service

The following rates and revisions are authorized:

Class and Grade of Service	Monthly Rates*@ (Flat Rates)	Monthly Rate* (Measured Rates) 1/
Business		
One-Party	$24.50	$20.05 (0)
Two-Party	19.75	-
Four-Party	19.75	-
Multi-Party	17.80	-
Multi-Line	35.95	20.05 (0)
Key Line	35.95	20.05 (0)
PBX Trunk	35.95	20.05 (0)
Semi-Public	24.50	24.50
Farmer Line (See Schedule X-2)		
Residence		
One-Party (Flat Rate)	9.15	12.65
One-Party (Measured Rate)	-	7.65 (200)
Two-Party	7.70 2/	7.70
Four-Party	7.70 2/	7.70
Multi-Party	7.10	- 4/
Multi-Line (Flat Rate)	15.75	12.65
Multi-Line (Measured Rate)	-	7.65 (200)
Key Line (Flat Rate)	15.75	12.65
Key Line (Measured Rate)	-	7.65 (200)
Farmer Line (See Schedule X-2)		

* EAS (Extended Area Service), SRA (Special Rate Area) and Zone increments where applicable are in addition to the monthly rates shown.

@ All exchange access lines served from the Apple Valley Central Office of the Victorville exchange are excluded from these revisions until the requirements set forth in Ordering Paragraph 4 of this order are met.

1/ The implementation of measured services shall be as set forth in Ordering Paragraph 10 of this order except for the Exeter and Lemon Cove exchanges for which the Measured Service Conversion Date shall be within the first 6 months of 1983.

All affected customers shall be provided written notice of the implementation of measured service within 60 days prior to the implementation of measured service.

Usage allowances for measured rate services are shown in "( )" following the proposed monthly rates. The usage allowances, where shown, are in terms of message units. Where no "( )" is shown following the authorized rates, the service is a flat rate service.

RATES AND CHARGES

Schedule Cal. P.U.C. No. A-1, Network Access Line Service (cont'd)

2/ Two-Party Line and Four-Party Line Business and Residence Services are limited to existing customers on the same premises in the Exeter, Lemon Cove, Mammoth Lakes, Weaverville, Gilroy, Bishop and Sanger exchanges.

3/ All Two-Party Line and Four-Party Line Business Services are withdrawn and upgraded to One-Party Line Services in each exchange coincident with the implementation of measured service in each exchange.

4/ Multi-Party Business and Residence Service is withdrawn in the Exeter, Lemon Cover, Mammoth Lakes, Weaverville, Gilroy, Bishop and Sanger exchanges.

The number following a rate as shown above under the measured-rate structure for one-party line services designates the unit allowance of measured-rate service area usage under the measured rate quoted. The rate for each unit over the allowance is 1c and applies as follows:

Measured Service Band ##	Initial Period 1-Minute#	Each Additional Minute #
Local	3 units	1 unit
9-12 miles	6 units	3 units
13-16 miles	8 units	5 units

or portion thereof

The determination of the applicable measured service units shall be based upon the present length of the extended (local) calling area route(s) in accordance with the listed mileage bands. No expansion of extended area routes shall be made under these provisions. Routes under the "Local" Measured Service Band shall include all present extended routes between contiguous exchanges.

Measured-rate service usage unit day rate and discounts apply as follows:

1. Full rate applies 8:00 a.m. to 5:00 p.m. Monday through Friday.
2. 30% discount applies 5:00 p.m. to 11:00 p.m. Monday through Friday.
3. 60% discount applies all other hours/days including holidays. Ø

Discounts are applicable to messages originated during periods listed in 1, 2 or 3 above.

Ø Holidays are as set forth in Schedule Cal. P.U.C. No. 53-T, I.2, of The Pacific Telephone and Telegraph Company.

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Schedule Cal. P.U.C. No. A-1, Network Access Line Service (cont'd)

No service connection or move and change charges shall apply to changes by residence customers between flat and measured service in an exchange in which measured-rate services are offered for a period of 120 days after the implementation of measured-rate services in that exchange.

Extended Area Service Rate Increments

Proposed increments as set forth in Exhibit No. 56 Appendix Q are authorized.

Special Rate Area and Zone Area Increments @

Proposed increments as set forth in Exhibit No. 56, Appendices R and S, as modified below are authorized:

Exchange	Zone Increments *			
	B1	B2	R1	R2
Victorville				
Zone 1	-	-	-	-
Zone 2	$2.20	-	$2.20	-
Zone 3	4.40	-	4.40	-
Zone 4	4.40	-	4.40	-

@ All exchange access lines served from the Apple Valley Central Office of the Victorville exchange are excluded from these revisions until the requirements set forth in Ordering Paragraph 4 of this order are met.

