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ORIGINAL

Decision No. 86593

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of The Pacific Telephone and Telegraph Company, a corporation, for telephone service rate increases to cover increased costs in providing telephone service.	Application No. 55492 (Filed February 13, 1975; amended January 16, 1976)
Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, inter-company settlements, contracts, service, and facilities of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.	Case No. 10001 (Filed November 12, 1975)

(Appearances listed in Appendix A)

THIRD INTERIM OPINION

The Pacific Telephone and Telegraph Company (Pacific) seeks rate relief of $119.6 million in the application which is part of this proceeding. Because certain problems need our immediate attention we wish to issue an interim opinion and order on the subject of "held orders", and certain other service problems. Hearings on these subjects were held in various cities on various dates in March through July of this year.

I. HELD ORDERS

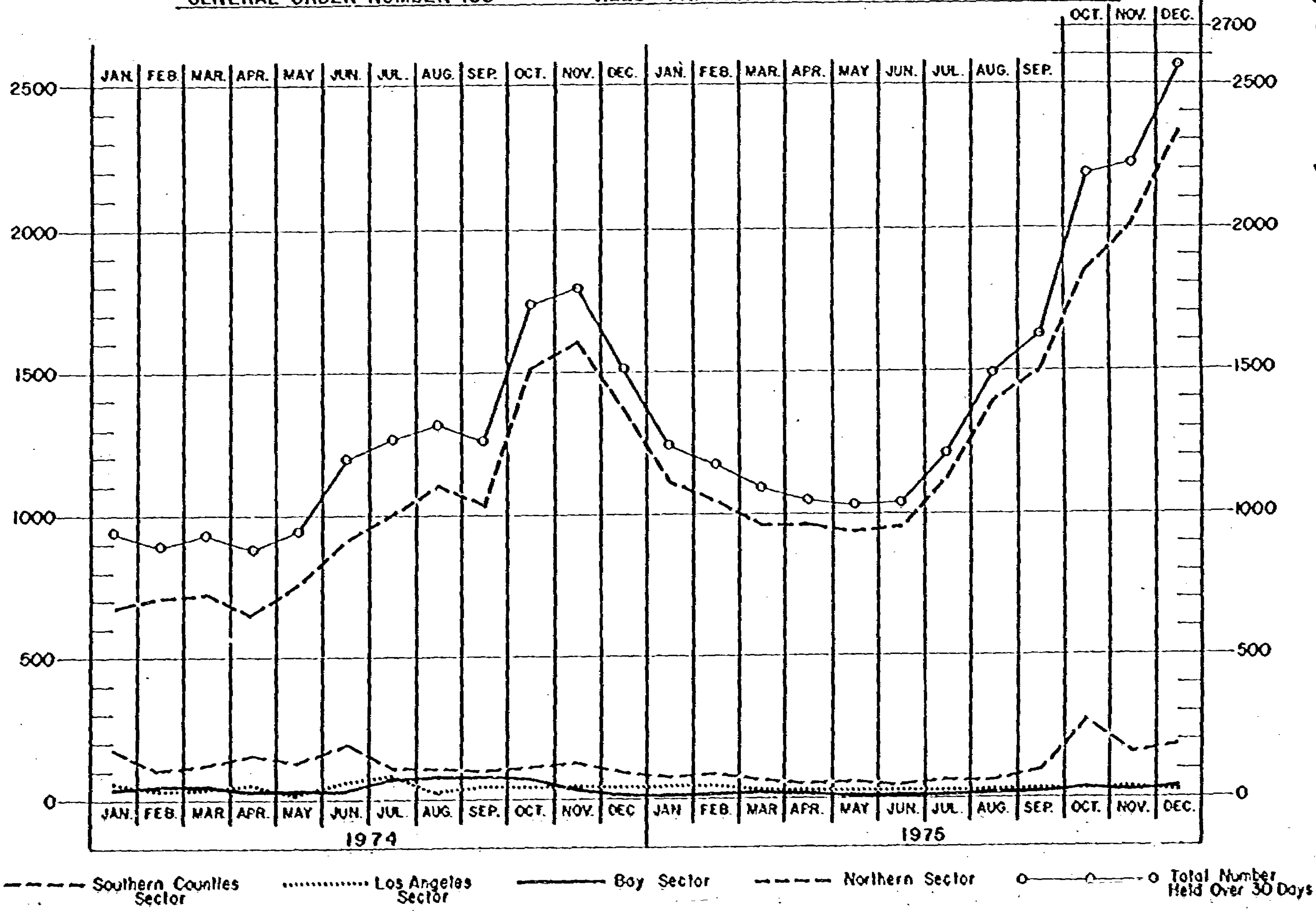
General Order No. 133 defines a held primary service order as a request for primary telephone service delayed over 30 days because of lack of telephone utility plant. A held regrade service order is defined as a request for a change in grade of an existing primary service delayed over 30 days because of a lack of telephone utility plant.

The staff's Exhibit 36, a report on Pacific's telephone service quality, contains several charts showing unfilled orders for 1974 and 1975. The staff prepared two charts on a GO 133 basis, showing (1) primary service orders held during 1974 and 1975 and (2) regrade orders held for the same period, broken down by the company's major geographic sectors. These charts illustrate the problem we are faced with and are reprinted here.

