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ORIGINAL

Decision No. 87505 JUN 28 1977

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of General Telephone Company of California, a corporation, for authority to increase its rates and charges for telephone service.	Application No. 55383 (Filed December 16, 1974)
Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, practices, contracts, service, and facilities of GENERAL TELEPHONE COMPANY OF CALIFORNIA, a California corporation; and of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.	Case No. 9911 (Filed May 6, 1975)

(Appearances listed in Appendix A)

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O P I N I O N

By Application No. 55383, General Telephone Company of California (General) seeks to increase its rates and charges for intrastate telephone service by $45.9 million annually, after settlements, based on its estimates of intrastate operations for test year 1976. Almost $7.5 million of this additional revenue requirement initially contended for by General has already become available as the result of recent increases in the rates of The Pacific Telephone and Telegraph Company (Pacific) pursuant to Decision No. 85287 dated December 30, 1975 in Application No. 55214 and Case No. 9832. Increases in Pacific's rates increase General's revenues to this extent through the operation of settlement agreements and through certain of Pacific's rates, such as those for multi-message unit and message toll services, applying also to General.

In Case No. 9911, an investigation initiated by the Commission, the scope of these proceedings is enlarged to cover essentially all aspects of General's public utility operations and rates and to cover separations procedures, settlement agreements, and the level of toll and other rates affecting Pacific, General, and the other independent telephone companies.

Public Hearing

After due notice, 26 days of public hearings were held before Examiner Main from August 13, 1975 to January 19, 1976 in Los Angeles for the most part, but also at various locations throughout General's service area.

Nine of those days of hearing were reserved expressly for testimony from General's customers. Some 70 customers testified, many of them protesting any increase in rates. About 25 included service complaints in their testimony. At the examiner's direction General proceeded to investigate those complaints and reported on them in Exhibit 34.

During the course of the proceeding testimony and exhibits were presented by witnesses for General, the city of Los Angeles, and the Commission staff. On the last day of hearing, Application No. 55383 was submitted subject to the filing of concurrent opening briefs on February 19, 1976, and concurrent reply briefs on March 9, 1976; Case No. 9911, however, was continued, for non-rate directory advertising matters only, to a date to be set. In all other respects, Case No. 9911 stands ready for decision concurrently with Application No. 55383.

The purpose in keeping Case No. 9911 open is to provide an opportunity to Ad Visor, Inc., to undertake appropriate discovery and present evidence concerning the rules, practices, and guidelines governing directory advertising relating to General. However, to proceed expeditiously and avoid duplication, a consolidation of Case No. 9911 with the other Ad Visor cases may be indicated, as Ad Visor, Inc., has numerous formal complaints pending against General.

Background

General is a member of the General System, of which the domestic telephone operating subsidiaries comprise the largest independent (non-Bell) telephone system in the United States. General Telephone and Electronics Corporation (GT&E) is the parent company with communications, manufacturing, and research subsidiaries.

General, which is by far GT&E's largest telephone subsidiary, operates in approximately a 10,000-square-mile area in Central and Southern California, serving 250 communities in portions of 16 counties. Its intrastate operations were last analyzed by the Commission in Application No. 53935 and Case No. 9578 on a test year 1974 basis. Following 32 days of hearing the Commission issued Decision No. 83779 therein on November 26, 1974. In the present proceedings, a fair rate of return, affiliated interest adjustments, quality and adequacy of service, and operating results under present rates are principal elements within an over-all determination of intrastate revenue requirements.

Rate of Return

A reasonable rate of return is adopted by the Commission, and applied to the adopted intrastate rate base, to determine a utility's prospective revenue requirement. General's last authorized rate of return was 8.85 percent.

Although we have much testimony in this record on rate of return, and a range of rate of return recommendations presented by the parties, the data on which the testimony was based is stale. We prefer to have testimony before us that is based on relatively current conditions when we make a determination on a reasonable rate of return. When we establish what a reasonable rate of return for the future period when rates are in effect will be, it should be a determination based on a current record; that is only fair to both a utility and its ratepayers.

In our current review of the record on rate of return, and particularly in view of the time that has lapsed since the testimony was presented, we find it appropriate for purposes of this opinion to not modify General's authorized rate of return from that we last found reasonable. We wish to further review the reasonableness of General's rate of return with the benefit of a more current record. Although we could reopen this proceeding and have further hearings, it would only further delay a determination on General's application and Case No. 9911. Accordingly, we will review General's rate of return in Case No. 10001, consolidated with Pacific Telephone's Application No. 55492. General is a respondent in Case No. 10001. We will also review Pacific Telephone's rate of return in Case No. 10001. Both General and Pacific, as well as the staff and interested parties, should present testimony and recommendations in that proceeding, based on current conditions, with respect to what constitutes a reasonable rate of return.

We will now discuss the capital structure of General and the cost rates for its debt and preferred stock.

Two sets of slightly different capital ratios, reflective of General's estimated capital structure as of December 31, 1976, were presented. We will adopt, for the purposes of this proceeding, the following capital ratios: long-term debt, 48 percent; short-term debt, 6 percent; preferred stock, 6 percent; and common equity, 40 percent.

Applicant's embedded debt cost is 6.33 percent. The cost factor adopted for short-term debt is 8 percent and the cost factor for preferred stock is 6.21 percent. A weighted aggregate cost of these capital components of 3.89 percent results and is adopted.

When we apply an 8.85 percent rate of return to the above adopted capital structure and cost rates for debt and preferred stock, a return on common equity of 12.40 percent results.

Affiliated Interests

As a holding company GT&E controls, in addition to telephone operating companies and other interests, GTE Automatic Electric Incorporated, General Telephone Directory Company, GTE Service Corporation, and GTE Data Services Incorporated, which transact a substantial amount of business with General. Certain ratemaking adjustments applicable to that business have been established over the years. In the aggregate the adjustments made for these affiliates in our adopted test year intrastate operating results, as shown in Table 1, infra, are a net reduction in General's expenses of $3,889,000 and a reduction of $18,707,000 in General's rate base. The individual adjustment for each affiliate is discussed in the following subsections:

Automatic Electric Adjustment

GTE Automatic Electric Incorporated (Automatic or Automatic Electric) and its subsidiaries are the developing, manufacturing, supply and distributing companies for the telephone operating companies controlled by GT&E. Automatic is the largest non-Bell manufacturer of telephone equipment in the United States. In addition to products of its own manufacture, Automatic purchases products manufactured by others for sale to its customers. In our rate decisions on General since 1968 (Decisions Nos. 75873, 79367, and 83779), we have restricted Automatic's return on equity, applicable to the portion of its investment devoted to serving General, to 12 percent for ratemaking. In its showing in this proceeding the staff has so restricted Automatic Electric's earnings. It resulted in a net intrastate expense reduction of $1,372,000 ($1,614,000 total company) and an intrastate rate base reduction of $15,233,000 ($17,818,000 total company). Although General initially proposed a lesser ratemaking adjustment for Automatic Electric, it later adopted the adjustment determined by the staff for this proceeding.

In our decisions cited above, we discussed the complexities inherent to a precise determination of a fair return for Automatic Electric. After careful deliberation, we held in those decisions that "Automatic would be treated fairly if it earned a return on its common equity approximating the return on common equity of a broad spectrum of American industry." In our staff's view a 12 percent return on common equity continues to approximate the return on common equity of that broad spectrum. We do not disagree. Accordingly, the adjustment for affiliated interests in our adopted intrastate operating results will include for Automatic Electric a net expense reduction of

$1,372,000 and a rate base reduction of $15,233,000 as determined by the staff.

Directory Company Adjustment

With respect to the General Telephone Directory Company (Directory Company) we will adjust intrastate operations, for the purpose of this rate case, to hold Directory Company earnings from its business with General to the rate of return allowed General. This is the same basis for adjustment as that prescribed in the last three rate proceedings on General. The Directory Company performs a directory service for the telephone operating companies controlled by GT&E as well as for a number of other non-Bell telephone operating companies. This service includes the sale of directory advertising, the compilation of the alphabetical and classified sections of the directory, and the printing of two-column directories.