Custom Calling Service

Proposed rates and charges as set forth in Exhibit No. 56, Appendix L are authorized.

Rotary Hunting Service

The following rate is authorized:

	Monthly Rate
Individual charge per line in rotary	$1.00

Victorville Zone Realignment

Continental shall revise the Victorville exchange zones as set forth in Exhibit No. 79.

Schedule Cal. P.U.C. No. A-2, Outside Plant Facilities

Proposed rates and charges as set forth in Exhibit No. 56, Appendix P are authorized.

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Schedule Cal. P.U.C. No. A-3, Telephone Sets

Proposed rates and charges as set forth in Exhibit No. 56, Appendix A are authorized.

Schedule Cal. P.U.C. No. A-9, Telephone Answering Service

Proposed rates and charges as set forth in Exhibit No. 56, Appendix B are authorized.

Schedule Cal. P.U.C. No. A-10, Key Telephone System Service

Proposed rates and charges as set forth in Exhibit No. 56, Appendix C are authorized.

Schedule Cal. P.U.C. No. A-14, Directory Listings

Proposed rates as set forth in Exhibit No. 56, Appendix K are authorized.

Schedule Cal. P.U.C. No. A-15, Supplemental Equipment

Proposed rates and charges as set forth in Exhibit No. 56, Appendix D are authorized.

Schedule Cal. P.U.C. No. A-17, Foreign Exchange Service

The following rates and revisions are authorized:

Foreign District Area Service	Monthly Rates Business	Monthly Rates Residence
One-party line	$24.00	$12.45
Key line	30.40	19.10
Trunk	46.45	-
Each ½ mile or fraction thereof	1.00	1.00

Foreign Exchange Service	Monthly Rates
Business-message rate	
One-party, PBX, Key and Multiline	$30.00
Business-Flat rate incremental charge	
One-party, PBX, Key and Multiline	No charge
Two-party	10.50
Four-party and Suburban	7.50
Residence-incremental charge	
One and two-party	2.60
Four-party and Suburban	2.25

RATES AND CHARGES

Schedule Cal. P.U.C. No. A-17, Foreign Exchange Service (Cont'd)

	Monthly Rates
Mileage Rates	
Contiguous exchanges	
Each ½ mile or fraction thereof	$ 3.10
Noncontiguous exchanges	
Each interexchange mile	12.00

Farmer line service

a. Contiguous exchange

Foreign Exchange	Local Exchange	Class	Type	Monthly Rates
Visalia	Exeter	Res.	Flat	$ 6.50
Wooding	Knights	Bus.	Flat	11.35
	Landing	Res.	Flat	6.50
Parlier	Sanger	Res.	Flat	6.50
Fresno	Sanger	Bus.	Flat	13.00

b. Noncontiguous exchange

Foreign Exchange	Local Exchange	Class	Type	
Fresno	Tivy Valley	Bus.	Flat	13.00

Schedule Cal. P.U.C. No. A-18, Vacation Rate Service

Continental is authorized to withdraw this service provided that vacation rate services will continue for those customers who are currently on vacation rate through the maximum period specified in the present tariff or until the customer requests reconnection of full service, whichever is sooner.

Schedule Cal. P.U.C. Nos. A-21, A-22, A-23, A-24, A-25, B-4 and G-3, Interexchange Receiving Service, Special Billing Number Service, Joint User Service, Special Dial Trunk Line Service, Customer's Transfer Service, Toll Service-Station Service, and Customer-Owned Private Telephone Lines Connected to Utility-Owned Private Branch Exchange System

Proposed rates and charges as set forth in Exhibit No. 56 Appendix N, Sheets 1 and 2 are authorized.

Schedule Cal. P.U.C. No. A-28, Fire Reporting Systems

Proposed rates and charges as set forth in Exhibit No. 56 Appendix E are authorized.

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Schedule Cal. P.U.C. No. A-30. Service Connection and Move and Change Charges

The following rates are authorized:

	Business	Residence
Service Order and Central Office Activities		
Customer Order	$16.00	$15.00
Line Access, per line	30.00	22.50
Premises Work Activities		
Premises Visit, per visit	25.75	25.75
Wiring and block/jack per location	25.50	25.50
Station/equip. connection standard telephone set	13.00	7.50

Schedule Cal. P.U.C. No. G-1. Private Line Services and Channels

Proposed rates and charges as set forth in Exhibit No. 56, Appendix F are authorized.

Schedule Cal. P.U.C. No. G-2. Miscellaneous Private Line Services and Equipment

Proposed rates and charges as set forth in Exhibit No. 56, Appendix G are authorized.

