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ORIGINAL

Decision No. 86802

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of CONTINENTAL TELEPHONE COMPANY OF CALIFORNIA, a California corporation, for authority to increase its rates for telephone service.	Application No. 55376 (Filed December 12, 1974)

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Scott LeFaver, for the City of Gilroy; Fred Wilken, for the People of Sanger; and Jerry Fuchs, for Gilroy Dispatch; protestants.
William L. Knecht and William H. Edwards, Attorneys at Law, and Ralph O. Hubbard, for the California Farm Bureau Federation; Neal C. Hasbrook, for the California Independent Telephone Association; and Brundage, Beason, Reed, Pappy & Hacley, by Jeff Pesses, Attorney at Law, for the International Brotherhood of Electrical Engineers; interested parties.
Lionel B. Wilson, Attorney at Law, Kenneth Chew, and George A. Amaroli, for the Commission staff.

OPINION

Background

Continental Telephone Company of California (Continental) seeks approximately $15.6 million in additional revenue. Of that amount Continental has already received approximately $6.20 million in interim rates (D.84662 dated July 15, 1975; D.85252 dated December 16, 1975; D.85293 dated December 30, 1975). Continental is a subsidiary of Continental Telephone Corporation (CTC) which owns 99.6 percent of its common equity. CTC owns numerous telephone operating companies in 41 states, Canada, and five other foreign nations. It also has manufacturing, service, and leasing subsidiaries. Continental performs most of its telephone service in California. However, it also has some operations in Nevada and Arizona. The California operation consists of 78 exchanges scattered throughout the state, largely in rural areas.

The application alleges that there is a serious downtrend in return on common equity justifying higher rates. It asserts that substantial recent investments and the need for expansion and upgrading of service would complicate financing problems if rate relief is not given. Applicant relies heavily on the fact that it uses accelerated depreciation with flow-through and therefore has less opportunity to protect minimum interest coverage requirements than companies which normalize. It requests authorization to change to normalization. More specifically, applicant claims that it needs to sell $10 million of bonds annually to finance its planned plant requirements, and that it would face difficulties in selling these bonds at reasonable rates of interest if it is deprived of adequate common equity earnings. It also asserts that increasing costs of toll operations, despite improvements in separations procedures and increased volume, depress earnings on toll operations. It seeks a return of 14-1/2 percent on common equity.

Continental's exchange rates are now set at varying levels. It requested authority to place all basic exchange rates on a uniform statewide basis at $8.60 per month for residential individual service and at $19.75 per month for individual business service with corresponding changes in multi-party service.

Applicant is the product of several mergers of smaller independent telephone companies in various locations in the state. Its last rate proceeding, A.52859, A.52805, and C.9296 three years ago, was the first general rate case for Continental in its present form. The principal issues in that proceeding were determined by D.81896 (September 25, 1973) as modified by D.81988, D.82076, and

D.82888. The Commission therein found that the existing rates produced enough revenue after adjustments so that applicant's return was well within the rate of return range alleged by Continental to be reasonable. The Commission therefore denied any general revenue increase; however, there were several minor local reductions and increases intended to reduce the disparity between exchange rates.

One of the specific requests in that proceeding, as in this, was a proposal for uniform rates throughout applicant's exchanges. Because of the decision not to significantly alter rate of return only a few minor changes in exchange rates were made; most of the inter-exchange differences remained.

Interim Relief

D.84662, issued in this application on July 15, 1975, determined that applicant needed to issue substantial amounts of debt securities to roll over its existing short-term financing, and found that applicant's recent earnings were insufficient to meet generally accepted interest coverage tests. In order to raise the coverage ratio sufficiently to permit the sale of bonds, an interim rate increase, subject to refund, was granted in the form of a surcharge of 9.06 percent on exchange rates as well as on all intrastate toll bills rendered by applicant. The increase was intended to produce $1.657 million in revenue.

Continental petitioned to modify that decision. It claimed that the rate relief given was insufficient because of an unrealistically optimistic toll revenue estimate adopted at the urging of the Commission staff. It claimed that a revenue shortfall had forced it to postpone the bond issue and that serious consequences had been averted only because the short-term lender had been persuaded to grant a short extension. Continental projected a further deterioration in earnings, despite a drastic cost reduction effort conducted at the risk of service deterioration.

This included the postponement of significant new construction and laying off both salaried and wage-earning employees. It also sought modification of the refund condition that had been attached to D.84662. It claimed that it needed $1.853 million in revenue, in addition to that already granted, by March 31, 1976 to permit timely issue of the debt securities. D.84924 dated September 16, 1975 overruled a staff motion to dismiss the petition. After further hearings D.85252 dated December 16, 1975 granted further rate relief. This relief could be characterized as a partial general rate increase because it was issued after complete hearings, including cross-examination of all witnesses. While the decision did not attempt to resolve the disputes between the parties over rate of return and rate design, the rate level chosen was intended to give applicant the minimum amount of relief not subject to substantial dispute. Because of the deferral of the rate design issue, this amount of relief was spread by means of a surcharge on exchange and on applicant's intrastate toll billings as before. D.85252 increased the surcharge to 27.33 percent, subject to refund, and was designed to produce revenues of $9.4 million annually, including the $1.657 previously found justified.

In a separate proceeding (Application of Pacific Telephone and Telegraph Company, A.55214 and C.9832, D.85287) the Commission established new, higher statewide toll rates. In that decision the Commission recognized that the new statewide toll rates would provide an extra $3.2 million dollars in toll settlements to Continental. The Commission subsequently issued D.85293 dated December 30, 1975 which reduced Continental's surcharge by an amount necessary to offset this additional $3.2 million.

Continental offered to stipulate to certain issues for the purpose of this proceeding in order to avoid extensive litigation and hearing time on results of operations. The Commission accepted the stipulation for the purpose of the interim decisions and will adopt the stipulated results of operations for this decision.

Applicant's exhibits on results of operations for test year 1975 were prepared in the fall of 1974 based on its 1975 budget. The staff's results of operation evidence reflected more current information as well as the impact of various affiliated adjustments. The staff's results of operations presentation, including the affiliated adjustments proposed by the utilities division, showed a rate of return on total California operations at present rates without surcharge, of 6.76 percent or 0.02 percent higher than the comparable rate of return reflected in applicant's exhibits. The principal differences between applicant's and staff's showings were a lower staff estimate of toll service revenue, combined with a lower estimate of operating expenses based on later information. The staff disallowed certain expenses asserted to be excessive or unsupported.

It was applicant's position that the lower staff estimates of 1975 operating revenue were essentially correct but that staff adjustments or disallowances in operating expenses were incorrect; it was applicant's position that all payments to affiliates should be allowed in full.

Applicant's stipulation in large measure was motivated by its belief that protracted hearings testing the validity of the estimates made by applicant and staff and the propriety of the ratemaking adjustments proposed would not be productive in view of the fact that the rates of return at present rates according to both parties are essentially identical. Table 1 below sets forth in comparative form the original showing of applicant, the staff results of operation, and the showing to which applicant was prepared to stipulate for purposes of this proceeding. The Commission adopted the proffered stipulated results of operations as the basis for the surcharge adopted in D.85252. Table 2 separates the stipulated results by function.

TABLE I

Continental Telephone Company of California
Summary of Earnings Based on Utility and Staff Estimates
Estimated 1975 at Present Utility Rates
Total California Operations

(Dollars in Thousands)

Item	Utility 1975	Staff 1975	Utility Stipulated 1975	
Operating Revenue				
Local Service	$ 15,011	$ 16,415	$ 16,415	
Toll Service	56,200	49,027	49,027	
Miscellaneous	1,898	1,926	1,926	
Subtotal	73,109	67,368	67,368	
Uncollectibles	476	330	330	
Total	72,633	67,038	67,038	
Operating Expenses				
Maintenance	14,097	13,642	13,642	
Traffic	8,175	7,817	7,817	
Commercial	4,321	4,072	4,072	
Gen. Off. Sals. & Exps.	6,728	5,270	5,340	
Other Operating Exps.	2,494	2,840	2,840	
Subtotal	35,815	33,641	33,711	
Depreciation	14,236	13,921	13,921	
Taxes Other Than on Income	7,294	6,878	6,878	
Taxes Based on Income	638	(1,609)	(1,569)	(1)
Subtotal	22,168	19,190	19,230	
Adjustment - Wage Increase	-	294	294	
Adjustment - Affiliates	-	(359)	(349)	(2)
Total	57,983	52,766	52,886	
Net Operating Revenue	14,650	14,272	14,152	
Weighted Average Depreciated Rate Base				
Unadjusted	217,306	213,924	213,924	
Adjustment - Affiliates	-	(2,684)	(2,677)	(3)
Adjusted	217,306	211,240	211,247	
Rate of Return	6.74%	6.76%	6.70%	

(Reduction)

(1) Includes 1975 Tax Act additional investment credit on ratable flow through.