PACIFIC TELEPHONE AND TELEGRAPH COMPANY

STATE OF CALIFORNIA

GENERAL ORDER NUMBER 133 — HELD PRIMARY SERVICE ORDERS OVER 30 DAYS



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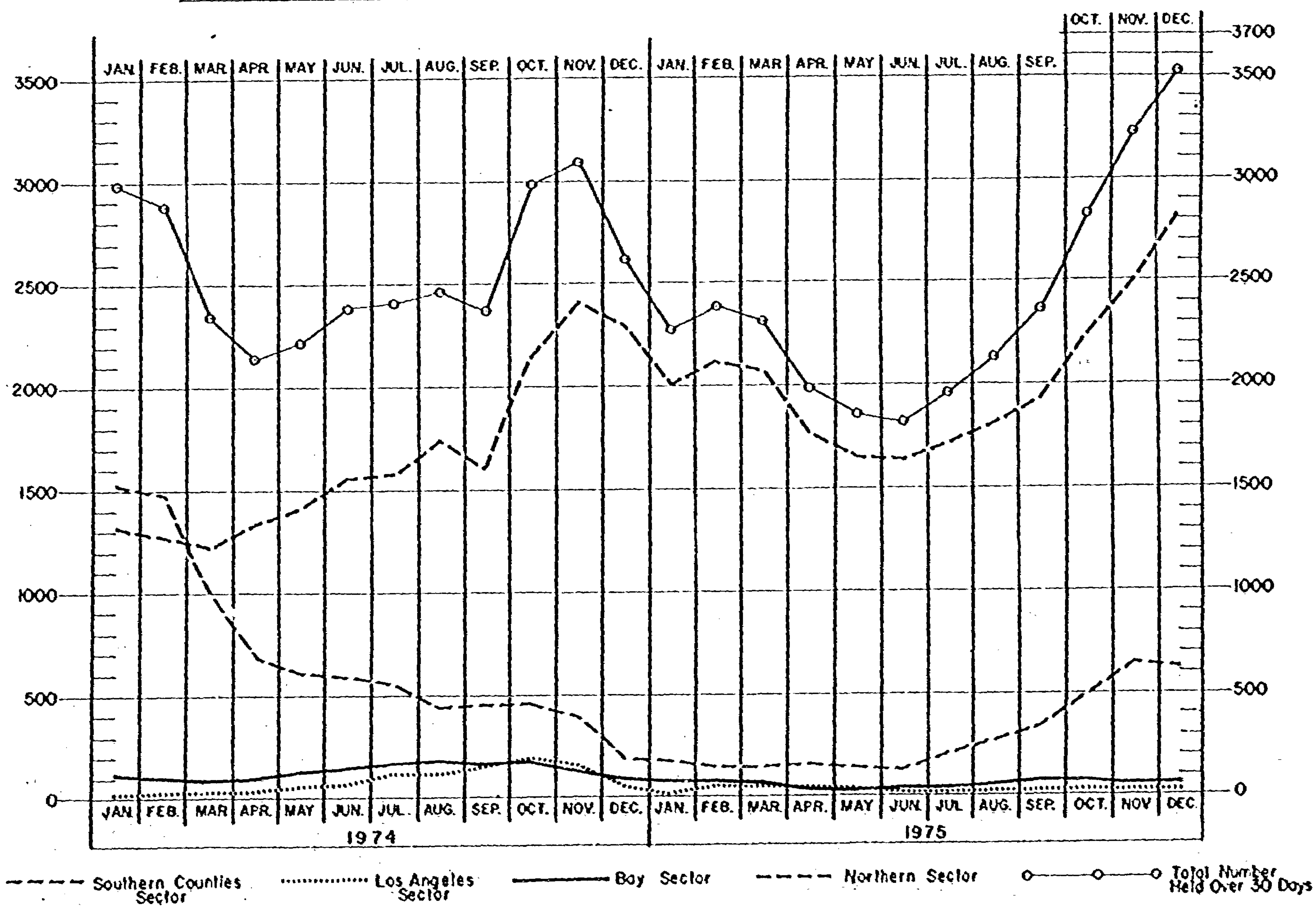
PACIFIC TELEPHONE AND TELEGRAPH COMPANY

STATE OF CALIFORNIA

GENERAL ORDER NUMBER 133 — HELD REGRADE SERVICE ORDERS OVER 30 DAYS



Pacific prepares information for held orders on a slightly different basis: it compiles a count of held orders for both primary and regrade service ("main service and regrades report"). Pacific defines held orders as customer requests for main services and regrades uncompleted by the day of a monthly count (usually taken on the 25th day of the month). Based upon such data, the staff constructed two additional charts showing (1) the number of unfilled "main" service orders for the same period as the preceding charts, on Pacific's own reporting basis, and (2) a similar chart for regrade orders. Again, the charts are broken down by major geographic sectors. These charts follow.

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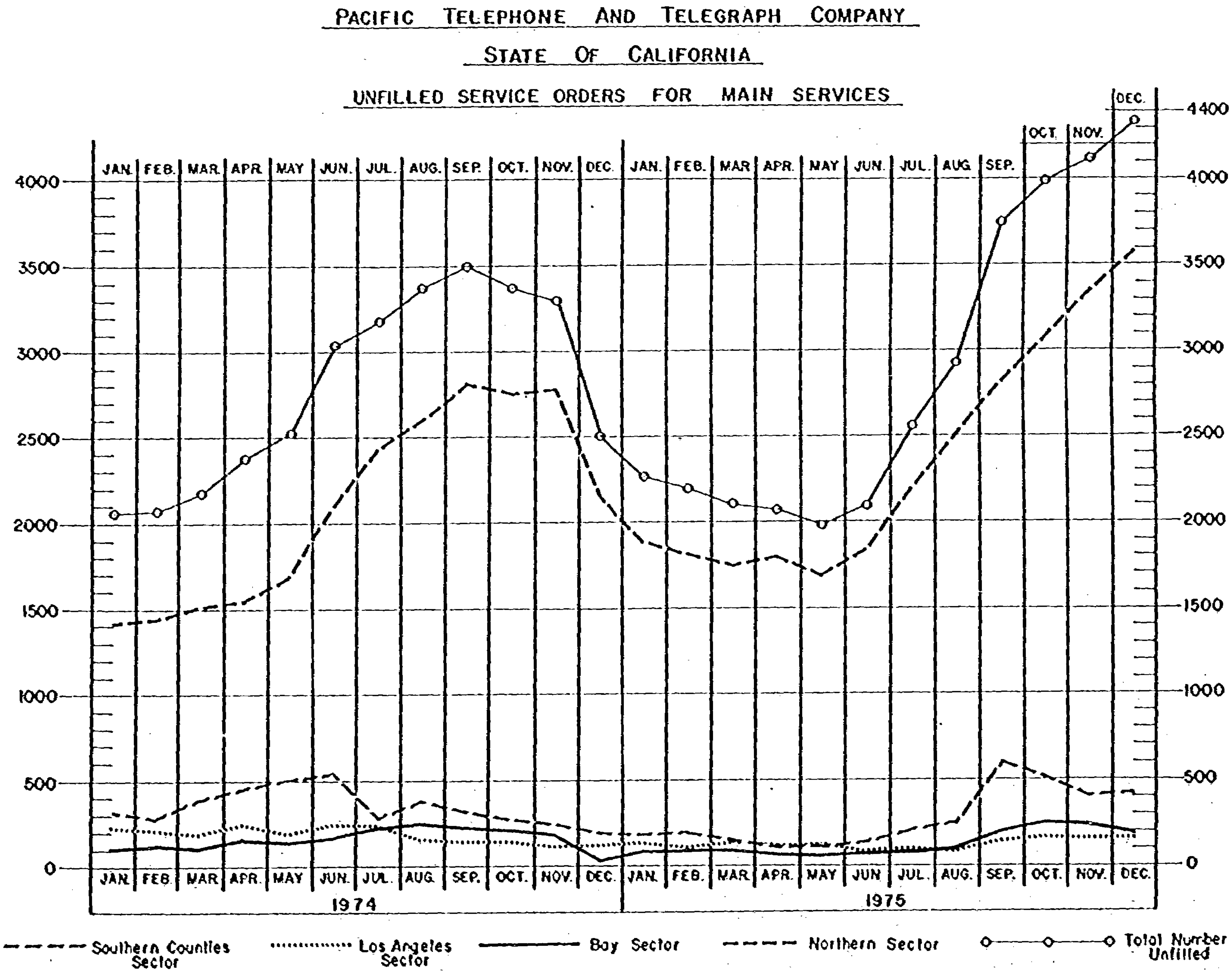