Schedule Cal. P.U.C. No. G-4, Utility-Provided Music Access System

Proposed rate as set forth in Exhibit No. 56, Appendix H is authorized.

Schedule Cal. P.U.C. Nos. L-2 and L-3, Pocket Paging Service and Personal Signaling Service System

Proposed rates and charges as set forth in Exhibit No. 56, Appendix M are authorized.

Schedule Cal. P.U.C. No. X-1, List of Contracts and Deviations

Continental is authorized to increase rates as set forth in Exhibit No. 56, Section 2.3, paragraph 30.

Schedule Cal. P.U.C. No. X-2, Obsolete Service or Equipment

Proposed nonrecurring charges and increases of 30% over present monthly rates as set forth in Exhibit No. 56, Appendix I, Sheets 1 thru 18 as modified below are authorized.

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RATES AND CHARGES

Schedule Cal. P.U.C. No. X-2, Obsolete Service or Equipment (Cont'd)

Deletion of the requirements shown by asterisks on Sheets 3 thru 9 is authorized contingent on Continental providing an appropriate index for the above schedule.

Farmer Line

	Monthly Rates	
	Business	Residence
Each local primary station		
San Miguel#	$22.15	$22.15
Alpaugh, Corcoran, Cuyama, Farmington, McKittrick, Ripon, Snelling and Taft	5.90	2.95
Colfax	2.50	1.40
minimum	4.20	4.20
Each extended primary station		
Exeter, Knights Landing,	5.90	2.95
Tivy Valley and Robbins	9.60	4.20
Sanger		

\# The rates shown for San Miguel exchange are the yearly rates.

Schedule Cal. P.U.C. No. Z, Billing Surcharge

Continental is authorized to implement an attrition allowance as set forth in Ordering Paragraph 12 of this order.

(END OF APPENDIX A)

APPENDIX B

RATES AND CHARGES

The rates of Continental Telephone Company of California are changed as set forth below:

Schedule Cal. P.U.C. No. A-1, Network Access Line Service

The following rates are authorized:

Class and Grade of Service	Monthly Rates* (Flat Rates)	Monthly Rate* (Measured Rates)	
Business			
One-Party	$28.35	$23.90	(0)
Two-Party	22.10	-	
Four-Party	22.10	-	
Multi-Party	19.90	-	
Multi-Line	39.85	23.90	(0)
Key Line	39.85	23.90	(0)
PBX Trunk	39.85	23.90	(0)
Semi-Public	28.35	28.35	
Residence			
One-Party (Flat Rate)	10.35	13.85	
One-Party (Measured Rate)	-	8.85	(200)
Two-Party	8.65	8.65	
Four-Party	8.65	8.65	
Multi-Party	7.95	-	
Multi-Line (Flat Rate)	17.70	13.85	
Multi-Line (Measured Rate)	-	8.85	(200)
Key Line (Flat Rate)	17.70	13.85	
Key Line (Measured Rate)	-	8.85	(200)

* EAS (Extended Area Service), SRA (Special Rate Area) and Zone increments where applicable are in addition to the monthly rates shown.

Schedule Cal. P.U.C. No. A-17, Foreign Exchange Service

The following rate is authorized:

Mileage Rates	Monthly Rate
Contiguous exchange Each ½ mile or fraction thereof	$3.50

(END OF APPENDIX B)

Appendix C

Calculation of Interest During Construction Rate to be Effective ____________

Line No.	Item	Amount	Ratio	Composite Cost	Wtd. Cost Before Taxes	Wtd. Cost After Taxes
		Col. (a)	Col. (b)	Col. (c)	Col. (d) =Cols. (b) x (c)	Col. (e) =Col.(d) x (1-51.12%)
		(Dollars in Millions)				
	A. Capital Structure and Weighted Costs of Capital					
	I. Embedded Capital as of ____________					
1	Long-Term Debt	$	%	%	%	%
2	Preferred Stock Equity					
3	Common Stock Equity			1/		
4	Total Embedded Capital	$	100.00%		%	%
5	II. Average Short-Term Debt Last 12 Months	$		%		%
	III. New Security Issues Last 12 Months					
6	Long-Term Debt	$	%	%	%	%
7	Preferred Stock Equity					
8	Common Equity					
9	Total New Security Issues	$	100.00%		%	%
	B. Construction Expenditures and Sources of Funds Last 12 Months					
	I. Construction Expenditures Required ____________					
10	Total Gross Construction Expenditures	$				
11	Less Deferred Taxes					
12	Net Construction Expenditures Required	$				
	II. Sources of Construction Funds					
	Internally Generated Funds					
13	Depreciation Accruals	$	%			
14	Retained Earnings					
15	Other Internally Generated Funds					
16	Average Short-Term Debt					
17	Other Externally Generated Funds					
18	Total Sources of Construction Funds	$	100.00%			