(2) Composite expense effect for operations of all affiliates.

(3) Composite rate base effect for operations of all affiliates.

TABLE 2

Continental Telephone Company of California
Separated Summary of Earnings Utility Stipulated
Year 1975 Estimated Present Rates

(Dollars in Thousands)

Item	Total Calif.	Interstate	Total Intrastate	Total State Toll	State Message Toll	State Private Line	Total Exchange
Operating Revenues	$ 67,368	$13,726	$ 53,642	$ 35,301	$ 34,492	$ 809	$18,341
Uncollectibles	330	67	263	173	169	4	90
Revenues After Unc.	67,038	13,659	53,379	35,128	34,323	805	18,251
Total	67,038	13,659	53,379	35,128	34,323	805	18,251
Operating Expenses							
Maintenance	13,797	2,755	11,042	7,020	6,620	400	4,022
Traffic	7,928	1,530	6,398	4,862	4,857	5	1,536
Commercial	4,100	487	3,613	1,459	1,435	24	2,154
Gen. Off. Sal. & Exps.	5,340	981	4,359	2,826	2,738	88	1,533
Other Operating Exps.	2,840	555	2,285	1,520	1,485	35	765
Subtotal	34,005	6,308	27,697	17,687	17,135	552	10,010
Depreciation & Amort.	13,921	2,575	11,346	6,971	6,665	306	4,375
Property & Other Taxes	5,500	1,030	4,470	2,791	2,662	129	1,679
Payroll Taxes	1,378	255	1,123	772	754	18	351
State Income Tax	56	118	(62)	88	130	(42)	(150)
Federal Income Tax	(1,625)	222	(1,847)	(525)	(277)	(248)	(1,322)
Aff. Int. Exp. Adj.	(349)	(66)	(283)	(175)	(168)	(7)	(108)
Net Operating Expenses	52,886	10,442	42,444	27,609	26,901	708	14,835
Net Operating Revenues	14,152	3,217	10,935	7,519	7,422	97	3,416
Rate Base							
Tel. Plant in Svc.	249,591	46,723	202,868	126,667	120,802	5,865	76,201
Tel. Plnt Under Constr. N.I.B.	3,779	709	3,070	1,940	1,840	100	1,130
Materials & Supplies	3,088	519	2,569	1,463	1,405	58	1,106
Working Cash	2,864	533	2,331	1,495	1,449	46	836
Less Dep. Res.	45,302	8,612	36,690	23,108	21,971	1,137	13,582
Less Tax Def.	96	18	78	51	49	2	27
Subtotal	213,924	39,854	174,070	108,406	103,476	4,930	65,664
Aff. Int. R/B Adj.	(2,677)	(506)	(2,171)	(1,350)	(1,296)	(54)	(821)
Total Rate Base	211,247	39,348	171,899	107,056	102,180	4,876	64,843
Rate of Return	6.70%	8.18%	6.36%	7.02%	7.26%	1.99%	5.27%

(Red Figure)

Applicant emphasizes that its stipulation to the staff results of operations should not be taken as agreement with any of the affiliated adjustments made by staff. It takes the position that its relationship with affiliates is just and reasonable and that no adjustments should be made. It has reserved the right to dispute in any subsequent proceeding, any of the affiliated adjustments, or other ratemaking adjustments incorporated in the staff showing herein.

With respect to the treatment for ratemaking purposes of investment tax credit, applicant's offer to stipulate does not require final determination by the Commission. For the purpose of determining the stipulated results of operation the 4 percent investment tax credit available under the Internal Revenue Code since 1971 has been flowed through to consumers. While accepting this method of accounting for the credit for the purpose of this proceeding only, applicant reserves the right to renew its request for authority to normalize.

The additional 6 percent investment tax credit available to applicant under the Tax Reduction Act of 1975 has been treated in the stipulated results of operations according to the ratable flow-through method of accounting which was elected by applicant under the applicable provisions of Section 46(f) of the Internal Revenue Code as amended by the Tax Reduction Act of 1975. The staff does not agree with this method of accounting for the additional investment tax credit and challenges the election.

In this proceeding, however, the difference between the two methods of accounting for the additional investment tax credit is relatively insignificant. The federal income tax expense reflected in the stipulated results of operations would be only approximately $40,000 less and the net operating revenue approximately $40,000 greater if the additional 6 percent investment tax credit were flowed-through to net income. It is therefore applicant's position that the Commission may adopt the stipulated results of operation without making any final determination of the propriety of the election made by applicant under the Tax Reduction Act of 1975.

In view of the small dollar amount involved we do not believe this question is a material issue. Adoption of the summaries of earnings and the findings and conclusions set forth below are not indicative of a precedent or a final decision on these tax matters.

Rate of Return

The only issue presented to the Commission on the subject of rate of return is the appropriate allowance on Continental's common equity. In its brief Continental has stated that it had no objection to the Commission's adopting the capital structure and embedded cost of senior securities proposed by staff.

Continental seeks a rate of return in the range of 9.9 percent to 10.1 percent which would allow it to realize about 14 percent to 14-1/2 percent on its common equity. The staff, on the other hand, recommends a rate of return in the range of 9 percent to 9.3 percent which would allow Continental to realize about 11.70 percent to 12.45 percent return on common equity. Based on the staff recommendation the after-tax interest coverage for debt would be about 2.39 to 2.47 times, as compared to approximately 2.51 times under applicant's common equity recommendation. Using the stipulated estimates of revenue, expenses, and rate base for the 1975 test year, a 1/10 of 1 percent change in the rate of return on intrastate operations would change the total revenue requirement by about $365,100. Thus, there is a $2,920,800 difference between the staff and Continental based upon a difference of 0.80 percent in the rate of return recommendation (10.1% - 9.3%).

The staff's rate of return witness presented a study which consisted of 26 tables related to interest rates, earnings, capital structure, and other data pertaining to growth in net telephone plant investments. Trends and five-year averages for the years 1970-1974 were shown in a form which compared Continental's operating results with averages developed for 10 independent telephone companies, six General Telephone system companies, seven Bell system companies, General Telephone Company of California (General) and The Pacific Telephone and Telegraph Company (Pacific). Other tables set forth general trends in interest rates, bond yields, and the development of embedded cost of debt and preferred stock for Continental. The study contained interest coverage comparisons with the other selected utilities. Data regarding common stock equity, dividends, and earnings for Continental and for the selected telephone utilities were shown. A ten-year summary of Continental's capital structure and comparisons of earnings on total capital experienced by the selected utility groups were also set forth. Information pertaining to average net plant investment, operating revenue, expenses, and net operating income for Continental and the other selected utilities was presented. The final two tables related to the applicant's projected capital structure and the rate of return recommendation.

In his concluding statement to the Commission on direct testimony, the witness, after discussing many of the factors he considered in making his recommendation stated:

> "I believe that the earnings allowance for common stock equity produced by my recommendation would result in fair rates for subscribers and provide a reasonable return to holders of the applicant's common stock. A rate of return is reasonable if it supplies funds sufficient to service the company's senior securities and produces a common equity allowance which would permit moderate increases in retained earnings after a suitable dividend to common stock holders. I believe that a rate of return within my recommended range of 9.00% to 9.30% would achieve these objectives."