In this proceeding Ad Visor, Inc., has caused attention to be focused upon whether the seller's commission for advertising placed by National Yellow Page Service (NYPS) accounts in General's directories was included in Directory Company's revenues, as used by either the staff or General to develop the Directory Company adjustment. Evidence on this point disclosed that the commission to sellers of NYPS advertising was excluded; that in estimated year 1975 such commissions amounted to about $1.4 million of which only about 10 percent, or $140,000, was to Directory Company, itself, as seller; that in May 1975 Directory Company reduced the commission it pays to sellers from 35.6 percent to 26 percent; and that such a reduction in commissions, if annualized for test year 1976 to render its full effect, will yield increased directory net revenues to General of $109,000 and to Directory Company of $82,000. By also taking into account the seller's commission on NYPS advertising by General's subscribers, Directory Company's net revenues increase slightly more, i.e., by about $5,000 at the new lower commission rates.

Before this further evidence on NYPS advertising, the staff's showing included an intrastate net expense reduction in General's operating results of $1,133,000 ($1,143,000 total company) as an adjustment for Directory Company, to which General did not take exception. The $1,133,000 figure developed initially was in effect later increased $114,000, i.e., the $109,000 + $5,000 specified above, by the staff to $1,247,000. We have increased the latter figure by $82,000 to compensate for the net revenue increase to Directory Company in that amount specified above. The adjustment for affiliated interests in our adopted intrastate results corresponding to Directory Company is thus a net expense reduction of $1,329,000.

The staff recommended, and our order will provide, "that General Directory Company be required to prepare records showing the full effect of its income resulting from business done for General Telephone Company of California or in connection with customers of General Telephone of California. This should include all commissions received from advertising placed in directories outside of General's service areas."

Service Company and GTEDS Adjustments

GTE Service Corporation (Service Company) renders advisory assistance in legal, financial, and operational matters, as well as other services to GT&E and its subsidiaries. Service Company furnishes its services to affiliates on a cost-of-service basis.

GTE Data Services Incorporated (GTEDS) was formed in 1967 to provide data processing services to the General System telephone companies as well as to other organizations outside the General System. For the system telephone companies it now performs the following functions: the operation of computer facilities and microfilm services; the leasing of computer equipment; the development of special programs or systems; and the development of a Business Information System (BIS).

Late in this proceeding, System Development Corporation, a subscriber of General and a competitor of GTEDS, sought to appear, contending that the prices of GTEDS to others are subsidized by payments by General, to undertake virtually unlimited discovery, and to recall witnesses. Weeks before that, staff members from both the Commission's Finance and Accounts Division and Utilities Division, who had examined, on a timely basis, the transactions between General and GTEDS, testified and put their studies in evidence. The appearance was denied as untimely.

According to the staff "GTEDS keeps the direct costs associated with its operations separated between various functions, such as BIS, Computer Service, Computer Leasing, Commercial Operations, etc. Administrative and corporate expenses, after elimination of certain costs which can be directly assigned, are then allocated to each type of service on the basis of the ratio of estimated revenue from that service to GTEDS total estimated revenue. In allocating the total costs of western regional expenses and indirect BIS expenses among all the General System telephone companies, GTEDS uses the allocation method developed..." and used by Service Company to which the staff takes exception. The staff is of the opinion that a four-factor method, which we will take up later, is more equitable.

Pursuant to Decision No. 83779, a study was provided to the staff by General comparing the alternative costs General would incur if General, instead of GTEDS, operated the data processing activities. These costs were evaluated along with other engineering economic studies which examined "the areas relating to data processing billing, namely customers, toll messages, multi-message units, employees and stations-in-service." The staff concluded from its evaluation that the estimated costs of data processing do not appear unreasonable.

In addition to the alternative cost criterion, Decision No. 83779 requires, for ratemaking purposes, that the rate of return on GTEDS business with General not exceed the rate of return allowed for General's utility operation. Because of that requirement the staff has adjusted the net income of GTEDS on its business with General to correspond to the rate of return upon which rates were last set for General.

For expenses incurred in the development of BIS, our adopted operating results in Decision No. 79367 and again in Decision No. 83779 reflected General's test year payment to GTEDS for BIS expenditures rather than an amortized amount. For the 1976 test year the staff adhered in its showing in this proceeding to the payment basis. Based upon the difference between test year payment to GTEDS and the higher annual amortized amount, a net expense decrease of $285,000 is included as part of the GTEDS adjustment in the affiliated interest adjustment within our adopted intrastate operating results. In addition, because there is no unamortized balance applicable to ratemaking, a reduction of $3,474,000 in intrastate rate base is also included, i.e., the $3,474,000 is the intrastate portion of a $4,064,000 unamortized balance for the GTEDS BIS program on General's books to be excluded from General's rate base where it was included in deferred charges used in developing the estimate of a working cash requirement.

As brought out earlier, the staff takes exception to the method employed by Service Company and GTEDS to allocate general and indirect costs among the General System telephone companies. That allocation method, which is carried through into billings, makes a pro rata distribution of such costs on the basis of the ratio of total operating expenses and taxes of each participating General System telephone company to the total operating expenses and taxes of all participating General System telephone companies.

The staff's method requires the use of four factors for the allocation and has long been accepted by the Commission for allocating common or general office expenses among operating districts or departments of California utilities. The four factors for telephone utilities are number of main stations, number of employees, direct expenses, and plant in service. As in Decisions Nos. 79367 and 83779 we decline to accept either allocation method and once again adopt a middle-ground approach. This results in a net expense reduction of $166,000, as the Service Company's part of the affiliated interest adjustment, and a net expense reduction of $177,000 as part of GTEDS portion of such adjustment, to General's intrastate operating results for test year 1976. The entire GTEDS portion is a net expense reduction of $1,022,000 and a rate base reduction of $3,474,000.

Service

Service is discussed, as follows, in the staff results of operation report on General.

> "The Standard Service Range and Reporting Service Level as defined in General Order No. 133 and the Company Objective Indexes are shown in utility Exhibit No. 9 accompanying the prepared testimony of R. D. West.
>
> "The service measurement which reflects maintenance is Customer Trouble Reports. The standard service range is at or below 6.5 per 100 stations and the reporting level is 8.0 or more per 100 stations.
>
> "Since General Order 133 has been effective, the only month in which Customer Trouble Reports reached the reporting range was in January of 1974. These reports were due to rain storm damage in the Indio exchange."
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> * * *
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> "Toll operator answering time and directory assistance operator answering time are the two service measures from General Order (G.O.) No. 133 which directly concern the utility's traffic department. The standard service range and reporting service level as defined in G.O. 133 and the utility's objective index for these two service measures are shown in utility exhibit No. 9 prepared by John J. Casey and R. D. West. The total utility average for both service measures have been consistently well above the standard service range since G.O. 133 became effective in October of 1972. Only four of the twenty-four toll office reporting units have been in the reporting range. They are Corona (May, June of 74), Redondo (June 74), Santa Barbara (July, August of 74) and West Los Angeles (Jan., Feb., & March of 73), and July of 74). The cause was generally a combination of underestimating call volume together with heavy absenteeism. None of the reporting twenty directory assistance offices have been in the reporting range."

Throughout the service hearings, held in various parts of General's serving territory, there was sparse attendance. Testimony and statements from the public related primarily to rate matters or serving arrangements, and not quality of service. To the extent irregularities in services rendered were involved, General was directed to investigate and report the results. Those results were reported in Exhibit 34.

Our assessment of the record is that General's level of service[2/] is adequate. As with all telephone companies, however, General should follow programs to meet present and future communication needs. In this regard, General should continue, consistent with sound economics, its projected conversions from step-by-step to electronic central office switching equipment.

2/ General is required by Decisions Nos. 75873 and 83779 to meet higher objectives for service performance than those prescribed in General Order No. 133. Consistent with the higher objectives, General must report at the following levels:

Speed of Answer Toll	89.0
Directory Assistance	82.0
Dial Tone Speed	98.2
Dial Service	98.3
Customer Trouble Reports	6.0
Installation Commitments	90.0

These reporting levels by being more stringent provide an added safeguard in detecting and remedying service deterioration.

Results of Operation

In preparing this application, which was filed December 16, 1974, General made its estimates of total company operations and separated results of operation for test year 1976. In September 1975 the staff completed and distributed to the parties its comparable studies.