Line No.	C. Calculation of Interest During Construction Rate		Gross Rate	Net Rate
	Internally Generated Funds			
19	Depreciation Accruals	Ln. 13 Col.(b) x Ln. 4 Cols. (d) & (e)	%	%
20	Retained Earnings	Ln. 14 Col.(b) x Ln. 3 Col. (c)		
21	Other Internally Generated Funds	Ln. 15 Col.(b) x Ln. 4 Cols. (d)		
22	Average Short-Term Debt	Ln. 16 Col.(b) x Ln. 5 Cols. (d) & (e)		
23	Other Externally Generated Funds	Ln. 17 Col.(b) x Ln. 9 Cols. (d) & (e)		
24	Interest During Construction Rate		%	%
25	Monthly Compounded Interest During Construction Rate		%	%

1/ Current CPUC Authorized Rate of Return on Common Equity

(END OF APPENDIX C)

The correct numbers, as shown in Table 2 of Exhibit 67, which should have appeared for Continental in Exhibit 45, Chapter 13, Paragraph 8, are:

1982	
Station Apparatus	$ 4,067,000
Station Connections	8,230,000
Large PABX 478,000	
Subtotal-Station Equipment	$12,775,000
1983	
Station Apparatus	$ 4,400,000
Station Connections	9,134,000
Large PABX	451,000
Subtotal-Station Equipment	$13,985,000

The staff also reduced Continental's estimate of 1982 and 1983 construction expenditures, based on its downward adjustment of Continental's estimates for station equipment expenditures. The staff downward adjustment of $4.8 million in 1982 and $1.8 million in 1983 is based on two factors. For the apparatus and station connection portions of estimated station equipment expenditures, the staff based the adjustment on its lower estimate of "main station gain" for 1982 and 1983. For the large PBX portion of the estimated station equipment expenditures, the staff contended that the $1 million reduction in both 1982 and 1983 is a "judgment amount" based upon a "softening of the economy."

The staff agreed that main station gain is equated with the "addition of new customers", and does not include construction expenditures incurred to service "customer movement and the addition of extension telephones".

The staff recognized that when Continental customers move within an exchange, or lease a replacement phone, or add an extension telephone, there would be station equipment expenditures, but no main station gain.

There being no need for further accruals to this account we will order termination of the account as of December 31, 1982.

Adopted Treatment for Balancing Account
$(1,000)

Revenue Reserved (Est. 12/31/82)		$12,457
Adj. for Toll Settlement Ratio		(2,771)
Balancing Account		9,686
Adj. for (OII 84) Shortfall		(420)
Adjusted Balancing Account		9,266
Deferred Amounts		
Min. Norm. for Sta. Conn. (1982)	452	
Min. Norm. for All Other Accts. (12/1/82)	727	
		1,179
Amount for rate reduction		8,087*

(Red Figure)

*Subject to adjustment reflecting actual final entries and accrued interest.

IX. Revenue Requirement

A. Net-To-Gross Multiplier

Staff and Continental differ on the proper net-to-gross multiplier to be applied to additional revenues granted as a result of this proceeding. Staff advocates a multiplier of 1.90; Continental's corresponding recommendation is 2.0591. The parties differ slightly on the proper rate for uncollectibles. The chief dispute, however, is over the appropriate rate for California Corporation Franchise Tax to be incorporated in the calculation of the multiplier. Continental applied the statutory rate of 9.6%. Staff used CTC's effective rate of 1.7267%.

CTC, as Continental's parent, files a combined report on the operations of the Continental system. For state tax purposes, the

RATES AND CHARGES

Schedule Cal. P.U.C. No. X-2, Obsolete Service or Equipment (Cont'd)

Deletion of the requirements shown by asterisks on Sheets 3 thru 9 is authorized contingent on Continental providing an appropriate index for the above schedule.

Farmer Line

	Monthly Rates	
	Business	Residence
Each local primary station		
San Miguel#	$22.15	$22.15
Alpaugh, Corcoran, Cuyama, Farmington, McKittrick, Ripon, Snelling and Taft	5.90	2.95
Colfax	2.50	1.40
minimum	4.20	4.20
Each extended primary station		
Exeter, Knights Landing,	5.90	2.95
Tivy Valley and Robbins	9.60	4.20
Sanger		

The rates shown for San Miguel exchange are the yearly rates.

Schedule Cal. P.U.C. No. Z, Billing Surcharge

Continental is authorized to implement an attrition allowance as set forth in Ordering Paragraph 12 of this order.