In reaching his recommendation for rate of return, the witness carefully considered the impact on debt coverage and financing. He indicated that a prudent investment strategy for applicant would balance equity and debt financing in order to reduce the severity of potential coverage problems. He claimed that strengthening the equity position at this time would be prudent notwithstanding the higher return allowed equity capital, since too much reliance on debt could cause the company to be more vulnerable to unfavorable changes in the economic cycle. Under such circumstances, the tax advantages derived from selling more debt could be offset by higher embedded interest costs and probable lower earnings, resulting in further requests for rate relief and even higher common equity allowances in order to improve interest coverage.

The witness contended that it was realistic to compare with other telephone utilities rather than other types of businesses since the latter are not public utilities which experience business and financial risks similar to those of the applicant. On the other hand, he claimed the business and financial risks of industrial enterprises differ considerably from those confronting public utilities because of the cyclical nature of the industrials' earnings and the generally higher proportions of common equity in their capital structure. Regulated monopolies can request rate relief when their earnings decline, thus, limiting their investors' risks; investors in industrial enterprises enjoy no such protection.

One of the staff tables reveals that, although Continental's earnings rate on common equity declined in 1974, Continental's times earned coverage compares favorably with similar telephone utilities. Another indicates that Continental's five-year average earning rate was higher than the other selected telephone utilities. A third shows that the trend of increases in applicant's operating revenues through 1974 compares favorably with the other companies.

Applicant contends that, "If the midpoint of Mr. Leonard's recommended range of common equity allowance is used, that recommendation would produce a return on common equity lower than that found reasonable by the Commission in 1972." (Continental's last rate proceeding, D.81896, supra.) This argument must be rejected; the staff witness, who was also the staff rate of return witness in that proceeding, then recommended a rate of return ranging from 7.70 percent to 8.00 percent as reasonable, which would have produced a common equity allowance of 10 percent to 10.80 percent. (It should be noted that applicant's rate of return recommendation in that proceeding produced a return on common equity ranging from 12.25 percent to 12.75 percent.) His present recommendation for allowance on common equity recognizes that the cost of equity has increased.

Continental's rate of return recommendation was presented by a professor of finance and business policy at a midwestern university. The witness' recommended range for the cost of Continental's common equity was derived from the "opportunity cost of capital" method or what has been called the "comparable earnings" approach. This approach reasons that inasmuch as applicant must compete for capital with both the regulated and industrial sectors of our economy, this Commission must set rates for Continental based on whatever the market demands as the cost of equity.

His comparisons were compiled from the Federal Power Commission's Class A & B Electrics, Moody's 125 Industrials, and Standard & Poor's 425 Industrials. He then determined the average return from these groups for two-time periods, 1946-1974 and 1965-1974, and found applicant's cost of equity to be slightly higher than those developed from his comparisons.

While this method is simple and direct, it gives no reliable indication of a reasonable return for Continental. This Commission has in prior rate decisions commented on the difficulty of measuring the rate of return on the basis of average earnings on book value of corporations facing different risks. (See General Telephone Co. of California (1969) 69 CPUC 601.) The Commission concluded that any analysis of return which relies significantly on earnings of a different industry must recognize that such earnings are not comparable to telephone utility earnings in the degree of risk involved.

This concern has been shared by the Federal Communications Commission and by other regulatory bodies. In American Telephone and Telegraph, (1967) 9 FCC 2d 30, 79, the FCC found that "the earnings of manufacturing companies do not provide a useful or reliable measure in fixing return to be allowed respondents herein." In Federal Power Comm. v Hope Natural Gas (1943) 320 U.S. 591, the U.S. Supreme Court expressed the governing principle thus:

> ". . . The return to the equity holder should be commensurate with returns on investments in other enterprises having corresponding risks. That return moreover should be sufficient to assure confidence to the financial integrity of the enterprise, so as to maintain its credit and to attract capital" (Emphasis added.)

This witness' comparison list in our judgment contains numerous companies whose equity holders face substantially higher risks than do Continental's. No sufficient attempt was made to adjust their rates of return for risk differentials. Thus, applicant's study cannot be relied on. We will adopt the low end of the staff's rate of return (9.0 percent) as the rate of return for applicant's exchange operations. That rate of return shall be applicant's overall rate of return.

Rate Spread

The staff rate spread proposal was designed to allow the Commission to select one of several alternative levels of exchange rates producing between $0.99 and $3.8 million in additional exchange revenue. The alternates were stepped in even gradations, the fifth of six steps, for example, would produce $3.36 million which corresponds to an exchange rate of return of 7.9 percent.

The table below shows present and proposed exchange rates of applicant and two other major California telephone utilities, contrasted with the staff's recommended alternate rate spreads:

Comparative
Basic Exchange Rates
As of May 6, 197[illegible]

Item	Present: General	Present: Pacific	Present: Continental	Utility Proposed: General 1/	Utility Proposed: Pacific 2/	Utility Proposed: Continental	Staff Alternate Proposals: 1	Staff Alternate Proposals: 2,3,4	Staff Alternate Proposals: 5	Staff Alternate Proposals: 6	Applicant's Alternate Proposals: A	Applicant's Alternate Proposals: B	Applicant's Alternate Proposals: C	Applicant's Alternate Proposals: D
Residential														
1 FR	$ 5.95	$ 5.70	$3.50-$4.75	$ 6.00	$ 6.50	$ 8.60	$ 4.75	$ 4.75	$ 5.00	$ 5.25	$ 6.00	$ 6.50	$ 7.00	$ 7.50
2 FR	5.25	4.75	3.00- 3.95	5.30	5.45	7.80	3.95	3.95	4.05	4.25	4.85	5.25	5.65	6.10
4 FR	4.15	3.85	2.75- 3.35	Disc	4.40	6.45	3.35	3.60	3.75	3.95	4.50	4.90	5.25	5.65
SUB	5.25	4.35	2.50- 3.80	5.30	4.90	6.95	3.80	3.95	4.05	4.25	4.85	5.25	5.65	6.10
Key Trunks	5.95	5.70	4.00- 4.75	6.00	6.50	12.90	4.75	7.15	7.50	7.90	9.00	9.75	10.50	11.25
Business														
1 FB	13.20	14.55	5.75- 9.60	13.35	16.60	19.75	9.60	10.50	11.50	12.10	13.80	14.95	16.10	17.25
2 FB	10.50	10.75	5.15- 7.45	10.65	12.25	16.70	7.45	8.80	9.25	9.75	11.10	12.00	12.95	13.90
SUB	10.50	9.75	4.35- 7.40	10.65	11.10	14.20	7.40	8.80	9.25	9.75	11.10	12.00	12.95	13.90
Key Trunks	13.20	14.55	5.95- 9.60	13.35	16.60	29.65	9.60	13.80	14.50	15.20	17.40	18.85	20.30	21.75
PBX Trunks	19.80	21.85	9.40-14.40	20.00	23.60	39.55	14.40	21.85	23.00	24.15	27.60	29.90	32.20	34.50
Semipublic	7.65	6.80	2.90- 4.80	7.80	8.50	12.90	4.80	7.10	7.50	7.90	9.00	9.75	10.50	11.25
Annual Gross Revenue Increase (In Thousands of Dollars)							821	1,483	1,869	2,284	3,565	4,423	5,277	6,145

1/ A.55383
2/ A.55492 Amended

A 55376 b1

The rate spread set forth in the "Utility Proposed" column is that contained in the application. When added to the proposed move and change charges and other rate elements discussed below, it would produce the full $10.6 in exchange rate relief sought by applicant. (Applicant sought an additional $5.0 million in additional toll revenue.) Applicant's Alternate Proposals A through D are intended to be used if the Commission grants less than the full $10.6 million. For example, the spread in Alternate A, when added to the move and change charges and other elements, produces added revenues of $5.1 million and an exchange rate of return of 8.96 percent. Alternate B produces added revenues of $6.0 million and an exchange rate of return of 9.61 percent.

Staff and applicant agree on most of the elements of rate spread. There is, however, a dispute between staff and applicant over the degree to which the basic exchange rates must be raised to meet the necessary revenue requirement.

It is staff's position that the principal burden of Continental's revenue requirement should be met by placing a substantial surcharge on all of applicant's billed intrastate toll. The adoption of this recommendation by the Commission would assertedly comply with a tradition that the rate of return on basic exchange services should be lower than the intrastate toll rate of return.