Pursuant to the examiner's request, the staff and General jointly prepared Exhibit 19, which compared both total company and intrastate results of operations differences between General and the staff. Upon review of Exhibit 19 and the results obtained by the staff, using later data, General adopted some of the staff's results relating to General's operations. According to General, it did so on the basis that if the later data used by the staff had been available when the application was prepared, it would have independently arrived at substantially the same figures using its own forecasting method.

In Table 1 on page 23 (mimeo) a comparison is made of intrastate results of operation, at present rates, as adopted by General from staff estimates (column (a)), as estimated by the staff (column (b)), and as adopted (column (c)). These results include the $7.5 million of additional revenues for General by virtue of changes in Pacific's rates pursuant to Decision No. 85287, supra, and reflect the use of test year normalization of accelerated depreciation and ratable flow-through of the investment credit3/ in estimating federal income taxes.4/ Test year normalization was

3/ Increased to 10 percent for 1975 and 1976 by the Tax Reduction Act of 1975.

4/ Test year flow-through of accelerated depreciation was used in estimating State income taxes.

Table 1

General Telephone Company of California
Results of Operation, Test Year 1976
Intrastate Operations

(Thousands of Dollars)

Item	General (a)	Staff (b)	Adopted (c)	Differences by Which Staff's Estimate Exceeds Our Adopted Estimate: Total (d)	Property Tax (e)	Tel. Plt. Under Constr. (f)	Working Cash (g)	Settlement Ratios (h)	Advertising (i)	Vacation Accruals (j)	Affiliated Interest Adjustment (k)
Operating Revenues											
Local Services	$ 386,940	$ 385,341	$ 384,881	$ 460	$ (252)	$ -	$ -	$ 712	$ -	$ -	$ -
Toll Services	189,289	190,113	185,992	4,191	(342)	-	-	4,533	-	-	-
Miscellaneous	47,411	47,411	47,411	-	-	-	-	-	-	-	-
Uncollectibles	(8,617)	(8,617)	(8,617)	-	-	-	-	-	-	-	-
Effects of Decision No. 85287	7,500	7,500	7,500	-	-	-	-	-	-	-	-
Total Operating Revenues	$ 622,523	$ 621,748	$ 617,097	$ 4,651	$ (594)	$ -	$ -	$5,245	$ -	$ -	$ -
Operating Expenses & Taxes											
Maintenance Expense	$ 109,638	$ 105,842	$ 106,933	$(1,091)	$ -	$ -	$ -	$ -	$ -	$(1,091)	$ -
Traffic Expense	37,128	35,577	36,031	(454)	-	-	-	-	-	(454)	-
Commercial Expense	55,525	53,139	53,791	(652)	-	-	-	-	(315)	(337)	-
General Office Salaries & Expense	37,471	36,531	36,796	(265)	-	-	-	-	-	(265)	-
Other Operating Expense	35,228	35,228	35,228	-	-	-	-	-	-	-	-
Subtotal	$ 274,990	$ 266,317	$ 268,779	$(2,462)	$ -	$ -	$ -	$ -	$(315)	$(2,147)	$ -
Depreciation	91,103	91,103	91,103	-	-	-	-	-	-	-	-
Total Operating Expenses	$ 366,093	$ 357,420	$ 359,882	$(2,462)	$ -	$ -	$ -	$ -	$(315)	$(2,147)	$ -
Taxes Other Than on Income	67,034	58,494	59,762	(1,278)	(1,278)	-	-	-	-	-	-
State Income Tax	10,040	11,520	10,765	755	62	-	-	472	28	193	-
Federal Income Tax	57,118	64,303	60,637	3,666	299	-	-	2,291	138	938	-
Total Operating Expenses & Taxes	$ 500,285	$ 491,727	$ 491,046	$ 681	$ (917)	$ -	$ -	$2,763	$(149)	$(1,016)	$ -
Adjustments for Affiliates	(3,350)	(4,149)	(3,889)	(260)	-	-	-	-	-	-	(260)
Effects of Decision No. 85287	3,950	3,950	3,950	-	-	-	-	-	-	-	-
Net Operating Expenses	$ 500,885	$ 491,528	$ 491,107	$ 421	$ (917)	$ -	$ -	$2,763	$(149)	$(1,016)	$(260)
Net Operating Revenues	$ 121,638	$ 130,220	$ 125,990	$ 4,230	$ 323	$ -	$ -	$2,482	$ 149	$ 1,016	$ 260
Rate Base											
Telephone Plant In Service	$1,898,546	$1,894,303	$1,897,648	$(3,345)	$ -	$ -	$ -	$ -	$ -	$(3,345)	$ -
Telephone Plant Under Construction	32,392	-	-	-	-	-	-	-	-	-	-
Property Held for Future Use	1,189	1,189	1,189	-	-	-	-	-	-	-	-
Depreciation Reserve	(442,499)	(441,407)	(442,541)	1,134	-	-	-	-	-	1,134	-
Materials & Supplies	12,795	12,795	12,795	-	-	-	-	-	-	-	-
Reserve for Deferred Taxes	(109,670)	(109,427)	(109,670)	243	-	-	-	-	-	243	-
Working Cash Allowance	1,142	(6,748)	(852)	(5,896)	-	-	(5,896)	-	-	-	-
Adjustments for Affiliates	(18,707)	(18,707)	(18,707)	-	-	-	-	-	-	-	-
Total Rate Base	$1,375,188	$1,331,998	$1,339,862	$(7,864)	$ -	$ -	$(5,896)	$ -	$ -	$(1,968)	$ -
Rate of Return	8.85%	9.78%	9.40%	0.38%	0.03%	-%	0.04%	0.19%	0.01%	0.09%	0.02%

( ) Denotes Red Figure

used pending resolution of this issue on remand to the Commission by the California Supreme Court (City of Los Angeles v PUC (1975) 15 Cal 3d 680). Accordingly, the rates set by this decision must, to the extent they relate to the accelerated depreciation issue, be made subject to refund. A similar procedure was followed in regard to this tax issue in Decision No. 85287.

As shown in column (c) of Table 1 our adopted estimates of intrastate operation at present rates yield a 9.40 percent rate of return. In columns (d) through (k) of Table 1 the items at issue between the staff and General are shown in relation to our adopted results. We will now proceed to discuss those issues and their resolution.

Property Tax

The staff estimated $58,484,000 in Taxes Other Than on Income (column (b) of Table 1), including ad valorem tax expense of $49,416,000 which was $8,550,000 lower than General's. According to the record the latter's estimate overstates the assessed valuation, whereas the staff's estimate understates the composite tax rate. Adjusting the staff estimate of ad valorem tax expense to reflect a composite tax rate of $12.71, obtained by increasing the composite tax rate of $12.29 for fiscal year 1975-1976 by 3.4 percent, increases that estimate to $50,694,000. Our adopted figure for Taxes Other Than on Income of $59,762,000, column (c) of Table 1, is the sum of the $50,694,000 figure plus $9,068,000 for payroll and other taxes. In addition, associated with the higher expense level for property tax is an increase of $594,000 in operating revenues, through settlements with Pacific, as shown in column (e) of Table 1.

The foregoing determination is consistent with General's employing a calendar year accrual basis to report ad valorem tax expense. Accordingly, we have not been persuaded to adopt a proposal belatedly made by the staff, as an off-shoot of the vacation accrual issue, column (j) of Table 1, which would base ad valorem tax expense on a fiscal year accrual basis.

The tax in question becomes a lien on the property in March of the calendar year and its payment is made in two installments, one in the last half of the calendar year (December 10) and one in the first half of the succeeding year (April 10). A calendar year accrual basis is a generally accepted accounting procedure.

Because the Commission historically has adopted this expense for a utility based on the manner in which the utility books it, the rates in effect for General over the years have reflected ad valorem tax expense on a calendar year accrual basis, not on an as paid fiscal year basis. We note that the staff did not recommend a concomitant accounting change, which would presumably have income tax consequences. In our view neither a departure from our historical practice of having the ratemaking treatment consistent with the accounting nor a requirement that General change its ad valorem tax expense accounting to a fiscal year accrual basis is necessary or warranted. The staff proposal is not adopted.