APPENDIX B
PAGE 1
RATES AND CHARGES

The rates of Continental Telephone Company of California are changed as set forth below:

Schedule Cal. P.U.C. No. A-1, Network Access Line Service

The following rates are authorized:

Class and Grade of Service	Monthly Rates* (Flat Rates)	Monthly Rate* (Measured Rates)	
Business			
One-Party	$28.35	$23.90	(0)
Two-Party	22.10	-	
Four-Party	22.10	-	
Multi-Party	19.90	-	
Multi-Line	39.85	23.90	(0)
Key Line	39.85	23.90	(0)
PBX Trunk	39.85	23.90	(0)
Semi-Public	28.35	28.35	
Residence			
One-Party (Flat Rate)	10.35	13.85	
One-Party (Measured Rate)	-	8.85	(200)
Two-Party	8.65	8.65	
Four-Party	8.65	8.65	
Multi-Party	7.95	-	
Multi-Line (Flat Rate)	17.70	13.85	
Multi-Line (Measured Rate)	-	8.85	(200)
Key Line (Flat Rate)	17.70	13.85	
Key Line (Measured Rate)	-	8.85	(200)

* EAS (Extended Area Service), SRA (Special Rate Area) and Zone increments where applicable are in addition to the monthly rates shown.

Schedule Cal. P.U.C. No. A-17, Foreign Exchange Service

The following rate is authorized:

Mileage Rates	Monthly Rate
Contiguous exchange Each ½ mile or fraction thereof	$3.50

II. Summary of Decision

This decision grants Continental rate relief in the amount of 16.13 million or 11.4% based on test year 1983. Of the 16.13 million in rate relief, $12.13 million will be derived from rates authorized herein, while the balance of $4 million will be realized from the balancing account pursuant to D.93655. Continental originally requested $31,082,000. The increase authorizes Continental to earn 12.79% on rate base which results in a return on equity of 15.75%. An attrition methodology is adopted which requires a final determination of various cost elements before a specific attrition allowance is granted for 1984. Interest from balancing account monies will be applied to partially offset any computed attrition. Both Continental and staff proposed a specific attrition award of $4.31 million without further review.

The most significant rate changes to produce the adopted 1983 revenue requirement can be summarized as follows:

	Business Rates		Residence Rates	
Type of Service	Present Rates	Authorized Herein	Present Rates	Authorized Herein
One-Party	$17.50	$24.65	$ 7.00	$ 8.95
Two-Party	15.00	19.35	5.90	7.55
Four-Party	15.00	19.35	5.90	7.55
Multi-Party	13.50	17.45	5.40	6.90
Multi-Line	29.00	34.70	12.00	15.30
Key Line	29.00	34.70	12.00	15.30
PBX Trunk	29.00	34.70	* N/A	* N/A
Semi-Public	17.50	24.65	* N/A	* N/A

*Not Available

The decision provides that basic rates for customers served by Apple Valley Central Office shall remain at present levels until such time as service conforms to General Order (G.O.) 133 indices for a period of three consecutive months. The decision also provides for the implementation of nonoptional business measured exchange access service and optional residence measured exchange access service in certain of Continental's exchanges.

The staff estimates a reasonable M&S allowance to be 2.4% of Continental's estimate because that amount was expensed during 1980 and 1981. Staff argued that when M&S are drawn for Construction Work in Progress (CWIP), they are capitalized, and that estimates of the rate base include M&S for the test year.

Continental does not dispute staff's estimate of that portion of the M&S account which is expensed. Continental believes, however, that it will not earn a return on the remainder of the M&S expenditures under staff's proposal because Continental replaces inventory shortly after it is drawn down.

We agree with staff that construction expenditures are separately considered in CWIP and in rate base amounts. We will adopt staff's recommendation which prevents double counting of the capitalized portion of M&S expenditures.

4. Working Cash Allowance

a. Average Amount to Pay Expenses Before Collection of Revenue

The working cash allowance is included in rate base so that the utility's investors may be compensated for capital which they have supplied to enable the utility to operate efficiently and economically and for which it would not otherwise be compensated. Southern California Edison Co. (1978) 84 CPUC 734, 794. The allowance compensates Continental's investors for funds provided to pay the operating expense of the business in advance of receiving offsetting revenues and to fund other operational cash requirements needed for efficient operations. Both Continental and the staff followed the lead-lag approach set forth in CPUC Standard Practice U-16, Determination of Working Cash Allowance, September 13, 1968.

Continental and the staff are in agreement on the average lag in collection of revenues. They differ on the lag day

Using his DCF analysis the staff arrived at a return on equity of 15.5% to 17.0% (8.5% to 9.0% + (7.0% to 8%)).