The staff recommendation is based on several considerations. One is that toll is a much more risky business activity than basic exchange services and therefore demands a higher return. A second reason is that Continental's toll revenues have had a steady and continuous growth over the years, and have slackened only recently due to the recession. This continuous growth factor indicated to staff that Continental's present toll rates, even though they yield a higher rate of return, are acceptable to the general public, and that, as the economy returns to normal, Continental will again experience its historical growth in toll usage.

Staff also believes that by the adoption of its rate spread, the economic impact on subscribers can be lessened. A customer who needs basic telephone service has no control over the basic monthly expense for that service. With respect to toll charges, however, the customer makes the determination whether he can afford a specific toll call. Thus, by placing a greater burden on toll charges, the customer is left with a greater control over the cost of his telephone service. Moreover, the customer is, according to staff, more likely to accept a rate increase if the basic exchange rates are kept low than if these rates were raised to the level proposed by applicant.

Another reason the staff urges is that once the settlement effects of Pacific's rate case become known, it would be easier to make an adjustment to a surcharge to offset the additional toll settlement revenues that will flow to Continental, rather than adjust Continental's basic exchange rates.

The Commission has been faced with this issue previously and has stated:

> "Applicant's interchanged California intrastate toll service is furnished at rates filed with the Commission by the Pacific Telephone and Telegraph Company. The Commission in its Decision No. 56652 dated May 6, 1958, among other things, increased toll rates generally throughout California effective June 1, 1958, and stated that a rate of return on 7.7 percent would result from such business. Said decision also stated, in part, 'Applicant (Pacific Telephone) is the tariff filing utility for toll service generally throughout the state and accordingly has the obligation and responsibility of seeing that each of the connecting independent telephone companies receives its costs

> and a fair return on the plant devoted to the service.' In view of the action taken in said decision, of which we take official notice, we find that applicant is entitled to receive its costs including a fair rate of return on its plant devoted to interchanged intrastate toll operations. Applicant should not expect to offset any deficiencies in intrastate toll earnings by increases in local exchange rates, but should seek revision of its settlement contracts. In accordance with the provisions of Section 766 of the Public Utilities Code, if utilities do not agree upon the division between them of joint charges, this Commission, after hearing, may establish such division by order." (California Water and Telephone Co. (1959) 56 CPUC 742,746.)

It is applicant's position that the bulk of its revenue requirement should be met by raising the level of basic exchange rates and that a comparatively small toll surcharge be adopted. This position was presented by an assistant vice president of the Service Corporation, who is responsible for all rate case activities, tariffs, and revenues in the Western Region of Continental Telephone Corporation. The proposed rate increases in basic exchange services are needed, according to the witness as a result of Continental's recent experience of declining toll revenues.

Continental's rate spread witness argued that a too-high surcharge on toll would cause a diminution in toll usage by its customers. This repression in toll usage in turn could cause a reduction in the amount of plant allocated to toll service which in fact determines toll settlements. Such a reallocation of plant would also cause applicant's rate of return on basic exchange service to drop. Thus, Continental argues, it is possible that it would not realize its necessary toll revenue requirements if the staff rate spread were adopted.

Applicant claims that the staff arguments do not justify exchange rates far less than those of other California telephone utilities, especially when this effect is made possible only by very large subsidy from a toll surcharge.

Applicant has not directly challenged the principle that less necessary telephone services should to some extent subsidize more necessary services. As a general principle that theory is unobjectionable. We cannot, however, apply that principle, where a substantial toll surcharge is required to permit the continuation of exchange rates far lower than neighboring telephone utilities.

Any final relief which leaves Continental's toll rates above those applicable in other areas of the state violates the traditional policy of uniform statewide toll rates. Any such arrangement would likewise be a direct challenge to the finding of reasonableness underlying the contemporary statewide toll rates. Since the agreed-upon formula for dividing toll revenues is presumed to accomplish a reasonable division of pooled revenues (Section 766, Public Utilities Code), there is no logically defensible way that the Commission can permanently establish higher toll rates in one part of the state.

Fixing the toll rates for one company at levels higher than those charged by neighboring companies will cause practical problems. Beside the general repressive effect it would depress toll calls originating from Continental's service territory and encourage calls from outside the territory. Further it would complicate Continental's consumer relations; it would be very difficult indeed to convince a layman that a call from Victorville to San Francisco should cost 10 or 20 percent more than one from San Francisco to Victorville. The Commission recently questioned a similar directional rate differential as "an anomalous result, if indeed not an unduly discriminatory one". (App. of General Telephone Co. Etc., D.85740 in A.53935 (1976).)

The highest exchange rates recommended by staff produce an exchange rate of return of 7.98 percent, far lower than that concededly necessary for overall company operations. This result is palatable only if the unusually low exchange rates are subsidized by a significant toll surcharge. No staff witness would advance an opinion that such a low figure was a reasonable rate of return for an exchange operation.

Staff asserts that the extraordinarily low exchange rates subsidized by a toll surcharge, are necessary to protect some ratepayers who are particularly vulnerable to inflation. The objective is praiseworthy but the details are worked out in a hit-or-miss fashion, so that a surcharge shared by residential customers contributes to a subsidy shared by businesses. Furthermore, the staff has given no reason why this surcharge justification should be applied only to one telephone company. This problem area should be dealt with by a lifeline rate or some analogous solution, not by a toll surcharge.

Thus, none of the staff arguments are sufficient to override our strong preference for the principle of uniform statewide toll rates. We are not ready to declare this principle to be immutable; it is, however, so fundamental that it should be breached only for the most compelling reasons.

Applicant's support of a toll surcharge was reluctant and based on anxiety over a low toll rate of return rather than on principle. Since the close of this record the Commission approved new higher statewide toll rates (Re PT&T, D.85287 dated December 30, 1975 in A.55214). Nothing in this record would warrant a conclusion that those new rates are unreasonable for applicant alone out of all the participating utilities. If there are grounds to challenge the reasonableness of those rates the proper remedy is either new statewide rates or a proceeding under Section 766, Public

Utilities Code, to modify the settlement agreement, not a toll surcharge. Existing toll rates will therefore be presumed reasonable.

While we will separately find a rate of return for the company as a whole (9.0 percent), this is done to serve as a basis for disposing of the question of refunds and to set a rate of return for future operations. Realistically, applicant's true rate of return for the future will be a composite of the exchange rate of return set here and the toll rate of return set in the next statewide rate proceeding. Since toll accounts for approximately 70 percent of applicant's revenues, the exchange rate of return is a comparatively insignificant issue to applicant even though it is of major significance to applicant's customers.

We note that intercompany comparisons are one of the considerations specifically required in telephone rate proceedings (Section 827, Public Utilities Code). It was also one measure of rate reasonableness frequently referred to by customers who participated in the local hearings.

The approach we have followed produces exchange rates comparable to other California telephone utilities. This, in our opinion, provides a useful validation of the adopted rate of return, of the adopted rate spread, and the stipulated results of operation.

The exchange rates adopted, added to those minor rate increases discussed below, will produce $5,129,000 more in annual revenues than the rates in effect when this application was filed. However, it should be noted these rates produce annual revenues less than the surcharged rates now in effect; the difference is over $1,000,000 per year. The table compares requested increases with the revenue increase which will be authorized.

	Requested Increase	Adopted Increase
Individual, Party Line, Suburban, Key and PBX Trunks, and Semi-Public Phones (including 1975 station growth)	$ 9,331,293	$4,041,000 1/
Pay Station Service	78,245	-
Foreign Exchange Service	5,685	-
Vacation Rate and Employees Service	65,617	11,000
Move, Change, and Connection Charges	1,029,716	1,043,000
Radiotelephone	83,112	31,000
Total	$10,593,668	$5,126,000
Toll	5,000,000	-
Total	$15,593,668	$5,126,000
Toll settlement revenues from D.85287, supra	-	3,200,000
Total		$8,326,000

1/ This figure includes:

Basic Exchange Rates	$3,565
EAS, SRA, and Zone rates	20
Extension Telephones	67
Rotary Lines	8
PBX and Obsolete Equipment	188
Total	$3,848
+5% Station Adjustment	193
Total	$4,041

Effective control of toll rates, which provide over 2/3 of applicant's total revenues, is properly a function of a statewide proceeding. Since the bottom of the staff's recommended rate of return range, applied to applicant's exchange rate base and exchange expenses produces rates comparable to other California telephone utilities, we will select that figure, 9.0, as the adopted rate of return. The statewide toll rates carry a strong presumption of reasonableness; neither party has carried the heavy burden required to justify one company charging its customers higher toll rates as a permanent measure.