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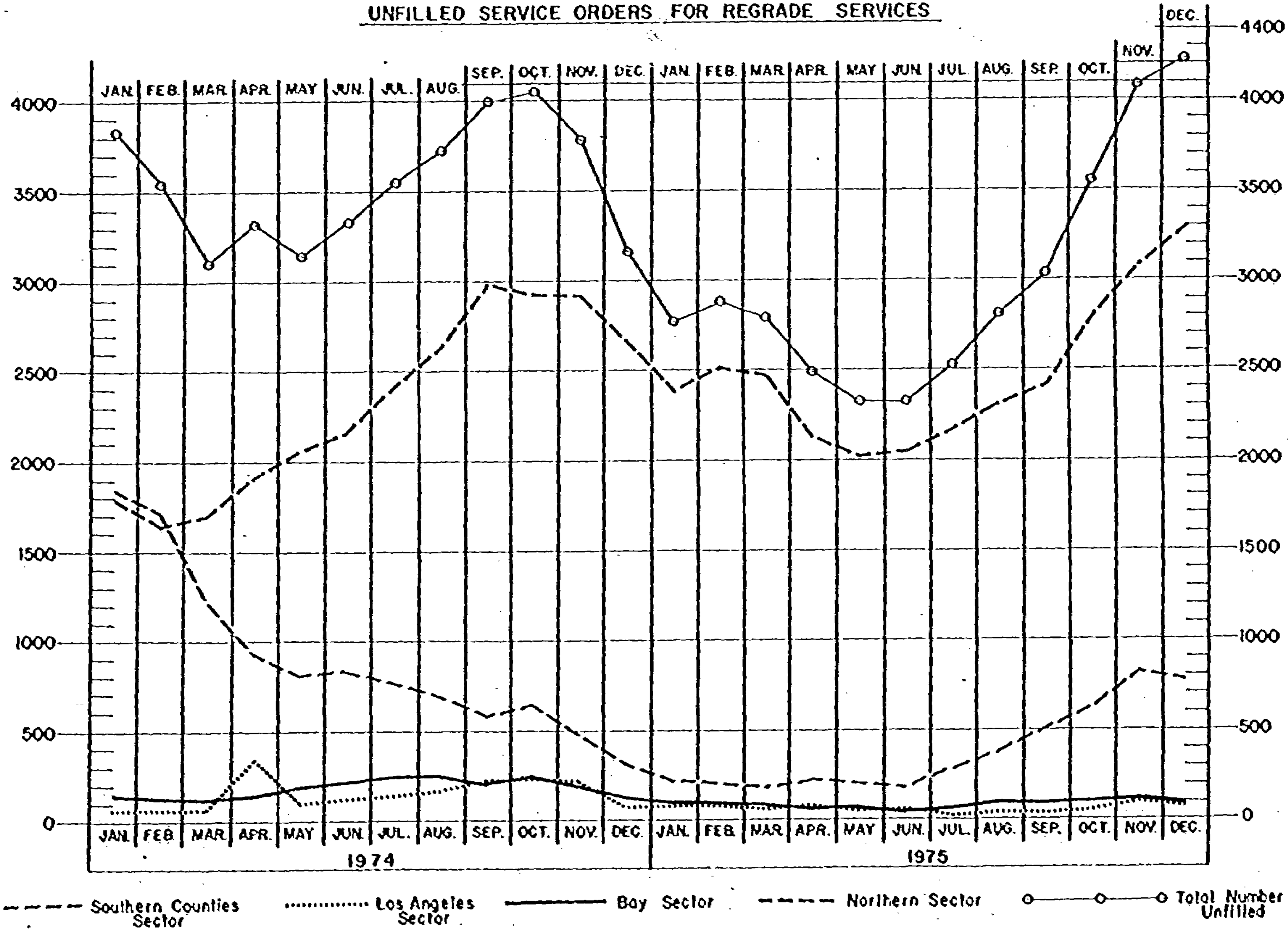
PACIFIC TELEPHONE AND TELEGRAPH COMPANY

STATE OF CALIFORNIA

UNFILLED SERVICE ORDERS FOR REGRADE SERVICES



In all four charts, it should be noted that almost all of the total increase in held orders over the latter part of 1975 is matched by a pronounced increase in such held orders for the Northern Sector (consisting basically, of Northern California exclusive of the San Francisco Bay area).