Telephone Plant Under Construction

General has included $32,392,000 of construction work in progress (CWIP) in its estimate (column (a) of Table 1) of intrastate rate base. That amount of rate base represents a gross revenue requirement, at an 8.85 percent rate of return, of about $5 million. The staff opposed the inclusion of CWIP in rate base.

From the ratepayer's standpoint it appears unlikely that this rate base treatment of CWIP, which immediately increases the revenue requirement, would be fully offset in the longer term through the effects on cost-of-service of eliminating capitalized interest, i.e., the allowance on funds used during construction (AFDC). Accordingly, unless there would be other effects that would redound to the benefit of the ratepayer, inclusion of CWIP in rate base is not in his interest.

In General's case we are not convinced that inclusion of CWIP in rate base would necessarily lead eventually to a fair rate of return lower than would otherwise be required. In this connection it was brought out that General has minimal needs for additional external financing and that General's financial condition has improved as a result of normalization of federal income tax expense. That normalization treatment, it should be added, is generally regarded in the financial community as one which improves the quality of reported earnings.

Since in General's case CWIP represents a relatively small portion of total capitalization and AFDC a relatively minor item on the income statement and so long as the conditions described in the preceding paragraph obtain, the ratemaking treatment of CWIP should have little effect on the fair rate of return determination.

As shown in column (c) of Table 1, the $32,392,000 for plant under construction has been excluded from our adopted intrastate rate base.

Working Cash Allowance

General took exception to the working cash allowance (WCA) reached by the staff and through rebuttal evidence supported certain changes to the study upon which that allowance was based. Those changes concern (1) compensatory bank balances; (2) lag in collection of revenue; (3) state income tax; and (4) deferred charges for small tools. The foregoing items, which will be taken up individually below, in the aggregate have the effect, after minor modification, of increasing the intrastate WCA by $8,043,000. That increase, however, is to be reduced by $2,147,000 in incremental vacation accruals which are viewed as available to meet working cash requirements. Such a reduction is consistent with our resolution of the vacation accrual issue, column (j) of Table 1, to be discussed later. After these changes the resultant adopted intrastate WCA is negative and amounts to $852,000; it exceeds the staff estimate by $5,896,000 and represents a difference of only 0.04 percent in rate of return (column (g) of Table 1).

As indicated above, the four items having an aggregate effect of $8,043,000 will now be taken up individually:

(1) Compensating Bank Balances. The staff witness was informed, at some point in his study, that compensating bank balances earned interest, and reduced by $1,100,000 the amount allowed for compensating bank balances. That reduction was based on incorrect information inasmuch as General's treasurer later testified that interest is not earned.

(2) Lag in Collection of Revenues. The staff witness reduced lag days for this item by one day and a half. This was done on the theory that earlier mailing of customer bills as a result of mailing efficiencies implemented by General in August 1974 causes earlier receipt of revenues. Earlier mailing of bills, however, does not change the bill's due date. A study by General of revenue lag days in June 1975, nearly a year after implementation of the mailing efficiencies, showed essentially no difference in lag days.

(3) State Income Tax. The difference between General and the staff is related to General's method of paying state income tax (SIT). The staff prepared this part of the WCA based on information provided by General to the effect that General had changed its accounting procedures for SIT from privilege year to income year, and that it was seeking Internal Revenue Service (IRS) approval of the change. However, the IRS denied General's request and in June 1975 General revised its books of account to return to a privilege year basis. The effect was for General to revert to paying SIT in advance and to including the tax in the subsequent year's cost of operations. The staff witness on SIT expense recognized the IRS denial of General's request by excluding an amortization to reflect the change. The staff witness on WCA was inconsistent in not recognizing the change.

It is appropriate to correct this inconsistency and compute lead days for this part of the WCA on the same basis used in previous rate cases on General. In so doing, it is also appropriate to observe a further consistency which is indicative of fair treatment: although reliance on the same basis used in previous rate cases in this instance favors General, it contrasts with:

> "... In the recent Pacific case the staff used 34.5 days as the lag in payment of the ad valorem tax; General and Pacific pay the tax on the same date; the lien date is the same; and both companies have receipts flowing in monthly. Because of these similar factors, General asserts that the lag study should have the same results for both companies.
>
> "The staff argues that the difference in treatment of Pacific and General resulted from Pacific's accruing ad valorem taxes on a fiscal year basis while General used a calendar year basis. In the 1958 General rate case the Commission fixed rates on the assumption that General accrued taxes on a calendar year basis. Results of operations is a factor in fixing rates and accounting procedure is a factor in determining results of operations. To achieve an equitable result there must be consistency in procedure. Consequently, the proper method to base a working cash study for General is by accruing ad valorem taxes on a calendar year basis. In our opinion, the staff method is reasonable." (General Tel. of Cal. (1969) 69 CPUC 601 at 659.)

By charging SIT to cost of operations on a privilege year basis, General has, over the years as the result of changes in the tax law, undergone for this item in the WCA determination a change from a small lag to a large lead in payment of the tax.[5/] Consistent treatment remains nonetheless in order.

(4) Small Tools. Prior to July 1, 1974, General capitalized small tools valued at $25 or more. On that date, General changed the dollar amount to $100, and began amortizing to expense the undepreciated balance of tools ($2,100,000) still in the plant in service account. The staff has recommended that the balance be transferred to a deferred debit account while it is being amortized and, although not objecting to this accounting treatment, General took exception to excluding this amount from rate base.

Because trending techniques were used in developing operating expenses, the amortizing to expense of the undepreciated balance of tools may have caused some distortion. In the circumstances, both General and the ratepayer should be treated fairly if one-half of that balance is included in the deferred debit portion of the WCA determination.

5/ Prior to 1965 the state income tax was due and payable in two equal installments on or before the fifteenth days of the third month and ninth month, respectively, following the close of the income year. Effective in the income year 1965 the State required an advance payment of the subsequent (privilege) year's tax. In 1965 this prepayment amounted to 20 percent of the estimated tax, in 1966 it was 35 percent, and in 1967, and thereafter until 1972, it was 75 percent of the estimated tax. Beginning with the income year 1972, prepayment of 100 percent of the estimated tax was required during the income year: 25 percent of the estimated tax is payable on the 15th day of the fourth, sixth, ninth, and twelfth months.

Settlement Ratios

The different settlement ratios used accounts for a difference of 0.19 percent between the rates of return derived by General and the staff on intrastate operations. That difference in rate of return relates, as follows, to state toll service and interchanged extended area service:

Service	Settlement Ratio Used* General	Settlement Ratio Used* Staff	Difference in Rate of Return
State Toll	6.0%	6.5%	0.16%
Extended Area	6.5%	6.8%	0.03%
Total			0.19%

*A settlement ratio is similar to a rate of return and is applied to an investment base, such as net plant plus working capital, to apportion return in state toll operations; for extended area operations it is the ratio of Pacific's exchange return to Pacific's exchange investment.

Before proceeding further, it should be noted that the settlement effects of Decision No. 85287 involving Pacific, issued December 30, 1975, have been kept separate from the settlement ratios issue and are accounted for under a separate set of entries on Table 1. As shown by the pertinent entry under operating revenues, General's test period revenues are estimated to increase, because of that decision, by $7.5 million, which consists of three components: a $10.2 million increase in intrastate toll revenue; a $3.5 million reduction in multi-message unit revenue; and an $0.8 million increase in extended area service revenues. The multi-message unit revenue reduction results because Decision No. 85287 converted certain multi-message routes to toll, thereby shifting revenue, expense, and investment settlement effects. Accordingly, toll settlement ratio and exchange settlement ratio will be discussed as estimated prior to Decision No. 85287.

Toll Settlement Ratio. General, along with all other independent telephone companies in the State, participates with Pacific in the sharing of intrastate toll revenues derived from intrastate toll service. The staff used a toll settlement ratio (TSR) of 6.5 percent, while General used 6.0 percent. This accounts for the staff's toll revenue estimate being $4,533,000 greater than General's.