We conclude that a composite rate of return resulting from the exchange rates set herein and toll rates set in Pacific's proceedings will be reasonable for applicant's operations.

Impact on Typical Customers

Applicant's present exchange rates for one-party residential service, without surcharge, range from $3.50 to $4.75. The new uniform exchange rate will be $6 instead of applicant's proposed $8.60 rate; however, when this goes into effect the present 18.25 percent surcharge will be eliminated. Thus, some customers will have a 7 percent increase in exchange rates while others will be increased as much as 45 percent. The cost of making a toll call from Continental's service area will be reduced by the elimination of the present 18.25 percent surcharge.

Present single-party business rates range from $5.75 to $9.60. These will be raised to $13.80, offset by termination of the surcharge. The net increase will thus range from 22 percent up to 103 percent. The business customer will experience the same reduction in the cost of toll calling as the residential customer. (In some exchanges there will be an additional EAS or SRA charge, discussed below.) This contrasts with applicant's original request for a uniform $19.75 business rate together with a substantial toll surcharge.

Other Rate Items/EAS and SRA Increments

When a billed number in question is within an exchange having Extended Area Service or is within a Special Rate Area within an exchange, there are uniform statewide increments to be added to otherwise applicable exchange rates, in consideration of the extra value and cost of the service provided. These normal increments have not yet been fully applied to Continental because its last rate case determined that no general increase in revenue was required. We will order full implementation; this will increase annual revenue by $20,000.

EAS Rate Increment Table

Main Station Ratio				Toll Rate Mileage Band							
				A		B		C		D	
				9-12		13-16		17-20		21-25	
Group	Small Exch. Over	Large Exch. Up To	Exch.	Bus.	Res.	Bus.	Res.	Bus.	Res.	Bus.	Res.
1	0	0.15	Small	$1.75	$0.60	$2.50	$0.85	$4.00	$1.35	$6.00	$2.00
			Large	0.25	-	0.35	-	0.45	-	0.55	-
2	0.15	.50	Small	1.20	.40	1.80	.60	2.70	.90	4.00	1.35
			Large	.60	.20	.75	.25	1.35	.45	1.95	0.65
3	.50	.80	Small	1.05	.35	1.65	.55	2.40	.80	3.60	1.20
			Large	.75	.25	.90	.30	1.65	.55	2.40	0.80
4	.80	1.00	Small	.95	.30	1.35	.45	2.10	.70	3.00	1.00
			Large	.90	.30	1.20	.40	1.95	.65	3.00	1.00

EAS Increments for individual, party, and surburban services are the same within a given exchange for all business and residence lines and are these shown in the above table. The increments on semipublic paystations, PBX trunks, and key system trunks are multiples of 0.75, 2, and 1.25, respectively, of the applicable increment for individual lines.

Extensions

Present extension rates are $1 for residence and $1.75 for business. A $0.25 increase will place Continental's business extension rates at the same level as Pacific's flat rate business extension rate and will produce an increase of $67,000. It is adopted.

Rotary Lines

Continental imposes a $0.50 charge for rotary lines associated with key sets. No parallel charge is made for rotary lines installed with PBX equipment. Continental proposes to make the charges uniform, and staff concurred. The annual revenue increase will be $8,000; it is adopted.

PBX and Obsolete Equipment

Continental's cost studies support a 30 percent increase in these items. Staff concurs. The revenue increase will be $188,000; it is adopted.

Vacation and Employee Rates

Both vacation and employee rates are 50 percent of the basic exchange rates. No change in rate level is proposed by either staff nor applicant.

Continental proposes that the maximum vacation rates be standardized to allow a maximum of six months; the staff concurs, with the proviso that the rate should not be available for less than one month nor more than once in a twelve-month period.

The revenue impact of applicant's modification is an $11,000 increase; it is adopted.

Move and Change Charges

A proposed increase in such charges only partially offsets increased labor costs. The staff concurs. The increased revenue will be $85,000; it is adopted.

Service Connection Charges

Continental proposed a more than 100 percent increase in service connection charges. Staff's rate spread was given in three alternatives depending on the overall revenue requirement adopted. Alternate No. 3 was an approximate 100 percent increase which would raise the service connection charges to levels comparable to similar charges of General and Pacific. The table below compares the various alternatives.

Service Connection Charges

Item	Present	Proposed Continental	Staff Alternate Proposal 2	Staff Alternate Proposal 3	Staff Alternate Proposal 6
Not in Place-Business					
Each Primary Station	$20.00	$45.00	$30.00	$40.00	$45.00
Each PBX Line	20.00	45.00	30.00	40.00	45.00
Each PBX Station	7.00	18.00	12.00	14.00	18.00
Each Extension Station	7.00	18.00	12.00	14.00	18.00
Not in Place-Residence					
Each Primary Station	12.00	30.00	20.00	25.00	30.00
Each Extension Station	5.00	15.00	8.00	10.00	15.00
In Place-Business					
Each Primary Station	20.00	45.00	25.00	35.00	45.00
In Place-Residence					
Each Primary Station	12.00	30.00	16.00	20.00	25.00
Reconnect-Business	10.00	22.50	15.00	20.00	22.50
Reconnect-Residence	6.00	15.00	10.00	12.00	15.00
Revenue Increase (Dollars in Thousands)			344	607	876

Alternate 6 generates the most appropriate share of the overall revenue requirement and is adopted.

Line Extension Charges

Continental sponsored the following changes in Schedule A-31, line extension charge:

a. Decrease the free footage allowance from 2,640 feet to 2,000 feet.

b. Increase the charge for each 100 feet or fraction thereof for extension to plant exceeding the free footage allowance from $10 to $40.

c. Withdraw the "Savings Clause."

d. Initiate conditions pertaining to extraordinary costs.

The staff recommends that this proposal be authorized. This tariff schedule has not been changed for almost 20 years and increased costs now warrant this increase in charges. This will result in an annual revenue increase of $81,763; it is adopted.

Other Items

Other rate issues could not be dealt with in this proceeding due to lack of information or reliable studies. The staff therefore recommends that applicant be directed to study the following services and include recommendations with its next rate application based on the results of these studies:

a. Mileage Rates (Schedule A-4)

Study and determine if mileage rates are compensatory.

b. Telephone Answering Service (Schedule A-9)

1. Establish uniform rates.

2. Consider comparability to PBX equipment rates.

c. Supplemental Equipment (Schedule A-15)

Study and determine if supplemental equipment rates are compensatory.

d. Move and Change Charges and Service Connection Charges (Schedules A-29 and A-30)

Study the feasibility of combining both charges in a three-part charge plan, similar to that provided by General and proposed for Pacific.

e. Directory Advertising Service (Schedule D-1)

Review rate levels in light of increased production costs and advertising costs of competing media.

Radiotelephone Rates

Continental's mobile telephone service is composed of two separate classes. Rate Group I is characterized as using older equipment. Less than 100 customers are on this service, which is provided in Barstow, Big Bear Lake, Ridgecrest, Sugar, and Victorville. For this group, applicant proposed a basic monthly charge decrease from $55 to $45, offset by a new basic service charge of $15 per month, producing a net increase of $5 per month. The total revenue impact of this change would be less than $6,000 per year.

Newer equipment is utilized in Blythe, Exeter, Garberville, Gilroy, Manteca, Parker Dam, Taft, and Weaverville. (Group II) The present monthly rate is $45. Applicant proposes an increase in that rate to $60 and the establishment of an $18 per month service charge. Applicant indicates that an increase of this magnitude would result in a 15 percent loss of customers. The Group II increase is estimated to net applicant $78,000 per year, if the increase results in customer terminations at the level projected by applicant. If there are fewer terminations the increase could produce as much as $100,000 per year in additional revenue.