Pacific's data identifies, on the basis indicated in Charts 3 and 4, reasons why requests for service are unfilled, as follows:

Reasons for Unfilled Orders

Reason Held	Main Service 1974	Main Service 1975	Regrades 1974	Regrades 1975
Plant facilities	93.1%	93.9%	98.9%	99.0%
Force	.3	.3	.2	-
Other	6.6	5.8	.9	1.0

The above development is seen better against a backdrop of what Pacific regards as a "normal" level of held orders. The record does not contain an estimate for all four sectors, but Mr. Hamish Bennett, Pacific's assistant vice president for Regulatory Planning, and its witness on the subject of service levels, stated that for the Northern Sector a normal held order level would be about 330 (Exhibit 54, page 2), with 90 percent of those orders held for less than 60 days (thus, according to staff reasoning, a normal level for the Northern Sector for orders held 60 days or longer, based upon Mr. Bennett's testimony, would be 33).

The staff's Exhibit 36 also developed information which tended to show a similar trend of buildups for orders held over 60 and over 90 days. Some such orders are, of course, held because they present special installation problems (e.g., locations far removed from any existing line) but the staff's data shows that much of this buildup was the result of shortages of plant margins (Exhibit 36, pp. 4-6). The situation resulted in a 1975 total of orders held over 60 days (as of November 30, 1975), as follows:

Held Orders - Over 60 Days - November 30, 1975

Sector	Primary Number	Primary Dollars (000)	Regrade Number	Regrade Dollars (000)	Total Dollars (000)
Northern	634	$10,568	922	$6,549	$17,117
Bay	8	204	26	428	632
Los Angeles	9	109	9	223	332
Southern Co.	36	399	60	299	698
State	687	11,280	1,017	7,499	18,779

The dollar amounts indicate "relief project dollars" required to serve these orders as of November 30, 1975, by which is meant funds either added to the existing budget or diverted from other purposes to meet the problem of held orders.

In its brief, the staff presents us with more recent data for orders held over 90 days and warns us that the problem which was present in 1975 continues into 1976. The information was compiled from Pacific's annual reports to the Commission, and compares Pacific's performance with that of General Telephone Company:

Primary Orders Held Over 90 Days - 1976

Company	1-1-76 Main Stations	January Total	January Per 1,000 M.S.	February Total	February Per 1,000 M.S.	March Total	March Per 1,000 M.S.
Pacific:							
Northern Region	3,500,000	1,209	0.345	1,234	0.353	1,268	0.362
Southern Region	3,500,000	62	0.018	75	0.021	75	0.021
Total	7,000,000	1,271	0.182	1,309	0.187	1,343	0.192
General:	1,700,000	6	0.004	5	0.003	8	0.005

The Staff's Position

The staff argues that the held-order situation is entirely traceable to budget cutting on the part of Pacific which was unwarranted by financial considerations, and that, therefore, strong action should be taken by the Commission.

Pacific filed this application before we disposed of its previous rate increase request (Application No. 55214). It made a "motion to set public hearings" on August 1, 1975 which we denied (Decision No. 84938 dated September 30, 1975). One of the reasons for our denial was that Pacific would have to file a major amendment to this present application as soon as the amount of relief awarded in Application No. 55214 was known. This, of course, was what occurred. Nevertheless, Pacific, as the staff points out, expressed its concern over the Commission's action in a letter dated June 18, 1975, to the Commission. The letter discusses Pacific's problems concerning bond ratings and other financial considerations. The letter then states:

> "We will reduce our 1975 construction program by $25 million. As you know, capital expenditures are a long-term proposition so if we are not to incur severe cancellation penalties we cannot substantially reduce our program when half of it already has been carried out and most of the remainder has been committed. However, even this cut will mean deferral of certain projects.
>
> "As to expenses, we will reduce our 1975 levels by $25 million. We contemplate having on our payroll some 1,000 fewer people at the end of 1975 than we had planned at the outset of the year. This means, among other things, we foresee less hiring for the balance of 1975." (Exhibit 36, Appendix A, Sheet 6 of 7.)

The staff points out that while this letter also discusses possible layoffs, Pacific actually contemplated a reduction in force before the problems discussed in the letter arose. According to Exhibit 53, Pacific was considering a reduction of 1,000 employees in February 1975.

Pacific's Board Chairman, Mr. Hull, announced his view of the problem to Pacific's shareholders in its quarterly report for the fourth quarter, 1975 (p. 4):

> "Despite the increase in our earnings per share, our post-tax interest coverage for the 12 months ended November 30 was 2.34, compared with 2.39 for the same period last year. This continued decline in coverage is a threat to our bond rating.
>
> "During the past four quarters we have been operating under stringent expense budget controls. Unfortunately, in some areas such limits have affected the quality of our service. I can personally assure you we are doing our best with the available resources." (Emphasis added.)

The staff points out that although a recurring theme of the quarterly reports is alleged financial problems, the reports themselves indicate reasonable financial health, making the budget controls instituted by Pacific unreasonable. The staff points to various statements and figures in the quarterly reports (Exhibit 56) indicating financial health. The January 1976 quarterly report states that earnings for the twelve-month period ending November 30, 1975 were $1.78 per share compared with $1.62 for the comparable twelve months in 1974. Pacific's post-tax interest coverage for 1975 was 3.41. The staff argues that in order to judge

Pacific's financial health it should compare <u>reported</u> rate of return with return on a flow-through basis, which was 9.9 percent for mid-1975.[1/]

The staff also questions whether some of Pacific's budget control procedures were really the result of any disagreement with Commission action or were simply overzealous trimming. The staff's Exhibit 36 summarizes Pacific's own budget "views" for its direct operating expenses.

PACIFIC'S BUDGET VIEWS - 1975-1976

View Date	Direct Operating Expense Budget[1/] 1975	1976
	(Millions)	
December 1974[2/]	$1,347.2	$1,531.5
Change	(15.2)	(13.4)
March 1975	1,332.0	1,518.1
Change	(23.1)	(93.2)
July 1975	1,308.9	1,424.9
Change	.2	(.2)
October 1975	1,309.1	1,424.7
Change	-	13.0
November 1975[3/]	1,309.1	1,437.7
Change	-	13.3
December 1975	1,309.1	1,451.0
Cumulative Change	(38.1)	(80.5)
Cumulative Change, Percent	(2.8)%	(5.3)%

(Red Figure)

1/ Maintenance, Traffic, Commercial, Marketing, Other.

2/ Basis for A.55492, filed February 13, 1975.