To obtain a credible estimate of a TSR, General made a detailed analysis of the conditions under which both General and Pacific will operate during the period when the settlements occur. General's TSR was developed by combining Pacific's and General's estimates of future revenues, expenses, and investments and separations factors, including effects of operational planning and contracted wage increases. Those items are shown on page 1 of Exhibit 32 and form the basis for General's estimate of 6.0 percent. A later estimate made in August 1975, based on then current data, produced a slightly lower TSR of 5.8 percent.

In developing his estimate of TSR, the staff witness looked at recorded ratios and trended them. He also considered Pacific's estimate of 5.9 percent for the TSR ratio for the test period and changing economic conditions. Subsequently, the staff witness attempted to buttress his TSR estimate by stating that he discerned a recent increase in the upward trend of toll messages, and that increased toll revenues would cause the TSR to increase. General's rebuttal evidence, however, is persuasive that there was not an increase in the upward trend of toll messages and that even if there were, it may not mean the TSR will increase.

TSR is the product of the interrelationship of toll revenues, expenses, and investment. General's TSR was based on an assessment of those fundamental components during the test period. We are persuaded that General's estimate of TSR is better founded and should be adopted.

Exchange Settlement Ratio. General derives revenues from settlements for interchanged extended area service (EAS) with Pacific. Estimated EAS settlement revenues during the test period are derived from the estimated exchange settlement ratio (ESR) which will prevail. The staff estimated EAS settlement revenues to be $712,000 greater than General's estimate. The reason for the difference in estimates is caused by the staff's use of a 6.8 percent ESR compared to General's 6.5 percent ESR.

The reliability of the estimated ESR is a product of the accuracy of the estimate of revenues, expenses, and investment of General devoted to exchange operations. In effect, General receives its expenses devoted to EAS, plus a return on its investment, less a revenue credit based on its EAS billings. The resulting payment from Pacific is known as the connecting company payment. General derived its ESR of 6.5 percent by estimating its expenses and investment for exchange operations using separations factors trended for test period conditions and estimating Pacific's exchange rate of return which will prevail in the test period. General derived its ESR from its best estimates of operating conditions as they will exist in the test period. The reliability of the ESR thereby derived is then tested by review of the resulting connecting company payment, since these payments historically have been stable over a period of time. Using this technique, General tested and confirmed the reasonableness of its 6.5 percent ESR with data obtained from Pacific's Application No. 55214. A similar verification was made from data obtained from Pacific's Application No. 55492 (1975-1976 test period), which resulted in an ESR of 5.8 percent.

The staff witness trended recorded monthly and twelve-month moving average ESR's to derive his estimate of 6.8 percent. His reliance on recent trends in the monthly and twelve-month moving average ESR's was clearly inappropriate. The recorded data reflects only historical conditions. For example, the recorded data has been trending upward since the issuance of Decision No. 83162, which increased exchange rates. In relying on recorded data only, the staff witness simply assumed it was representative of what the future would depict. However, after the passage of twelve months from the date those increased revenues became effective, the twelve-month moving average will fully reflect the revenue increase and will again commence its downward trend because of the impact of increasing costs of operation. The staff's reliance on historical data fails to take this into consideration. The impact of increasing costs, however, is clearly shown in Exhibit 32, which shows on its page 4 that the twelve-month moving average trendline, with the revenue effects of Decision No. 83162 removed, is downward, i.e., costs are increasing more rapidly than revenues.

The staff witness stated he also considered General's estimate of 6.5 percent and what he thought was Pacific's estimate of 6.75 percent for business with General. However, the 6.75 percent ESR should not have been used since it related to Pacific's business with Continental Telephone and is derived in a manner different from and has nothing to do with the development of an ESR for General's EAS settlements with Pacific. The ESR for Pacific's business with General that the witness should have considered was 6.47 percent. The witness attempted to buttress his ESR estimate by saying an increase in the upward trend of toll messages would tend to increase the ESR because more plant and expense would be assigned to toll. As discussed in the section on TSR, there is not an increase in the upward trend of toll messages. Even with a linear uptrend in toll messages, the fact is that the ESR has been declining, not increasing. The staff witness also attempted to support the reasonableness of his ESR by showing that his estimate of the connecting company payment was only 2 percent ($226,000) greater than General's estimate, thereby confirming in his mind the use of a higher ESR. However, he later conceded he made an incorrect computation and that his estimated connecting company payment was approximately $680,000 higher (6 percent) than General's estimate. This wide variation from payment levels that are historically stable indicates the staff's estimated ESR is too high. We are persuaded that General's estimate of ESR is better founded and should be adopted.

Advertising

General estimated advertising expense to be $1,188,000 greater than the staff's estimate. The reason for the difference in estimates was due to an adjustment by the staff of $1,749,000 to total company advertising expense. The staff's lower estimate was caused by its limitation of advertising expense to 0.25 percent of the staff's estimated operating revenues. This amount, after being reduced by $398,000, because of a reduction in General's test period advertising program (which was not disputed by General), and after being reduced to an intrastate basis, accounted for the $1,188,000 difference in estimates.

Although the amount of the original advertising budget was not expressly specified in the record, it was presumably $3,551,000 ($720,764,000 X .0025 + $1,749,000) and included an educational services program. The revised advertising budget, however, was not $3,551,000, less $398,000, or $3,153,000, but was $2,935,000 and excluded educational services. From the staff's using $398,000, instead of $616,000, as the downward budget revision, it is inferred that the amount for educational services in the original budget was $218,000.

In Decision No. 83779, the Commission allowed General an advertising expense equivalent to 0.25 percent of its operating revenues after comparing General's advertising with that of Pacific's. The allowance so derived was less than what General spent and was caused, in part, because specific details of the advertising program for the test period in that case were not available. In this case, specific details of General's test period advertising program, except for "educational services," are part of the record.

The Commission in recent years has on several occasions explained the appropriate standard by which telephone utilities should guide themselves in seeking approval of advertising expense for ratemaking purposes. In Decision No. 83162 the Commission said:

> "The need for much of Pacific's advertising program is obvious. It is important that Pacific tell its customers how to use the telephone system. Improper use of the system overloads equipment, causes additional burdens on telephone operators and other personnel, requires added employees, causes ratepayers to overlook many of the benefits of modern telephony, and causes frustration in the ratepayer who cannot understand why a simple telephone call cannot be put through without problems.

> What is less understood is that advertising generates income to the company which is used to offset losses on those services which are rendered below cost, such as residential flat rate and lifeline service. The losses in these services are made up from profits on the remainder of the system. To the extent that advertising will increase revenues on other portions of the system, basic flat rate residence service and lifeline service will be priced so that millions can afford it."
> (Mimeo. page 49.)

General's advertising budget, as revised for 1976, of $2,935,000 consists of $412,000 for institutional advertising, $475,000 for informational/instructional advertising, $1,877,000 for sales/promotional advertising, and $171,000 in salaries and overhead allocable in some appropriate way to the three advertising categories used. In light of this mix of advertising, the allowance determined by the staff should, in our considered judgment, be increased by about $360,000, or $315,000 on an intrastate basis. This would be more in keeping with the criteria of Decision No. 83162 and would have the ratemaking effect of limiting the reduction in promotional advertising to between 15 and 20 percent of budget, while retaining informational advertising intact and eliminating institutional advertising in its entirety. Implicit in this treatment is disallowance of the $218,000 in an educational services program classified as advertising in the original advertising budget. That amount is unsupported on this record.

Wage Annualization

General is obligated to pay certain wage increases for hourly employees during the test period pursuant to an agreement with the Communications Workers of America. These increases, together with increases to be granted management employees to maintain historical wage relationships with hourly employees and pension expense associated with these increases, have been annualized as an adjustment by General for the test period. The staff is opposed to the wage annualization and accordingly rejected that adjustment.

The staff argues that trended data based on moving totals and spanning a period of years preceding and including the test year properly reflect the actual payment of wages and their year-to-year trended and projected increases. The historical, conservative, and realistic ratemaking approach is not to benefit the utility at the expense of the ratepayer for an unrealized expense. Although in some instances we have departed from our historical approach and permitted annualization of wages, we feel that our basic position that annualization of expenses, including wages, is not warranted, is correct and should be adhered to in this case. This issue has been before us before in regard to General and we held that wages should not be annualized. In Gen. Tel. Co. of Cal. (1969) 69 CPUC 601, 660 we said:

> "The wages of General's employees were raised in July 1968. General estimated wage expense as if the wages had been in effect since January 1, 1968. The staff argues that if one expense increase is annualized, then all increases in revenue, expenses, and rate base should also be annualized. The staff argument is sound. One expense should not be considered without also considering effects of all other items comprising revenues and expenses. When trying to determine which expenses General might reasonably have incurred in 1968, we should avoid including expenses that we know were not incurred."