The radiotelephone increase proposal is not based on separated cost figures but is intended to keep applicant's rates in line with similar rates charged in other parts of California. The basic purpose of this proposal is to ensure that these customers bear their fair share of applicant's total revenue requirement.

We note that radiotelephone service is offered by numerous utilities which have no toll or exchange obligations. These utilities frequently compete with each other and with the radiotelephone services of conventional telephone companies. For this reason we think a single telephone company's proposal for a general increase in these rates should be based on evidence concerning the separated costs of providing the service. Since no such evidence was supplied the proposed rate increase is not justified by the record. However, there is an unjustified interexchange rate differential which should be remedied; the present monthly rate for Group II customers should be increased to Group I levels. This increase will be $10 per month, and is estimated to produce $30,840 additional annual revenue; this increase is adopted.

Quality of Service

The staff service witness based his analysis on Commission General Order No. 133 which provides a number of indices for telephone utility service. These are: held primary service orders, held regrade service orders, installation commitments, customer trouble reports per 100 stations, dial tone speed, dial service, toll operator answering time, and directory assistance operator answering time.

The staff service witness noted that most of Continental's service area is sparsely settled and rural in nature. Much of the plant was installed by various predecessor telephone companies, using different manufacturers' equipment, installation standards, and density. The variety of equipment in different age groups and the initial lack of uniformity of operating standards has made the provision of consistently reliable service difficult. The witness noted, however, that Continental has developed and implemented uniform practices and procedures and centralized planning and quality controls. In his opinion these activities have resulted in an overall improvement of service.

He analyzed the complaints most frequently mentioned in correspondence to the Commission and expressed at the public hearings during this proceeding. In his opinion, problems with noise, cross talk, and fading of conversation could be lessened by replacing old plant, by increased maintenance, and by reducing the number of parties on a party line. Complaints concerning service difficulties occurring after a rainfall could be corrected by replacement of old outside plant and by extension of applicant's cable pressurization program. Difficulties with toll calls could be due to two different types of problems. If the problem is in local circuitry, the same remedies as suggested for noise, cross talk, and fading would be appropriate. If, however, the difficulty is in the toll network itself, then the elimination would, in most instances, require cooperation between Pacific and Continental. Slow operator response in his opinion should be rectified by improved assignment and training of operators. His review of the General Order No. 133 results indicated a possible excessive number of held primary orders in Earp, Gilroy, Manteca, and Victorville. There were possibly an excessive number of held regrades in Blythe and in Victorville. All other General Order No. 133 measures indicated satisfactory performance.

In summary, the witness felt that the quality of service provided by Continental was reasonable and is improving. He recommended that improvement could and should be made by remedial action directed at specific trouble spots. He recommended orders to Continental to reduce its party line fill, to develop improved procedures for trouble shooting toll problems with Pacific, to continue its cable pressurization program, to improve traffic operator load management, and to reduce held orders. Finally, he recommended that it would be appropriate to expedite detection of possible developing trouble trends. He recommended that Continental should be required to report all indices for customer trouble reports, dial tone speed, and toll operator answering time falling between the norm and the reporting level in General Order No. 133.

The staff service witness also commented on the volume of consumer complaints concerning small local calling areas, the high cost of primary services in suburban areas, and the lack of lifeline service. He suggested that applicant adopt the base rate area and special rate area guidelines observed by General and Pacific. He also suggested a review of the feasibility of optional EAS when requested by a substantial percentage of customers. In his opinion the best way to handle the specific problems underlying the request for lifeline service would be a provision keeping available a reasonably low cost residential service for low users. In most areas this would be accommodated by multi-party service.

Applicant claims that the quality of service provided by its system can be summarized by quoting the introductory sentence to the summary in the staff report. "Overall, the quality of service provided by Continental appears to be reasonable and is improving." Applicant goes on to argue that, considering the nature of the territory which applicant serves, the service provided is excellent. Applicant had no objection to the staff's specific recommendations concerning service matters and in some instances specifically stated that it was in agreement with the recommendation. The only objection was to the staff's recommendation calling for a study of and a report on a program for the selective introduction of extended area service. There the company witness testified that applicant does not object to the making of such a study, provided that the options considered are not limited to the form of extended area service which is technically referred to as "optional". We agree. Applicant may consider any alternative it feels practical.

Exchange Rate Equalization

There has been some opposition to applicant's proposal to put all exchanges on an equal rate basis. The best developed came from the representative from Gilroy. He suggested that because of the high growth in that community, Gilroy customers might well be entitled to lower rates than customers in other areas.

It would appear that the converse would be true. Applicant recently completed the installation of an expensive electronic central office in the Gilroy exchange. Furthermore, the high-growth factor in this area means that a disproportionate share of newer and, hence, higher-priced equipment, installed by higher-priced labor, and financed by higher-priced capital, is located in the Gilroy area.

The existing interexchange rate differences are in each case a product of historical accident, rather than of a comprehensive objective method of relating rate levels to either service or cost. The task of attempting to provide a new system would prove of minimum advantage to the great mass of consumers. We will adopt uniform exchange rates. This conforms to our policy in Pacific's and General's areas.

Pay Station Rates

An increase in pay station rates, would require a significant capital investment if instituted throughout applicant's service territory. The staff suggested that this is not an appropriate time for the Commission to require changes in applicant's service offerings which are capital intensive. Applicant concurred in this view and suggested that if the Commission wished to consider pay station rates on this record it should at most authorize a future phase-in of higher pay station rates by advice letter filing at such time as particular areas are completely equipped with single-slot pay phones capable of providing local pay station service at a rate higher than 10¢.

Proposed Contract and Accounting Changes

The following table summarizes the staff's adjustments based on affiliated relationships:

Summary of Staff Adjustments
Test Year 1975

	Adjustments (Reductions) to	
	Rate Base	Expenses
	(Dollars in Thousands)	
Continental Telephone Service Corporation	$ 523	$234
Contel Data Service Corporation	2	14
Leland Mast Directory Company	-	-
Medusa Leasing Corporation	291	64
Manufacturing and Supply Functions	1,868	47
Total	$2,684	$359

While the staff has recommended that these excessive charges be eliminated for ratemaking purposes, they are of the opinion that this would only result in a stop-gap measure and that this relationship will continue to be a problem in future rate proceedings of applicant, until a method is found to prevent excessive costs from being passed through to the operating utility.

The staff spent considerable time auditing the records of the affiliates, particularly the Service Corporation. Exceptions were noted in virtually every area reviewed, thereby requiring extensive testing of financial transactions. Since it was not possible to review every transaction, it is probable that some excessive costs billed to applicant were missed by the staff. However, they are confident that they have uncovered the bulk of such charges.

The staff claims that if these excessive charges are adjusted only for ratemaking purposes and not accounting purposes, they will still be recorded on the books of applicant and the staff will have to do extensive auditing of the affiliates in all future rate proceedings. Moreover, such charges, in the staff's opinion, have a measurable adverse financial impact on the utility's interest coverage computation.

Applicant has, in this application, twice requested interim rate increases based on a financial emergency because it could not maintain the times interest coverage requirements of its bond indenture in order to issue additional long-term debt. The computation of interest coverage is based on recorded figures. Therefore, to the extent that applicant's recorded figures include excessive charges from its affiliates, the financial crisis has been, in the staff's words, "somewhat self-created".

Applicant's toll settlements with Pacific are based on recorded figures; therefore, to the extent that applicant's recorded figures contain excessive charges billed from affiliates, they are passed through to Pacific. The ratepayers of other California telephone utilities are thus charged with costs which the Commission has disallowed for ratemaking purposes. Approximately 70 percent of applicant's business is toll; therefore, approximately 70 percent of its recorded operating expenses are included in its toll settlement procedures.

The staff urges us to take appropriate steps to ensure that in the future excessive charges billed to applicant by its affiliates are eliminated not only for ratemaking purposes but also for accounting purposes from the books of applicant, so that in the toll settlement process, the ratepayers of other California telephone utilities are not burdened with unreasonable costs.