3/ Basis for A.55492, amended January 16, 1976.

1/ See an analysis of Pacific's flow-through return in Decision No. 84938, supra, pp. 3-4.

The above table translates, according to the staff exhibit, into the following "view-to-view" reductions:

View to View	1975 (Millions)	1976 (Millions)
December 1974 to March 1975	$10.8	$12.9
March 1975 to July 1975	13.7	60.2
July 1975 to October 1975	.3	6.3
Cumulative Expense Reduction*	24.8	79.4
Cumulative Expense Reduction	1.8%	5.2%

* No "cutback" imposed in November and December 1975 views. This is the $25 million expense reduction in letter of 6/18/75, referred to above.

Based upon the above analysis, the staff's Exhibit 36 states (p. 14):

> Obviously the major budget adjustments made during the period December 1974 to December 1975, were "cutbacks". The effect of the above expense "cutbacks" on rate of return is approximately 0.2 percent increase for 1975 and 0.6 percent for 1976."

The staff's exhibit then offers a breakdown, based upon information gathered from company sources, which shows that "cutbacks" were accomplished by a combination of reductions in force and permitted overtime, deferral of routine maintenance and training time, increased workload per employee, and greater service risk.

One particular method used by Pacific to hold down costs which has direct relation to held orders is Pacific's adoption of certain guidelines which deferred high-cost installations. At the time of the staff exhibit, the guideline required deferral of all Northern Sector service orders which exceeded $2,000 per primary order and $1,000 per regrade order.

The staff is firmly of the opinion that none of the increase in held orders shown on the charts for late 1975 is the result of any normal, recurring trend. As Exhibit 30 (p. 7, paragraph 23) states, normally performance deteriorates in the middle of the year because of greater than average movement of telephone customers, but then, in fall and winter, because of a lower level of movement, performance improves.

In conclusion, the staff argues, inter alia, that the company has never attempted to allege in this application, let alone prove, any financial emergency,2/ and that, under the circumstances, the company's actions, which could have been expected to cause service problems, are violations of Public Utilities Code Section 451, which requires the furnishing of adequate service.

The staff's views of the company's actions lead it to make two alternate recommendations. The first suggested alternative (brief p. 16) is that the company be ordered to:

> "(1) Cancel its 'high cost' limitation on service orders.
>
> (2) Establish a program such that within six months of the effective date of the Commission's order, and thereafter, service will be provided, pursuant to filed tariff requirements, to applicants for primary service and for regrade of service* within 60 days of the service date requested. If at any time, Pacific anticipates inability to comply with this order, it shall promptly seek an extension of time by supplemental application herein setting forth all facts and justification for extension of time as to each service order it is unable to serve as ordered."
> (Exhibit 36, p. 18)

2/ Although there are certain averments concerning its financial condition in the "motion to set public hearings", no interim relief has ever been requested in spite of the assigned Commissioner's expressed willingness to investigate any emergency which might exist and render a prompt decision on such a problem (Transcript 23).

In the alternative, the staff recommends a reduction of Pacific's assigned 8.85 percent rate of return (cf. General Telephone Company (1969) 69 CPUC 601, 690-692).

The Company's Position

Pacific strongly disagrees with the staff's view of the record and the staff's recommendations.

Pacific first points to its generally high level of service based upon many indicators, pointing out that staff witness Macario testified that the general service level was reasonable "with no significant decline in the last two years..." (Exhibit 50 p. 4-EM) and that staff witness Carlson testified that maintenance service "generally represents a quality of service well above the level which would be considered unsatisfactory" (Exhibit 38, p. 4, ALC).

Regarding held primary orders in particular, Pacific's position is that (1) the situation in the Northern Sector was not caused by its budget measures but by unusual growth patterns not covered by Pacific's forecasting, and (2) Pacific has already implemented a plan to reduce the held order problem to a reasonable level. Pacific's witness Bennett testified (Exhibit 54, p. 1):

"1. The actual demand for main telephone service in California in 1975 was significantly greater than had been anticipated at the end of 1974. Economic forecasts were predicting a downturn in the economy which Pacific reflected in its demand forecasts. As a matter of fact, demand for telephone service continued to be strong.

"2. Most importantly, the greatest increase in demand for service and the most significant increases in unanticipated demand were in the rural areas served by Pacific where it is more difficult to forecast accurately the exact location and date when new facilities will be

> needed for growth; where it is more costly to provide these facilities; and where it requires more engineering analysis and construction time, which increases the time interval necessary to provide service."

Mr. Bennett pointed out that Pacific did not make any underestimate of main telephone station growth in 1975 but that what occurred was the forecasts were incorrect regarding what geographical areas of the state the growth would occur (Transcript 1148; 2001-03). He further testified that in spite of the capital restrictions, the actual dollars spent by the Northern Sector Customer Operations Group in 1975 exceeded the amount originally allocated to them in the December 1974 view of 1975.

Regarding the limitations on high cost orders in the Northern Sector, Mr. Bennett stated this was simply a method of setting priorities so that the most service for the most customers could be provided for the money spent.

Mr. Bennett laid out the following plan for dealing with the held order problem:

> "In 1973, Pacific spent $51.2 million in Subscriber Loops and Structures in its Northern Sector. In 1975, Pacific increased these expenditures to $71.6 million. Our plan calls for the spending of about $30 million more for outside plant loops and structures in 1976 than was spent in 1975. Comparable increases are planned for 1977 and 1978. This means that the total to be spent in 1978 will be about $140 million in this Sector alone, virtually doubling the amount spent in 1975.
>
> "Under this proposal, the Sector would be down to normal held order levels (about 330) by year-end 1978.

"The Northern Sector has already begun to implement this plan as follows:

1. Stimulate transfers within Pacific which will add over 80 construction craft employees to its regular force.
2. Temporarily obtain about 50 fully qualified engineers to augment our engineering staff for the remainder of 1976.
3. Temporarily obtain about 80 qualified construction craft employees during the last 7 months of 1976. Together with these employees, we plan to temporarily obtain supervisors and the necessary tools and motor vehicles.
4. Establish a hiring and training program at an increasing rate, which, when added to the above requirements, will result in a net force increase of 23 percent by year-end.
5. Increase authorized overtime levels for the engineering and clerical forces to 10 percent.
6. Increase authorized overtime levels for craft and supervision forces to 11 percent.
7. Spend $2.2 million more for motor vehicles and work equipment.
8. Allocate an additional $1.0 million for training needs of new force additions and the living expenses of the temporarily obtained people.