The staff witness also used a DCF analysis on comparable companies which produced returns ranging from 15.06% to 17.81%. He concludes that his recommended return on equity compares with what investors expect for comparable companies.

The staff witness recommends a return on equity in a range of 16.25% to 16.75%. The midpoint of the staff recommendation produces an after tax coverage of 2.56 times which is an improvement over prior decisions where the after tax coverage averaged 2.46 times.

We believe a 15.75% return on equity will balance the interests of Continental's ratepayers and shareholders. We find this level is reasonable, allowing Continental to earn a 12.75% rate of return and a times interest coverage of 2.48.

VIII. Balancing Account Relating to Certain Toll and EAS Settlement Revenues

The evidence indicates that certain adjustments should be made to the balancing account. The evidence also indicates that a final decision regarding the balancing account cannot be made at this time.

First, Continental and the staff agree that the toll settlement ratio to be used to calculate the revenue Continental receives as a result of D.93367 is 7.65% and that the local exchange revenues to be reserved for the balancing account are overstated by $2,771,000 (i.e., revenues of $2,559,000 and accrued interest of $212,000). Secondly, Continental and the staff agree that the amount to be deducted from the balancing account under D.93728, as modified by D.82-01-100, is $420,000. This amount represents the aggregate requesting such changes. We will also require Continental to notify affected customers of any requested changes in the measured implementation schedule coincident with Continental's filing of a request to change such schedule.

B. Foreign Exchange Service

Continental proposes, (1) to convert all contiguous foreign exchange (FEX) service mileage charges to a rate-center-to-rate-center basis, (2) to establish a channel termination charge of $18.60 per month, and (3) to increase mileage charges to $4.55 per mile per month. FEX is presently priced approximately 570% below cost. Continental's proposal would price FEX service closer to full cost.

The Commission staff is opposed to such a dramatic increase. The staff points out that FEX may be the only service available to some customers and for others the proposed conversion may make phone service prohibitively expensive.

Staff proposes that if such increases are justified by the cost of providing the service, the increase should be spread over several years at a maximum rate of 50% in any single year.

We concur with the staff; however, we believe the increase should be the same percentage as the increase in basic service rates. Further, Continental's proposal to convert FEX mileage charges to a rate-center-to-rate-center basis does not contain any data concerning what effect such a change would have on individual customers with respect to increased costs. It is possible that for some customers FEX may be the only service available and for others the proposed conversion may make phone service prohibitively expensive. Without such information the proposal must be rejected.

TABLE 4

Continental Telephone Company of California
California Operations
Adopted Annual Customer Billing Increase

Item	Amount (000's Omitted)
Terminal Equipment	
Telephone Sets	955.5
Telephone Answering Service	48.0
Key Telephone Systems	1,832.0
Supplemental Equipment	46.7
Fire Reporting Systems	2.8
Private Line and Channel Service	44.1
Miscellaneous Private Line Services & Equipment	3.1
Utility-Provided Music Access System	.4
Obsolete Service or Equipment	837.0
Contracts & Deviations - Terminal Equipment	96.7
Service Connection & Move & Change Charges	1,203.1
Directory Listing	39.8
Custom Calling Service	2.3
Pocket Paging Service & Personal Signaling Service System	26.7
Rotary Hunting Service	30.7
Interexchange Receiving Service/Special Billing Number Service/Joint User Service/Special Dial Trunk Line Service/Customer Transfer Service/Toll Service-Station Service/Customer-Owned Private Telephone Lines Connected to Utility-Owned Private Branch Exchange Systems	36.8
Vacation Rates Service	34.2
Foreign Exchange Service	371.1
Mileage Rates (Outside Plant Facilities)	246.7
Extended Area Service	78.1
Special Rate Areas & Zone Areas	233.8
Victorville Zone Realignment	(304.2)
Basic Exchange Access Line Service	10,807.3
Service for the Handicapped	(43.8)
Billing Surcharge	-
Total	16,628.9
Less Settlements	498.9
	16,130.0

(Red Figure)

XI. Allowance for Attrition

Continental requests an additional $4,308,000 for 1984 due to operational attrition, as set forth in Exhibit 73, as revised by Exhibit 88. No request is made for financial attrition. The staff does not dispute this figure.

Attrition may be defined as erosion in a utility's earnings when its operating and financial expenses increase at a more rapid rate than its revenues and productivity gains. The two main components of attrition are financial attrition and operational attrition. Neither Continental nor the staff have proposed a financial attrition allowance. The effect of attrition for the year after a general rate increase is to preclude the utility from earning its authorized rate of return during that year. Both Continental and the Commission staff agree that an allowance should be provided through a rate increase to compensate the utility for attrition expected to occur in the year following the test year.