The Commission once before attempted to modify a telephone company's inter-affiliate agreements. (Pacific Tel. & Tel. Co. v P.U.C. (1950) 34 C 2d 822.) The Supreme Court reversed, holding that the Commission lacked the authority unless it found that the contract produced an impairment of the utility's capital. Without proof of impairment, disallowance of excess costs was held to be the sole appropriate remedy. The staff claims that the record here would support a finding that the financial emergencies discussed in D.84662 and D.85252 were "somewhat self-created." A finding to that effect would not meet the Supreme Court's impairment test. Thus, unless there are alternative grounds for modifying applicant's contracts, disallowance of excess costs is the only protection available against excessive affiliate profits. As an alternate theory, the staff suggests that its lack of man power to effectively administer a disallowance investigation should justify modifying affiliate contracts. We will not now attempt to determine whether the Supreme Court might be willing to consider this ground as an alternative to the impairment test.

The staff arguments concerning the distortion of toll settlements cannot be lightly dismissed. The staff's remedy does not go far enough, however; if Continental is required to place itself on an adjusted cost basis, while other participating utilities continue to base their settlement claims on recorded data, Continental's customers would then find themselves subsidizing the affiliated expenditures of other operating companies.

We cannot predict whether the Supreme Court would consider toll settlement impact as justification for modifying the terms of affiliate contracts. The staff may well wish to pursue this theory further; if so, it should select a proceeding in which all

California telephone companies are parties. We will not adopt the staff's proposal to require accounting and/or contract changes.

Continental Telephone Service Corporation provides legal, management, and administrative functions for the operating companies. Most of applicant's executive services are provided by employees of this corporation and, as a result, applicant has very few executives on its own payroll. Consequently, Continental's reports of executive and attorney's compensation under General Order 77-H is misleading. A person inspecting these reports would not receive a true picture of the amount of compensation enjoyed by those who provide executive services for this utility. We think it would be better practice for the executives and attorneys of affiliated companies to be treated as employees of applicant for purposes of General Order No. 77-H unless they perform no significant duties having a California nexus.

Contel Data Services performs data processing services. Medusa Leasing leases motor vehicles and other equipment to all Continental System subsidiaries. For both affiliates, the rate of return was adjusted to utility levels. Leland Mast Directory Company is a newly acquired directory publisher. The staff found that no adjustments were required.

Applicant's recorded disbursements include compensation to a number of consultants, who are former company executives, and who were in the past involved as owners or chief executives of acquired companies. The utility was unable to supply any information concerning any consulting services provided by these consultants. The staff therefore treated these payments as compensation for the acquisition of these companies and disallowed them as expenses.

The staff also discovered affiliated costs incurred in the ownership and maintenance of houses and condominiums, and a recreational vehicle. In many instances the properties were in resort or vacation areas, remote from applicant's exchanges. There were also certain expenses which were recreational and/or personal to company executives. Further questions were raised concerning the use of corporate aircraft for other than business purposes.

While these items are of small dollar value, their nature makes it impossible for our staff to ignore them. In this proceeding the issues will be disposed of simply by disallowing the challenged costs. These expenses also are now incorporated into the toll pool. We will expect the staff, without waiting for applicant's next rate case, to ensure that no ratepayer supports any of these costs.

Findings

1. An overall rate of return of 9 percent with a return on equity of 11.7 percent is found to be reasonable.

2. A rate of return of 9.0 percent is reasonable for applicant's exchange operations, and will be produced by the exchange rates set forth in Appendix A. Those rates are reasonable and justified and applicant's present exchange rates are unjust and unreasonable.

3. The rates authorized by this decision will increase applicant's revenue by approximately $5,129,000 over its revenue as of the date of filing this application. Current surcharge revenue from the interim decisions is more than $5,129,000; therefore, the effect of this decision is to reduce current rates.

4. No party has shown that the toll rates established by D.85287 in A.55214 are unjustly or unreasonably low. There is no reason to believe that applicant needs temporary toll relief

pending the next determination of statewide toll rates. A toll surcharge will generally depress toll revenues. It will also encourage reversal of calling habits encouraging calls to be initiated outside of applicant's service area. There is insufficient evidence to determine the revenue impact of these effects.

5. It is not appropriate to set applicant's exchange rates at a level significantly lower than those of other comparable telephone companies if this can only be accomplished by a substantial surcharge on toll rates.

6. The increase of rates to include standard EAS and SRA increments in territory where this extra value service is provided is justified and the resulting rates are reasonable.

7. The rates for line extensions adopted herein are comparable to rates charged in most areas of California; the rate increase is justified and the resulting rates are reasonable.

8. Continental's present rates are discriminatory in that rotary lines are provided without charge with PBX's but are charged for when provided in association with key sets. Equalization is justified and the resulting rates are reasonable.

9. A 30 percent increase in the charges of PBX and obsolete equipment is justified and the resulting rates are reasonable.

10. A change in rules to provide vacation rates for not less than one month or for more than six months nor more than once in a twelve-month period is justified and the resulting rates are reasonable.

11. An increase in move and change charges will only partially offset costs, and is justified.

12. Applicant should be required to treat all executives and attorneys employed by affiliated companies as its employees or attorneys for reporting purposes under General Order No. 77-H unless the employee's work has no significant relationship to California operations.

13. Applicant's proposed changes in line extension conditions and rates are justified and the resulting rates are reasonable.

14. Applicant should be directed to study and evaluate the reasonableness of the following schedules: A-4, A-9, A-15, A-29, A-30, and D-1.

15. Applicant notified its customers of its proposal to increase radiotelephone rates; there were no requests for additional public hearing on such increase.

16. The evidence does not support a finding of the costs, investment, or return presently affecting applicant's radiotelephone operations.

17. The present radiotelephone rate structure is discriminatory. The record shows no reason why Group II customers should continue to enjoy rates less than Group I customers. An increase of $10 per month for Group II customers will equalize radiotelephone rates.

18. Continental's overall quality of service is good and as a whole is improving. The quality of its exchange service has not been shown to be significantly below or above that of other major California telephone utilities.

19. Complainant should develop improved procedures for dealing with noise, cross-talk, fading, and out-of-service conditions. Special reports of customer trouble calls, dial tone speed, and answering time should be required.

20. Some of applicant's customers have given up reporting certain kinds of trouble. Applicant should be required to urge customers to report all trouble.

21. Applicant should be required to:

a. Change within one year its tariffs, practices, and procedures to limit its suburban line fill to no more than eight parties per line.

b. File within six months a feasibility study for reducing line fill as follows:

1. Suburban service to four parties per line;
2. Urban residential service to two parties per line; and
3. Urban business service to one party per line.

c. Inform The Pacific Telephone and Telegraph Company of all customer complaints which result from failure of or insufficient Pacific Company toll trunking or switching equipment. When such troubles are not resolved within six months, they should be reported to the Commission.

d. Report within six months the extent of present and planned expansion of its cable pressurization program.

e. File within six months a feasibility study including cost data and rates for selective introduction of extended area service with alternatives it feels are practical.

f. Report reasons and suggested corrective action when any of its exchanges have more than 20 held primary orders or more than 30 held upgrade orders for two months in any General Order No. 133 reporting period.

g. Adopt the current staff Special Rate Area (SRA) and Base Rate Area (BRA) guidelines, and proceed with the establishment or enlargement of SRA's and BRA's where appropriate under those guidelines.

22. Present exchange rate differentials are products of historical accident, and are not justified by any available evidence. Exchange rates should be uniform.

23. A pay-station rate increase would require applicant to invest substantial amounts of capital; for that reason, it is not reasonable to increase pay-station rates at the present time.

24. There is a public need for low-cost basic telephone service. The record demonstrates that for applicant multi-party service is the only practical, available form of low-cost service.

25. To make multi-party service more useful in emergencies, applicant should be required to publicize the legal responsibilities of party-line users.

26. The amount involved in determining investment tax credit treatment is approximately $40,000. It is not necessary to determine the dispute between staff and applicant over the treatment of this item.

27. The stipulated results of operations should be adopted for the purposes of this proceeding.

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

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, Continental Telephone Company of California is authorized to file the revised rate schedules attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be five days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date of the revised schedules.