"In 1977, the Sector plans to transfer, or hire and train, an additional 80 or so employees before allowing normal attrition during 1978 to reduce the force to levels required to support the ongoing program.

"This plan has the advantage of maintaining a balanced construction program in the two and a half year time frame from now until year-end 1978. Force additions are planned in an economic manner and we estimate we can achieve productivity levels in the Northern Sector comparable with what was obtained in 1975.

> "In summary, the objective of this plant is to reduce held orders to normal operating levels by the end of 1978 and by that time to have sufficient plant capacity that these levels can generally be maintained. This plan allows the plant additions to be designed and constructed in such a way as to be economically sound, provide good service now and in the future, and to take advantage of the latest technological improvement." (Exhibit 54, pp. 2-4)

It should be noted that although this plan, according to Pacific's own estimates, will take two years to complete, this does not mean that customers presently having held orders will have to wait two years since there is a turnover in held orders. (Exhibit 54, p.4)

Pacific considers the staff's recommendations arbitrary and impractical. It first points out that it has never been possible to complete all held orders within 60 days. Rural areas pose special problems. Facilities must be installed where none exist. Overloaded wire must sometimes be replaced. Therefore, to require the formal filing of applications for all held orders over 60 days would serve no purpose. Assuming that Pacific were to take the necessary steps to fill all held orders within 60 days, this would cause "an extraordinary service undertaking, which would be uneconomic and inefficient. It would require Pacific to increase its spare capacity beyond normal levels, and would compromise the proper engineering and construction of telephone plant and facilities". (Pacific's brief, p. 10) Pacific points out that to do this would require precise predictions of growth along each cable route.

Added to this, according to the company, is the administrative burden for the Commission, as well as the company if Pacific has to file an application for each order it is not sure it will fill in 60 days (presumably, if we were to adopt the staff's suggestion, we would expect applications which anticipate the problem rather than those filed ex post facto).

The company proposes, as an alternative, that telephone utilities be required to augment their GO 133 filings by reporting the particulars on all orders held over sixty days.

Discussion

The preponderance of the circumstantial evidence shows that Pacific's budget measures played a significant part in the held order problem discussed above. While the company's forecasts failed to show unusual growth in the Northern Sector, certainly the company could have recovered faster from an increasing problem had it not taken the budget view it did for 1975. The budget-tightening measures coincided, in time, with the worsening of the held-order problem. While we need not determine that 100 percent of the held order problem is traceable to budgetary considerations, it would be ignoring realities to attribute the entire problem to incorrect forecasting. After all, it was Pacific's announced intention to safeguard earnings at the expense of service considerations, over the course of 1975. The record shows that Pacific succeeded in its objective. No financial emergency was ever demonstrated, nor in spite of Pacific's various statements, referred to above, in correspondence and stockholders reports, can any alleged earnings problems be traced to unreasonable regulatory lag.[3/] Pacific gambled that it could adopt stringent short-term

3/ See discussion, Decision No. 84938, supra.

budget tightening measures with no pronounced service problems. It lost this gamble insofar as held orders in its Northern Sector are concerned.

The company's recommendation does very little more than maintain the status quo. More detail on all telephone orders held over 60 days might speed up staff investigations of held order problems (and for this reason we will authorize a form of Pacific's suggestion) but it does not provide advance information.

We agree with Pacific, however, that the staff's particular "application" suggestion would impose a heavy administrative burden, and, if we add to it a requirement that all held orders shall be filled within 60 days, a financial and construction burden not beneficial either to the ratepayers or to the company.

We believe Pacific should be required, in the future, to request advance permission by way of application,[4] to impose any high-cost limitation on filling service orders. Existing high-cost limitations, if any are still in effect, will be ordered canceled within 30 days.

We also consider it appropriate to require Pacific to apply (formally) for permission to carry an excessive number of held orders. Whenever its forecasts show, for any reason including budgetary considerations, that its 60-day and over held orders, for any individual sector or for the company as a whole, will exceed the normal figure by 100 percent or more during the six months (approximately) following the application.

Since we have evidence on the "normal" amount of orders held over 60 days for Pacific's Northern Sector only, we will order evidence to be taken on this record of what should be considered "normal" for the remaining Sectors, and for the company as a whole.

4/ Applications referred to should be filed as separate proceedings and not "herein", as was suggested by the staff.

Regarding our orders on this subject, we accept Pacific's suggestion that notification to the Commission of the details of existing 60-day and over held orders should apply to all telephone corporations. We reject the notion, however, that our "application" requirements must apply equally to all telephone companies in order to avoid "equal protection of the laws" problems. We are not engaged in rule-making in imposing such requirements; we have had full evidentiary hearings regarding the problems of one company, and we are ordering this company to correct such problems.

We believe that Pacific's program to bring the present Northern Sector held-order problem back to normal levels is satisfactory for the present, and we will order Pacific to continue it. We reserve judgment regarding whether it will need future modification, depending upon the results it produces.

Lastly, we adopt the staff's suggestion that in view of Pacific's unreasonable budget management, a reduction in Pacific's assigned rate of return is justified. The measurement of this reduction should be calculated with reference to the amount of money Pacific's stockholders "saved" by way of budget holddowns which resulted in the buildup of held service in the Northern District. This is of necessity an estimate and not an amount which can be determined with mathematical certainty.

Bearing in mind that we believe that some of the excessive held orders were the result of Pacific's forecasting problems, traceable primarily to unprecedented growth in the Northern Sector, we will attribute (for the purpose of determining any rate of return adjustment) (1) excessive held regrade orders, and (2) orders held because they cost over $2,000 as resulting from erroneous forecasting. We will then determine the adjustment based upon the remaining primary service orders held over 60 days.

As of November 30, 1975, the 1,405 held orders for primary service in the Northern Sector translate into total required relief project dollars in the amount of $23,400,000. 921 of the held orders were for amounts of over $2,000, in the total amount of $12,873,000. Therefore, in our opinion, the projects unreasonably deferred by management discretion amounted to the difference of these two figures, or $10,527,000.