The method of computing the 1984 attrition allowance was presented by the staff in Exhibit 59 with subsequent final revisions set out in Exhibit 88. Continental took no exception to the staff showing. We will adopt the staff's methodology but will not authorize a specific attrition allowance until a more precise determination can be made of labor escalation, nonlabor escalation, payroll taxes escalation, and revenue growth at a later date. The Commission may also consider changes in base figures. The parameters and methodology to be used are as follows:

TABLE 6

CALCULATION OF LABOR, NONLABOR, AND PAYROLL TAX OPERATIONAL ATTRITION

Year 1984 - Total Company
(Dollars in Thousands)

Item	1983 A	Factor or Method Used to Estimate 1984 Increments B
Labor & Related Overhead	$55,095	Column A x Factor L
Nonlabor expenses	33,331	Column A x Factor NL
Payroll Taxes	3,598	1984 Wage Escalation & Payroll Tax Rate

Footnotes:

Factor L = (* - 0.025#) x 1.054** - 1

Factor NL = 0 x 1.054** - 1

* Est. Percent wage escalation

\# 2.5% estimated productivity growth

** 5.4% estimated customer growth

0 Est. Percent nonlabor escalation

XII. IDC Computation Method

The staff recommended in Exhibit 46 that the fixed formula method for computing IDC be adopted for Continental. The advantage of the IDC fixed formula is that it takes into account the unique operating conditions of the individual utility and its present financial condition. It further recognizes the costs of construction capital in a predetermined sequence from internal generation to external financing.

Under the present procedure there is no adjustment mechanism to reflect on a timely basis major changes in construction fund requirements or money market conditions. The present procedure also fails to consider short-term money as a major source of construction funds.

9. Continental should file tariffs which provide a program of services for handicapped customers consistent with the recommendations set forth in Exhibit 51. The program should be publicized by bill inserts immediately following the effective date of the tariffs.

10. The rate design set forth in Table 4 is reasonable.

11. The Victorville Zone changes as set forth in Exhibit 79 are reasonable and will be ordered.

12. Continental should include as a part of its next major rate application a study of boundaries as recommended in Exhibit 79.

13. Continental's overall quality of service is adequate, however, the quality of service provided to customers served by the Apple Valley central office has not shown any significant improvement since Continental's last rate increase application at which time service problems were disclosed.

14. Because there is an immediate need for the rate relief authorized this decision should become effective today.

15. The cost of service adopted is based on conventional normalization methods as mandated by ERTA consistent with Commission D.93848 dated December 15, 1981 in OII 24.

16. Continental should seek private letter rulings to resolve the deferred normalization issues. Upon resolution of the issues Continental shall inform the Commission for disposition by resolution of the deferred amount in the balancing account.

17. Eight million dollars of the balancing account should be applied to offset revenue requirements over the years 1983 and 1984. Interest accruals should be used to offset attrition and/or applied as a SUR credit to customer billings.

18. A change in the method for determining the IDC rate for Continental is necessary. The staff's recommended fixed formula method for computing IDC is reasonable and should be adopted.

19. Continental's proposal for a predetermined attrition allowance for 1984 is premature since more precise data for computation of the allowance will be available at a later date. The method adopted in this decision for making that computation is reasonable.

B. Conclusions of Law

1. The Commission concludes that the application should be granted to the extent set forth in the following order.

2. The rates authorized in Appendix A are just and reasonable. Any other rates applied after the rates in Appendix A are in effect are unjust and unreasonable.

3. Continental should file, within 30 days, an advice letter to establish charges for telephone deliveries that are not coincident with premises work.

4. Basic rates for customers served by the Apple Valley central office should remain at present levels until the service conforms to G.O. 133 indices for three consecutive months after which time Continental should file an advice letter requesting increases for Apple Valley central office customers to the rates authorized for all other customers by this decision.

5. Continental should be authorized to file an advice letter on October 3,1983 to establish a surcharge on local access customer billing to yield an increase in customer billing for 1984 to match the 1984 attrition allowance. The attrition allowance should be based on the methodology set out in Tables 5 and 6, updated to reflect the latest estimates of labor escalation, nonlabor escalation, payroll taxes, and revenue growth. Accrued interest on the balancing account amounts, including the deferred amount, for years 1983 and 1984 and released deferred amounts, if any, will be applied as an offset to the calculated attrition allowance. Such advice letter filing should not become effective prior to January 1, 1984 and shall be subject to authorization by Commission resolution action.

offset to the calculated attrition allowance. The attrition allowance for 1984 shall be implemented by the establishment of a local access customer billing surcharge. Continental's advice letter filing for a 1984 attrition allowance shall include, as an attachment, a showing of the development of the local access billing surchage.