2. Concurrently with placing Appendix A rates into effect, applicant shall cease to apply the surcharge authorized in previous orders.

3. Within sixty days after the effective date hereof, applicant shall file and serve as a pleading herein a calculation of the amounts collected by it under surcharges authorized by previous orders herein and a calculation of the intrastate rate of return earned by it on a recorded adjusted basis in the twelve months preceding the effective date. If such rate of return exceeds 9.0 percent, it shall also file a proposed refund plan.

4. In its next rate increase application, applicant shall include a study of the schedules listed in Finding 18 and of the problem areas listed in Finding 23.

5. Until four years from the effective date of this order applicant shall include in its General Order No. 133 reports of any service below standard but above reporting service level in the categories of customer trouble reports, dial tone speed, and toll operator answering time.

6. Applicant shall:

   a. Change within one year its tariffs, practices, and procedures to limit its suburban line fill to no more than eight parties per line.

   b. File within six months a feasibility study for reducing line fill as follows:

      1. Suburban service to four parties per line;

      2. Urban residential service to two parties per line; and

      3. Urban business service to one party per line.

   c. Inform The Pacific Telephone and Telegraph Company of all customer complaints which result from failure of or insufficient Pacific Company toll trunking or switching equipment. When such troubles are not resolved within six months, they shall be reported to the Commission.

   d. Report within six months the extent of present and planned expansion of its cable pressurization program.

   e. File within six months a feasibility study including cost data and rates for selective introduction of extended area service with alternatives it feels are practical.

   f. Report reasons and suggested corrective action when any of its exchanges have more than 20 held primary orders or more than 30 held upgrade orders for two months in any General Order No. 133 reporting period.

   g. Adopt the current staff Seecial Rate Area (SRA) and Base Rate Area (BRA) guidelines, and proceed with the establishment or enlargement of SRA's and BRA's where appropriate under those guidelines.

7. Within six months of the effective date hereof, applicant shall file a report on feasible alternative methods of providing low-cost, basic service. Such report shall include at least one proposal for procedures to assign priorities to exchanges for introducing the alternative decided upon, and include at least one proposal for public information and response on a local basis.

8. Within six months of the effective date hereof, applicant shall file a report detailing its progress to date and future plans for dealing with noise, cross-talk, and out-of-service conditions.

9. Within six months of the effective date hereof, applicant shall file a report detailing its progress to date and future plans for persuading customers to report all substandard service.

10. Until further order of the Commission, applicant shall treat all employees or attorneys of Continental Superior, Leland Mast Directory Company, and Medusa Leasing, as employees or attorneys of applicant for purposes of General Order No. 77-Series unless their duties during the calendar year have no significant California nexus.

11. Within six months of the effective date hereof, applicant shall file a report indicating its present methods and future plans to urge its customers to comply with legal requirements for use of multi-party lines in an emergency.

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

Dated at San Francisco, California, this 5th day of JANUARY, 1977.

Robert Batinovich
President
William Symons Jr.
Vernon L. Sturgeon
Leonard Ross

Commissioners

RATES

The rates, charges, and conditions of Continental Telephone Company of California are changed as set forth in this appendix.

Schedule Cal. P.U.C. Nos. A-1, A-3, A-5, A-7, A-10, and A-17, Basic Exchange, Paystation and Suburban Service, and Key and PBX Trunks

The following rates are authorized:

Residential	
Individual Line	$6.00 per month
Two-Party Line	4.85
Four-Party Line	4.50
Suburban	4.85
Key Trunks	9.00
Business	
Individual Line	$13.80 per month
Two-Party Line	11.10
Suburban	11.10
Key Trunks	17.40
PBX Trunks	27.60
Semipublic Paystations	9.00

In addition to the rates shown above, the uniform statewide increments for exchanges having Extended Area Service and for Special Rate Areas shall apply.

Schedule Cal. P.U.C. Nos. A-1, A-3, A-5, A-7, A-10, and A-17, Extension Stations

The following rate is authorized:

Business Extension Stations, exclusive of guest room extensions	$2.00 per extension station per month

Schedule Cal. P.U.C. Nos. A-7, A-10, and A-17, Rotary Hunting

The following rate is authorized:

Rotary Hunting	$0.50 per line per month

Schedule Cal. P.U.C. No. A-7, Private Branch Exchange Service

Proposed rates and charges as set forth in Exhibit 8, Section 2, for Private Branch Exchange Service are authorized.

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

Proposed rates and charges as set forth in Exhibit 8, Section 2, for Obsolete Service or Equipment are authorized.

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

Vacation rates for all exchanges shall be available for a minimum one-month period, and a maximum six-month period, and shall not be available more than once in any consecutive twelve months.

Schedule Cal. P.U.C. A-29, Move and Change Charges

Proposed charges as set forth in Exhibit 8, Section 2, for Move and Change Charges are authorized.

Schedule Cal. P.U.C. No. 30, Service Connection Charges

The following charges are authorized:

Not in Place - Business	
Each Primary Station	$45.00
Each PBX Line	45.00
Each PBX Station	18.00
Each Extension Station	18.00
Not in Place - Residence	
Each Primary Station	30.00
Each Extension Station	15.00
In Place - Business	
Each Primary Station	45.00
In Place - Residence	
Each Primary Station	25.00
Reconnect - Business	22.50
Reconnect - Residence	15.00

Schedule Cal. P.U.C. No. A-31, Line Extension Charges

The free footage allowance is decreased to 2,000 feet.

The charge for each 100 feet or fraction thereof for extension to plant exceeding the free footage allowance is increased to $40.00.

The saving clause shall be withdrawn.

The following Special Condition is authorized:

Extraordinary Costs

1. The applicant will be required to pay the representative costs below in addition to the associated line extension charges when the utility incurs extraordinary costs for:

A. Obtaining rights-of-way and easements for, i.e., railroad crossings, Bureau of Land Management, Forest Service, environmental impact studies, etc.

B. Rule No. 13 will apply to projects of a temporary or speculative nature.

C. Rule No. 15 will apply to customer requested route changes or construction differences.

2. Customers to line extensions regarding rights-of-way or easements which require payment (or annual fees) must negotiate with the necessary agency.

Schedule Cal. P.U.C. No. L-1, Radio Telephone Service

The following rates are authorized:

Primary Service and Fixed Mobile Telephone Service,
all exchanges, $55.00 per month

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

This schedule is cancelled.

A.55376

EAS Rate Increment Table

Main Station Ratio				Toll Rate Mileage Band							
				A		B		C		D	
	Small Exch.	Large Exch.		9-12		13-16		17-20		21-25	
Group	Over	Up To	Exch.	Bus.	Res.	Bus.	Res.	Bus.	Res.	Bus.	Res.
1	0	0.15	Small	$1.75	$0.60	$2.50	$0.85	$4.00	$1.35	$6.00	$2.00
			Large	0.25	-	0.35	-	0.45	-	0.55	-
2	0.15	.50	Small	1.20	.40	1.80	.60	2.70	.90	4.00	1.35
			Large	.60	.20	.75	.25	1.35	.45	1.95	0.65
3	.50	.80	Small	1.05	.35	1.65	.55	2.40	.80	3.60	1.20
			Large	.75	.25	.90	.30	1.65	.55	2.40	0.80
4	.80	1.00	Small	.95	.30	1.35	.45	2.10	.70	3.00	1.00
			Large	.90	.30	1.20	.40	1.95	.65	3.00	1.00

EAS Increments for individual, party, and surburban services are the same within a given exchange for all business and residence lines and are those shown in the above table. The increments on semipublic paystations, PBX trunks, and key system trunks are multiples of 0.75, 2, and 1.25, respectively, of the applicable increment for individual lines.

SRA Rate Increment Table

Distance to Main BRA	SRA Increment	
	Residence	Business
2/4 - 6/4	1/4	2/4
7/4 - 14/4	2/4	3/4
15/4 - 24/4	3/4	4/4
25/4 - 36/4	4/4	5/4
37/4 and over	5/4	6/4

The standard suburban mileage rate for the different service categories is added to the basic rates, based on the SRA increment for the distance between the main BRA and the SRA.