One other development requires comment. As a result of the improvement in productivity continuing into late 1975, it became apparent that the number of employees estimated by the staff for the test year would turn out to be too high. The staff did not deem it necessary, however, to revise downward its estimates of General's operating expenses. This was because of the incidence of another wage increase, one not reflected in those expenses. In this regard the staff ascertained that an additional wage increase of 4 percent was made to General's hourly employees for 1976. According to the staff's information, General had undertaken to do this because of (1) improved productivity on the part of remaining employees and (2) a noticeable falling behind in the wage levels of its hourly employees in relation to Pacific's. The staff determined that the decline in number of employees and the increased payroll rates and associated effects were virtually offsetting in their impacts on operating expenses.

Vacation Accruals

In our discussion of the working cash allowance issue it was brought out that we considered the $2,147,000 (column (j) of Table 1) in incremental vacation accruals as an amount of accrued operating expenses available to meet working cash requirements. We, therefore, deducted that amount from such requirements. Handled in this way vacation costs remain responsive to the year in which the vacations are earned while the lag in their payment reduces working cash requirements. That treatment, rather than the exclusion of those incremental accruals from test year operating expense as recommended by the staff, is appropriate for ratemaking. Clearly, the staff recommendation, i.e., treating vacation costs for ratemaking on an as paid or cash basis, would represent an unwarranted departure from accrual accounting.

General's vacation policy for hourly and management employees is essentially the same. Newly hired employees are eligible for a two-week vacation on January 1, following their date of employment after a three-month probationary period. The January 1 anniversary date also applies to vacation eligibility for existing employees. Additional weeks of vacation are granted based on length of service.

Since 1954, General has been accruing vacation pay. Throughout each calendar year, General analyzes the vacation liability for each of its employees as of January 1 of the next year and the books of account are adjusted to reflect this liability as of December 31 of the current year. Vacation taken during the year is charged to the applicable plant and expense accounts that year. However, the portion of vacation liability recorded as of December 31 that is charged to plant and expense during that year is only the increase or decrease in the vacation liability from the previous year. The increase or decrease in the liability is the increment of vacation pay due to new employees, increased wage rates, changes in employment classification, and increases in vacation earned because of length of service, net of reductions for employee terminations.

The liability for vacation pay that is being recorded by General is a liability that is fixed and determinable, allocable to specific individuals and identifiable as earned in a specific time period, which requires, under generally accepted accounting principles, that it be recorded in the year the vacation pay is earned rather than the year it is paid. The liability is fixed in that General must pay an employee after the January 1 date for earned vacation, even if the employee terminates or is discharged on or after that date.

As a general proposition, the IRS recognizes for tax purposes an expense, whether it be vacation costs or ad valorem taxes or some other accrued expense, in the year in which it is accrued (i.e., when the liability of General is fixed and determinable), and this Commission has usually accepted this practice for both accounting and ratemaking purposes. To do otherwise is to say, in effect, a fixed liability is not a cost. This ignores economic and financial reality.

This issue caused the staff a great deal of consternation, in part due presumably to General's shortcutting the accounting through which it accomplishes charging vacation costs to expense and plant accounts in the year in which the vacations are earned. The staff did not make a recommendation for an accounting change for vacation accrual in its financial report, but the staff witness testified otherwise and, finally, after much testimony and hearing time on this subject, the staff again reversed its position by withdrawing its recommendation for an accounting change.

General's estimated vacation accrual is reasonable and has been adopted in Table 1.

Affiliated Interest Adjustment

The pertinent affiliates (Automatic Electric, Directory Company, Service Company, and GTEDS) and the development of our adjustments adopted for each affiliate have been discussed at some length in earlier sections of this opinion. In the aggregate the adjustments to intrastate operations result in a net expense reduction, or conversely, a net revenue increase, of $3,889,000 and a reduction of $18,707,000 in rate base. The breakdown by affiliates is as follows:

Affiliate	Adjustment	
	Net Revenue	Rate Base
	(Thousands of Dollars)	
Automatic Electric	$1,372	$15,233
Directory Company	1,329	-
Service Company	166	-
GTEDS	1,022	3,474
Total	$3,889	$18,707

Condensed Summary of Adopted Results
Of Intrastate Operation

A recapitulation of adopted results of intrastate operation shown in column (c) of Table 1 for test year 1976 at present rates is set forth below:

Operating Revenues	$ 617,097,000
Operating Expenses	
Expenses Other Than Taxes	359,882,000
Income Taxes	75,352,000
Other Taxes	59,762,000
Total Operating Expenses	$ 494,996,000
Affiliates Adjustment	$ (3,889,000)
Net Revenues	$ 125,990,000
Rate Base	$1,339,862,000
Rate of Return	9.40%

(Red Figure)

As the above tabulation indicates, General's intrastate operations on the test year basis under present telephone rates produce a rate of return in excess of the 8.85 percent we have found to be fair.

Revenue Reduction

Applying a rate of return of 8.85 percent to the adopted intrastate rate base of $1,339,862,000 indicates the need for $118,578,000 in net revenues, or $7,412,000 less than the net revenues produced at present rate levels. Under test year tax rates and an allowance of 0.8 percent[6/] for uncollectibles, a

6/ Source: Exhibit 11, Table 3-A, column (G), lines 1 and 2.

net-to-gross multiplier of 2.130 is indicated, which when applied to a reduction in net revenues of $7,412,000, yields a reduction in gross revenues of $15,788,000. Such gross revenues represent a reduction of 2.6% from those produced at present rates during the test year.

Rate Spread

When effecting a rate reduction, it is generally desirable to spread such reductions to all customers through a reduction in basic exchange service rates. However, since 1968 the basic rates of Pacific Telephone and General have been at essentially the same level in the Los Angeles Extended Area (LAEA). To reduce General's basic rates by the entire amount of the revenue reduction would result in a distorted rate pattern. Accordingly, the reduction in basic exchange rates is limited so that General's rates are not more than 25 cents per month below Pacific in the LAEA. Rates for other areas of General are reduced by the same amount as the LAEA reductions.

Other than basic exchange service, the most widespread service is extension telephones. The order herein provides that rates for extension telephones will be reduced. The present extension rates include the cost of station wiring. In this regard the Commission takes official notice of the recent order of the Federal Communications Commission (Order 77-150, Docket No. 19129 issued March 1, 1977), which required AT&T to make an extensive study and submit a proposal to convert station wiring from a capital item to an item of expense. Such a change has desirable effects relative to reduced taxes, reduced capital requirements, and generally reduced revenue requirements. The order herein requires General to study and report on such a program as a first step towards expensing station wiring.

General provides Measured Local Service (MLS) to all business customers and to residence customers who have subscribed to measured service in the LAEA. Pacific Telephone also provides such timed service to LAEA customers under its Single Message Rate Timing (SMRT) plan to the same classes of business and residence customers. In the current Pacific rate proceeding (A-55492) there are a number of proposals to modify the SMRT plan to provide off-peak benefits and other changes to make charges more closely conform to actual use. However, the measuring equipment now in use by General has certain limitations which obviate the possibility of General adopting the proposed SMRT rate pattern at an early date. Instead of changing the charging pattern of General, the order herein provides a substantial reduction in the local message unit rate from 5¢ per unit to 3¢ per unit in order to achieve a more equitable relationship between the charges of the two utilities.