This $10,527,000 represents capital dollars not expended at the proper time, which Pacific should have expended to meet its public service obligation under Public Utilities Code Section 451. Accordingly, it is appropriate to reduce Pacific's return by an amount roughly equivalent to the savings realized by Pacific's stockholders by failing to make the required investment.

By this management decision, Pacific relieved itself of financing this amount at the current cost of debt capital (approximately 9 percent). Inasmuch as the plant investment was not made, the usual plant carrying charges - depreciation, maintenance, administration, ad valorem taxes, and other similar items - were not incurred. The translation of the effect of not making the $10,527,000 investment equates to a difference in rate of return of 0.007 percent. This return difference is equal to an adjustment in gross revenue of $740,000 per year. The specifics of this calculation appear in the table which follows:

CALCULATION OF PENALTY AGAINST RATE OF RETURN

Investment Not Made	$ 10,527,000
Cost of New Debt - Approx.	9%
Saving in Annual Interest	$ 947,000
Offset: Tax Reduction Not Realized Due to Increased Interest Deduction:*	$ (461,000)
Net Saving to Stockholders - Equivalent to Net Revenue	$ 486,000
Total Company Rate Base - Utility's Estimate	$6,851,502,000
Difference in Return	.007%
Intrastate Rate Base - Utility's Estimate	$5,375,777,000
	X .007%
Adjustment in Net Revenue	$ 377,000
Net-to-Gross Multiplier (Staff's Estimate)	1.966
Adjustment in Gross Revenue	$ 740,000

(Red Figure)

* State Corporation Franchise Tax @ 1.24% x 947,000 = $12,000
Federal income tax @ 48% x 947,000 - 12,000 = $449,000
Total Tax Offset - $461,000

The amount is, of course, calculated on a twelve-month basis (the investment figures are for the middle of the test year for this application). Pacific's exact penalty, however, will be determined by itself. We will allow Pacific to petition in this proceeding for a restoration of its full rate of return when it can make a showing that its held primary and regrade service orders (including those over $2,000) have been reduced to within a normal level. In this way, our minor rate of return reduction will not serve simply as a warning by way of a financial penalty but also as an incentive to upgrade service.

There is still remaining the problem of how to translate this reduction into a rate adjustment. Based upon the Application No. 55492 test year, our calculations indicate that if the initial residence service order charge (Schedule 28-T) is reduced from $12.00 to $11.65, the revenue decrease (less settlement) for the test year in this application is approximately $761,000. Since Pacific may petition for restoration of its full return in less than a year, this is an appropriate reduction. Also, since initial installation of residence service has been a serious problem, we believe it most appropriate to place the reduction in installation costs. This will be the order.

II. OTHER SERVICE CONSIDERATIONS

Pacific requests that we not wait until our final decision until disposing of two other service considerations, in order that it may proceed to estimate its future budgets. None of the parties to this proceeding object to Pacific's request. Since the record is complete regarding such items, and since we may deal with them without lengthy analysis, we will grant this request.

Metropolitan Service Conversions

Ordering Paragraph 2(a) of Decision No. 83162 requires Pacific's upgrading of service as follows:

> "For the exchanges of Bakersfield, Fresno, Modesto, Riverside, Santa Rosa, and Stockton business one-party measured service, residence one-party measured service with a 60-message allowance, and residence one-party measured service with a 30-message allowance, shall be introduced within five years. Concurrently, business two-party flat and residence two-party and four-party flat rate services shall be withdrawn."

Pacific requests a two-year extension of time to meet this requirement (until July 1981) for the Stockton, Modesto, Fresno, and Bakersfield exchanges. Pacific's reasons for this request were outlined by its witness Mr. C. L. Wade (Exhibit 94, p. 3):

> "By extending the required date of conversion for these four exchanges by two years, Pacific will save $1 million in costs of timing equipment. This would come about since the delay would allow the reuse of equipment removed from step by step central offices in the Los Angeles area when those offices are converted to E.S.S. switching equipment. In addition, the extension would allow Pacific to defer 2-1/2 million dollars of capital expenditures until 1980 and 1981."

The effect of this deferral is that residential customers will not have 30 or 60 call measured service, and business subscribers will not have measured rate service before July 1981.

Because of the savings in capital expenditures, the staff believes the company's request is justified. We agree that the lack of availability of measured service in those areas is outweighed by a worthwhile cost saving, and we will authorize this extension.

Upgrading of Rural Service

We believe that a different result must obtain regarding Pacific's request for a two-year extension (also to July 1981) to eliminate 8-party rural and 4-party urban service in 49 exchanges (listed in Exhibit 95, pp. 4-5).

This elimination was also ordered in Decision No. 83162. Pacific's argument is that it only wishes to defer installation in 49 of 314 exchanges, which involves a deferral of 12 percent of 92,000 stations. Again, the rationale is a cost saving in capital and manpower, and the company claims that it could then concentrate on meeting the Northern Sector's "extraordinary growth" (i.e., eliminating the "held order" problem discussed above). Pacific also claims that a deferral will allow it to proceed with installation of outside plant in a more orderly manner.

We believe that this is borrowing from Peter to pay Paul. Most of the 49 exchanges which would suffer deferral are in the Northern Sector. Considering the recent history of the Northern Sector's held orders there is no reason why it is fair to that sector's ratepayers to ask them to put up with one service deferral in order to cure another.

Pacific's witness Bennett's own testimony comments: "Much of our rural plant is old and in need of rehabilitation." (Exhibit 9, p. 39.) No one is responsible for this state of affairs except the company. Pacific should take whatever reasonable steps are necessary to cure its held order problem, particularly in the Northern Sector, without retrenchments in programs which will otherwise upgrade rural service.

Directory Assistance Recording

On brief, TURN requests that we reverse our position on Pacific's use of a recording now used in certain areas, which played before the "411" caller is connected to the automatic call director, which then connects the caller to a directory assistance operator. Our position on the use of this recording was explained in our previous interim decision in this matter (Decision No. 85487 dated February 18, 1976).