13. Continental is authorized to file revised rate schedule attached to this order as Appendix B and currently to cancel the presently effective schedule. Such filing shall comply with GO 96-A. The effective date of this revised schedule shall not be before January 1, 1985.

This order is effective today.

Dated DEC 8 1982, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

RATES AND CHARGES

The rates, charges and conditions of Continental Telephone Company of California are changed as set forth below:

Schedule Cal. P.U.C. No. A-1, Network Access Line Service

The following rates and revisions are authorized:

Class and Grade of Service	Monthly Rates*@ (Flat Rates)	Monthly Rate* (Measured Rates) 1/
Business		
One-Party	$24.65	$20.20 (0)
Two-Party	19.35 2/	- 3/
Four-Party	19.35 2/	- 3/
Multi-Party	17.45	- 4/
Multi-Line	34.70	20.20 (0)
Key Line	34.70	20.20 (0)
PBX Trunk	34.70	20.20 (0)
Semi-Public	24.65	24.65
Farmer Line (See Schedule X-2)		
Residence		
One-Party (Flat Rate)	8.95	12.45
One-Party (Measured Rate)	-	7.45 (200)
Two-Party	7.55 2/	7.55
Four-Party	7.55 2/	7.55
Multi-Party	6.90	- 4/
Multi-Line (Flat Rate)	15.30	12.45
Multi-Line (Measured Rate)	-	7.45 (200)
Key Line (Flat Rate)	15.30	12.45
Key Line (Measured Rate)	-	7.45 (200)
Farmer Line (See Schedule X-2)		

* EAS (Extended Area Service), SRA (Special Rate Area) and Zone increments where applicable are in addition to the monthly rates shown.

@ All exchange access lines served from the Apple Valley Central Office of the Victorville exchange are excluded from these revisions until the requirements set forth in Ordering Paragraph 4 of this order are met.

1/ The implementation of measured services shall be as set forth in Ordering Paragraph 10 of this order except for the Exeter and Lemon Cove exchanges for which the Measured Service Conversion Date shall be within the first 6 months of 1983.

All affected customers shall be provided written notice of the implementation of measured service within 60 days prior to the implementation of measured service.

Usage allowances for measured rate services are shown in "( )" following the proposed monthly rates. The usage allowances, where shown, are in terms of message units. Where no "( )" is shown following the authorized rates, the service is a flat rate service.

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RATES AND CHARGES

Schedule Cal. P.U.C. No. X-2, Obsolete Service or Equipment (Cont'd)

Deletion of the requirements shown by asterisks on Sheets 3 thru 9 is authorized contingent on Continental providing an appropriate index for the above schedule.

Farmer Line

	Monthly Rates Business	Monthly Rates Residence
Each local primary station		
San Miguel#	$21.75	$21.75
Alpaugh, Corcoran, Cuyama, Farmington, McKittrick, Ripon, Snelling and Taft	5.80	2.90
Colfax	2.45	1.40
minimum	4.15	4.15
Each extended primary station		
Exeter, Knights Landing, Tivy Valley and Robbins	5.80	2.90
Sanger	9.40	4.15

The rates shown for San Miguel exchange are the yearly rates.

Schedule Cal. P.U.C. No. Z, Billing Surcharge

Continental is authorized to implement an attrition allowance as set forth in Ordering Paragraph 12 of this order.

(END OF APPENDIX A)

APPENDIX B
PAGE 1
RATES AND CHARGES

The rates of Continental Telephone Company of California are changed as set forth below:

Schedule Cal. P.U.C. No. A-1, Network Access Line Service

The following rates are authorized:

Class and Grade of Service	Monthly Rates* (Flat Rates)	Monthly Rate* (Measured Rates)	
Business			
One-Party	$27.90	$23.45	(0)
Two-Party	21.85	-	
Four-Party	21.85	-	
Multi-Party	19.65	-	
Multi-Line	39.40	23.45	(0)
Key Line	39.40	23.45	(0)
PBX Trunk	39.40	23.45	(0)
Semi-Public	27.90	27.90	
Residence			
One-Party (Flat Rate)	10.15	13.65	
One-Party (Measured Rate)	-	8.65	(200)
Two-Party	8.60	8.60	
Four-Party	8.60	8.60	
Multi-Party	7.85	-	
Multi-Line (Flat Rate)	17.35	13.65	
Multi-Line (Measured Rate)	-	8.65	(200)
Key Line (Flat Rate)	17.35	13.65	
Key Line (Measured Rate)	-	8.65	(200)

* EAS (Extended Area Service), SRA (Special Rate Area) and Zone increments where applicable are in addition to the monthly rates shown.

(END OF APPENDIX B)