In summary the three-rate reductions have the following revenue effects:

Billing Decrease

Basic Exchange Rates	$ 7,019,000
Extension Rates	4,951,000
Local Message Rates	5,937,000
Total Decrease in Billing	17,907,000
Settlement Increase	2,101,000
Revenue Effect Before Deducting Uncollectibles of $126,400	15,806,000

Basic Exchange Monthly Rates, Primary Service

Class and Grade of Service	Extended Service LA Metropolitan Exchanges		All Other Exchanges(1)	
	Present	Authorized Herein	Present	Authorized Herein
Residence				
1-Party Flat Rate	$ 5.75	$ 5.45	$ 5.95	$ 5.65
1-Party Message Rate ("Lifeline")	3.00-30	2.50-30	-	-
2-Party Flat Rate	-	-	5.25	4.95
Suburban (SUB-R)	5.05	4.75	5.25	4.95
Business				
1-Party Flat Rate	-	-	13.20	12.80
1-Party Message Rate	7.65-80	7.25-80	-	-
2-Party Flat Rate	-	-	10.50	10.00
Suburban (SUB-B)	10.50	10.00	10.50	10.00
Semi-Public Coin Box (SPCB)	7.65	7.25	7.65	7.35
PBX-Trunk Flat Rate	-	-	19.80	19.20
PBX-Trunk Message Rate	3.80-0	3.60-0	-	-

(1) Rates shown are for local service and accordingly exclude rate increments for Extended Area Service where offered.

Extension Monthly Rates
All Exchanges

	Present	Authorized Herein
Residence	$1.15	$0.70
Business Flat Rate	1.85	.70
Business Message Rate	1.40	.70
PBX	1.50	1.50

Local Message Unit Rate

	Present	Authorized Herein
Local Service	5¢	3¢
FEX Service	6¢	4¢

As indicated on page 16 (mimeo), the rates established by this decision will be made subject to possible refund because of the use of test year normalization. Rates for General have been similarly conditioned since 1970 (Decisions Nos. 79367, 81824, and 83779).

Refunds

Decision No. 85531 dated March 2, 1976 in Pacific's Application No. 55214 modified Decision No. 85287 dated December 30, 1975 in that application "to include an additional ordering paragraph, number 15, as follows:

> "15. General will keep records of the settlement revenue received from Pacific flowing from this decision and hold the same subject to possible refund pending disposition of Application No. 55383 and until further order of the Commission."

From Table 1 it can be determined that the "Effects of Decision No. 85287" on net operating revenues amount to an increase of $3,550,000 which, when applied to the adopted intrastate rate base of $1,339,862,000, increases rate of return by 0.26 percent, from 8.85 percent to 9.11 percent under our adopted operating results. It thus becomes evident that the increased settlement revenue received by General from Pacific flowing from Decision No. 85287 should be flowed through to General's subscribers. Our order in this decision will so provide. Accordingly, General will be required to submit an appropriate refund plan, i.e., a plan to refund to customers amounts which in the aggregate will equal the increased settlement revenues in question received by General up to the date upon which the rates prescribed in Appendix B to this decision become effective.

Measured Local Service (MLS) in Outlying Exchanges

As requested by the Commission (Decision No. 83779, mimeo. page 56), General, through one of its witnesses, set forth a program to accomplish MLS service offerings in the Oxnard, Redlands, San Bernardino, and Santa Barbara exchanges, and presented plant, revenue, and expense effects of such an offering.

The effects include a revenue decrease of $560,000 and a rate base increase of $3,937,000, indicating the provision of MLS in those exchanges at this time is uneconomical. It is also premature in that MLS should be limited to the Los Angeles Metropolitan Area (LAMA) until public acceptance has been tested and evaluated.

Further, the central office equipment, which times MLS calls, has common equipment for 4,000 line increments, and is designed for use in large central offices, such as are prevalent in the LAMA. The four exchanges under consideration have primarily small central offices, with the possible exception of the San Bernardino exchange. The smaller central offices could not economically utilize the MLS equipment. General is presently studying alternatives to determine if there are more economical ways of providing MLS in smaller central offices. MLS will not be ordered now in those exchanges. But General will be ordered to file a comprehensive report on its study of potentially more economical ways of providing that service.

Changes in General's Accounting Practices

The staff recommended five modifications of General's accounting practices, procedures, and records:

> "1. Discontinue the practice of accumulating Interest During Construction (IDC) on land parcels and reverse all IDC accumulated in Account No. 211, Land, since January 1, 1971.
>
> "2. Reclassify Small Tools and Equipment currently being amortized to a deferred Debit Account.
>
> "3. Charge the write-off of abandoned or canceled work orders to a nonoperating account as required by the Uniform System of Accounts for Class A Telephone Companies.

"4. Discontinue the practice of using the April 1, 1967, workmen's compensation general public liability, and auto liability insurance rates, and to use applicable current rates.

"5. Record dues, donations, and contributions as miscellaneous income deductions in accordance with the Commission policy."

General does not oppose the above-enumerated recommendations; they appear reasonable; our order in this decision will direct General to adopt and implement them.

<u>Findings</u>

1. The reasonable estimates of intrastate operating revenues, operating expenses, and rate base, as discussed in this opinion and set forth in column (c) of Table 1, result in a 9.40 percent rate of return under present rates.

2. A fair rate of return for General at this time, based on the record developed in this proceeding, is 8.85 percent. The return on common equity, under the adopted capital structure and cost rates for debt and preferred stock, is 12.40 percent. Within the adopted capital structure the common equity portion is 40 percent. General's rate of return will be further examined in Case No. 10001.

4.a. The adopted intrastate operating results for test year 1976 yielding a 9.40 percent rate of return under present rates are appropriate, pursuant to our authority within the scope of Case No. 9911, to determine General's revenue excess.

b. General's net annual intrastate revenues should be reduced by approximately $7.4 million to lower its test year rate of return from 9.40 percent under present rates to the 8.85 percent found to be fair.

c. A decrease of approximately $15.7 million in annual intrastate gross revenues before deducting uncollectibles is needed to produce the $7.4 million in net revenues and is thus justified.

d. The rates and charges prescribed in Appendix B are designed to produce, in relation to present rates and charges, the required revenue decrease.

5. It is reasonable to set rates for this proceeding based on test year normalization, subject to possible refund, pending resolution of this issue on remand to the Commission by the California Supreme Court (City of Los Angeles v PUC (1975) 15 Cal 3d 680). Whatever decision is reached by the Commission on the remand will be applied in due course to this case.

6. The decrease in rates and charges required by this decision are justified and are reasonable; and the present rates and charges, insofar as they differ from those prescribed by this decision, are for the future unjust and unreasonable.

7.a. Increased settlement revenue to General results from Decision No. 85287 dated December 30, 1975 in Pacific's Application No. 55214.

b. Decision No. 85531 dated March 2, 1976 recognized that "the increase in General's revenue attributable to the receipt of increased settlement revenue from Pacific may result in unjust and unreasonable rates for General and modified Decision No. 85287 to include the following additional ordering paragraph:

> "15. General will keep records of the settlement revenue received from Pacific flowing from this decision and hold the same subject to possible refund pending disposition of Application No. 55383 and until further order of the Commission."

c. Exclusive of the increased settlement revenue to General resulting from Decision No. 85287, General's rate of return on a test year 1976 basis at pre-Decision No. 85287 rate levels is 9.14 percent.

d. Rates are being set in this proceeding to yield an 8.85 percent rate of return.

e. Accordingly, pursuant to Decision No. 85531:

(1) General should be required to refund to customers amounts which in the aggregate will equal the increased settlement revenue in question received by General up to the date upon which the rates prescribed in Appendix B to this decision become effective; and

(2) Within forty-five days after the effective date of this order, General should be required to file with this Commission a refund plan designed to make refunds to customers in harmony with part (1) of Finding 7.e. immediately above.

8. General is presently studying alternatives to determine if there are economical ways of providing measured local service in smaller central offices. General should be required to file with the Commission a comprehensive report on its study of more economical ways of providing that service.

9. The five staff recommendations with respect to accounting practices, procedures, and records set forth on pages 48 and 49 (mimeo.) of this decision are reasonable and should be implemented by General.

10. It is reasonable to direct through General that the Directory Company be required, as recommended by the staff, "to prepare records showing the full effect of its income resulting from business done for General Telephone Company of California or in connection with customers of General Telephone

Company of California. This should include all commission received from advertising placed in directories outside General's service areas." This requirement is to apply to directory business done on and after January 1, 1977.

12. General should be directed to undertake a study of the effects of converting treatment of station wiring from the present capitalized basis to an expense basis.