TURN believes that continuation of the use of this recording is contrary to the spirit of our Decision No. 86082, in Case No. 10085,[5/] dated July 7, 1976, in which we stated our belief that directory assistance service should continue to be available without charge. This is clearly erroneous . At no time did we state that we would stop trying to find other methods to reduce unnecessary use of directory assistance, thereby passing cost savings onto the ratepayers.

5/ The investigation into proposed directory assistance charge plans, which was instituted on our own motion on April 20, 1976 in order to remove this issue from Application No. 55492 and Case No. 10001.

Preliminary information indicates that in areas where the recording is in service, directory assistance volumes have been reduced, but there is, at present, inadequate experience with it to make any solid determination regarding its value. Our final determination concerning permanent use of this recording is appropriately reserved for our final decision herein.

Findings

1. Pacific failed to meet its public service obligation under Public Utilities Code Section 451 in that it engaged in unreasonable budgetary reductions, which contributed to the problem of excessive held orders for primary and regrade service.

2. The amount of such orders held for over 60 days in Pacific's Northern Sector is clearly excessive, and remedial action should be taken, as specified in our order herein, to prevent future recurrences of this situation.

3. For Pacific's Northern Sector, a reasonable estimate for the "normal" amount of orders held for 60 days or longer is 33.

4. Present high-cost limitations for filling orders for primary or regrade service should be terminated after 30 days.

5. Pacific should be ordered to continue with its present plans for reducing the volume of held orders in its Northern Sector, as detailed on pages 16-18, above.

6. Pacific's rate of return should be adjusted downward by 0.007 percent, as more fully set out in the opinion section of this decision.

7. Pacific's request to defer certain metropolitan service conversions for two years is reasonable and should be authorized.

8. Pacific's request to defer for two years elimination of 8-party and 4-party lines in certain areas until July 1981 is unreasonable and should not be authorized.

THIRD INTERIM ORDER

IT IS ORDERED that:

1. Pacific's rate of return is reduced 0.007 percent until such time as it makes a showing on this record that its held primary service and regrade orders are within normal limits. This reduction shall be achieved by reducing the initial residence service order charge (Schedule 28-T) from $12.00 to $11.65.

2. Pacific and all telephone corporations which are respondents in Case No. 10001 shall furnish the Commission with quarterly summaries giving the Commission reasonable detail concerning primary service and regrade orders held for over 60 days, and explaining what steps are being taken to fill such orders.

3. Pacific shall not impose any high-cost limitations upon primary service and regrade orders without first applying to the Commission to do so. Any such presently existing limitations shall be terminated no later than thirty days after the effective date of this order.

4. Whenever Pacific's forecasts show that it is reasonable to assume that its 60-day-and-over held orders will exceed the normal level by 100 percent or more (on a basis of a six-month forecast), it shall file an application requesting permission to exceed such limit, and shall, concurrently with the filing of such application, take appropriate remedial action to prevent such excess.

5. Pacific and the Commission staff are ordered to furnish, for the record in this proceeding, evidence which will allow us to determine the "normal" level of held orders on a company-wide basis and for sectors other than the Northern Sector.

6. The upgrading of certain metropolitan service required by Ordering Paragraph 2(a) of Decision No. 83162 shall be completed prior to the end of July 1981.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 2nd day of NOVEMBER, 1976.

President

Leonard Ross

Robert Batinovich

Commissioners

I do not agree with the treatment of the directory assistance recording, as I believe it represent a service reduction which should have been initially brought before the Commission

Leonard Ross

I will file a dissent

William Symons, Jr.

I dissent, bad order.

Vernon L. Sturgeon

APPENDIX A

LIST OF APPEARANCES
(Interim Issues)

Applicant: Milton Morris and B. Haven Walling, Attorneys at Law, for The Pacific Telephone and Telegraph Company.

Interested Parties: Leonard Snaider, Attorney at Law, and Manuel Kroman, for the City of Los Angeles; William Shaffran, Attorney at Law, for the City of San Diego; Ann Murphy, Attorney at Law, and Sylvia Siegel, for Toward Utility Rate Normalization; Herman Mulman, for Consumers Against Utility Service Exploitation; William L. Knecht, Attorney at Law, for California Farm Bureau Federation; Robert Laughead, for the City of San Francisco; Charlotte G. Hamaker, for the Santa Clara Valley Coalition; David L. Wilner, for Consumers Lobby Against Monopolies; and Lorin H. Albeck, Attorney at Law, for General Telephone Company of California.

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

COMMISSIONER WILLIAM SYMONS, JR., Dissenting

We have in the past reserved rate of return penalties (and that is what this is, regardless of the language simply calling it a "reduction") for situations in which a company demonstrates by consistent and routine maladministration, that it is not interested in providing reasonable service, or that it cannot do so because of management incompetence which the utility is reluctant to correct. (Compare General Telephone Co. D.75873 (1969) 69 CPUC 601; Citizens Utilities Company of California D.76996 (1970) 70 CPUC 799; Washington Water and Light Company D.83020, April 4, 1972; California American Water Co. D.86249, August 17, 1976)

The facts in this case do not fit this mold. I see nothing sinister about a utility reducing its budget in order to protect its times-interest coverage, nor in publicly announcing this objective to its stockholders. Taking action to protect the ability to finance improvements benefits the ratepayer at least as much as the stockholder.

The admittedly tight budget management over the period in question would have caused no problem whatsoever, had not an unprecedented population growth occurred in Pacific's Northern Sector. This growth pattern was so out of phase with past trends that no amount of good-faith forecasting could have predicted it. This, as the company witness Mr. Sullivan's testimony shows, is the real cause of the problem. The majority of the Commission uses hindsight to fine Pacific $740,000 for the outcome. Only when time machines become a reality will such treatment be justified.

I certainly do not argue that the situation in the Northern Sector is satisfactory and that the Commission should do nothing about it. We have ordered Pacific to continue its program to reduce the amount of held orders to a normal level. This order, if not carried out within a reasonable length of time, could form a basis for contempt proceedings at a later date as matters warrant. This resolution avoids unfair treatment of the utility and at the same time accomplishes a realistic approach to solution of problems in ratepayer service.

San Francisco, California
November 2, 1976

William Symons, Jr.
WILLIAM SYMONS, JR.
Commissioner