13. General's service is adequate. However, it is desirable that General continue its projected conversion from step-by-step to electronic central office switching equipment. General should be required to file a comprehensive report on its proposed program.

14. The investigation under Case No. 9911 should be continued to accommodate an eventual decision by the Commission on the remand of the test year normalization issue (City of Los Angeles v PUC, supra) and to provide an opportunity to Ad Visor, Inc., to undertake appropriate discovery and present evidence concerning the rules, practices, and guidelines governing directory advertising relating to General (see mimeo, page 3).

Based on the foregoing findings, we conclude that General's Application No. 55383 for rate increases should be denied and that a rate reduction, pursuant to our authority invoked by Case No. 9911, and refund, pursuant to Decision No. 85531, should be prescribed in accordance with the following order.

O R D E R

IT IS ORDERED that:

1. Application No. 55383 of the General Telephone Company of California (General) for authority to increase its intrastate rates and charges for telephone service is denied.

2. General is directed to file with this Commission, within fifteen days after the effective date of this decision and in conformity with the provisions of General Order No. 96-A, revised tariff schedules with rates, charges, and conditions modified as set forth in Appendix B. The effective date of the revised tariff sheets shall be five days after the date of filing. The revised tariff schedules shall apply only to service rendered on and after the effective date of the revised schedules.

3. Within forty-five days after the effective date of this order, General shall tender to this Commission for filing a refund plan to refund to customers amounts which in the aggregate will equal the increased settlement revenue received by General resulting from Decision No. 85287 up to the date upon which the rates prescribed in Appendix B become effective. Upon approval by this Commission of a reasonable refund plan, General shall make refunds in accordance with such approved plan.

4. Within ninety days after the effective date of this order, General shall prepare and file with this Commission a written report setting forth studies of alternatives to determine if there are economical ways of providing measured local service in smaller central offices.

5. General shall carry out the five staff recommendations with respect to its accounting practices, procedures, and records set forth on pages 48 and 49 (mimeo) of this decision.

6. General shall require the General Telephone Directory Company, commencing January 1, 1977, to maintain its records so that the full effect of its income resulting from business done for General or in connection with customers of General, including all commissions received from advertising placed in directories outside of General's service areas, is separately shown.

7. General's rates for intrastate telephone service shall continue to be subject to possible refund pending resolution of the test year normalization issue on remand to this Commission by the California Supreme Court (City of Los Angeles v PUC (1975) 15 Cal 3d 680). Whatever decision is reached by the Commission on the remand shall be appropriately applied in due course to this case.

8. General shall notify all connecting telephone companies that provide foreign exchange service from General's exchanges that the foreign exchange filed rates should be reduced by the amount of the reduction prescribed by this decision in General's pertinent local rates. Such changes in rates for foreign exchange service shall be applicable within twenty days after the effective date of this order.

9. General is directed to prepare a comprehensive study of the estimated plant, revenue, expense, rate, and service effects of converting from step-by-step to electronic central office switching equipment. This study shall include one or more feasible conversion programs together with General's recommendations. The report on this study shall be filed within six months of the effective date hereof.

10. General is directed to prepare a study of the plant, revenue expense, settlement, and rate effects of converting treatment of station wiring for extensions from the present capitalized basis to an expense basis. The report on this study shall be segregated to the following categories: (1) PBX, (2) key telephone systems, (3) other business and (4) residence. Included in the report shall be a proposed plan for such a conversion over a period of several years. The report shall be filed within six months of the date hereof.

11. Because this matter has been submitted since March of 1976 and because we perceive that both General and its customers will be best served by terminating this proceeding as quickly as is now possible, we will make this order effective on the date it is issued.

The Executive Director of the Commission is directed to cause a certified copy of this order to be served forthwith upon the General Telephone Company of California and to cause a copy to be mailed to each appearance of record.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 28th day of JUNE, 1977.

Robert Batinovich
President

William Symons Jr.

Vernon L. Sturgeon

Richard D. Gravelle

Commissioners

APPENDIX A

LIST OF APPEARANCES

Applicant and Respondent: Albert M. Hart, H. Ralph Snyder, Jr., and John Robert Jones, Attorneys at Law.

Protestant: Alexander Googooian, City Attorney, for the City of Bellflower.

Respondents: Milton J. Morris, Attorney at Law, for The Pacific Telephone and Telegraph Company; and Dinkelspiel, Pelavin, Steefel & Levitt, by Lenard G. Weiss and Alvin H. Pelavin, Attorneys at Law, for Calaveras, Dorris, Ducor, Evans, Happy Valley, Hornitos, Livingston, Mariposa County, The Ponderosa, Sierra, The Siskiyou, and The Volcano Telephone Companies.

Interested Parties: Neal C. Hasbrook, for California Independent Telephone Association; Norin T. Grancell, Attorney at Law, for Ad Visor, Inc.; Burt Pines, City Attorney, by Leonard L. Snaider, Attorney at Law, for the City of Los Angeles; Robert W. Russell and Manuel Kroman, for the Department of Public Utilities and Transportation, City of Los Angeles; Jack Krinsky and Fred Krinsky, for Ad Visor, Inc., California Motorcycle Dealers Association, California Refuse Removal Council South District, Central California Waste Disposal Association, San Bernardino-Riverside County Disposal Association, California Disposal Association, San Bernardino-Riverside Liquid Waste Association, and Inland Empire Chapter California Auto Body Association; Louis Possner, for the City of Long Beach; and Hilliard, McGuire & Bauer, by Paul J. Barba, Attorney at Law, for Telephone Answering Services of California, Inc.

Commission Staff: Timothy E. Treacy, Attorney at Law, Paul Popenoe, Jr., and James Pretti.

APPENDIX B

RATES

General's rates, charges, and conditions are changed as set forth in this appendix.

Schedule No. A-1
Individual and Party Line, Suburban, PBX Trunk and Semipublic Service

	Rate Per Month	
Class and Grade of Service	Extended Service Los Angeles Metropolitan Exchanges 1/	All Other Exchanges 2/
Business Service		
Individual Line - Flat	-	$12.80
Individual Line - Measured	$ 7.25(80)	-
2-Party - Flat	-	10.00
Suburban Business	10.00	10.00
Semipublic Coin Box	7.25	7.35
PBX Trunk - Flat	-	19.20
PBX Trunk - Message	3.60(0)	-
PBX Stations	1.50	1.50
Extension Stations	.70	.70
Residence		
Individual Line - Flat	$ 5.45	$ 5.65
Lifeline - Measured	2.50(30)	-
2-Party - Flat	-	4.95
Suburban Residence	4.75	4.95
Extension Stations	.70	.70

(Message allowance shown in parenthesis.)

	Rate per Unit
Measured rate service, each exchange unit over the allowance	3¢

NOTES

1/ Extended Service Los Angeles Metropolitan Exchanges

Covina	Monrovia	Sierra Madre
Downey	Ontario	Sunland-Tujunga
Etiwanda	Pomona	West Los Angeles
Huntington Beach	Redondo	Westminster
Long Beach	San Fernando	Whittier
Malibu	Santa Monica	

2/ Rates shown are for local service. Extended service, where offered, is offered at these rates plus extended service rate increments, which are unchanged.

RATES

Schedule No. A-1 (Continued)

All Other Exchanges

Arrowhead	Indio	Perris
Badger	Isleton	Pinyon
Banning-Beaumont	Joshua Tree	Redlands
Carpinteria	Laguna Beach	Reedley
Courtland	Lake Hughes	Salton
Crestline	Lancaster	San Bernardino
Desert Center	Lindsay	Santa Barbara
Desert Hot Springs	Lompoc	Santa Maria
Dunlap	Los Alamos	Santa Paula
Eagle Mountain	Meadowview	Santa Ynez
Elsinore	Miramonte-Pinehurst	Squaw Valley
Fowler	Moreno	Sun City
Grant Grove	Morongo Valley	Temecula
Guadalupe	Murietta	Thousand Oaks
Hemet-San Jacinto	Oxnard	Twentynine Palms
Homestead Valley	Palm Desert	Walnut Grove
Idyllwild	Palm Springs	Yucca Valley

Schedule No. A-19 Foreign Exchange Service	Rate per Unit
Each exchange unit over the allowance	4¢