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Decision No. 88232 DEC 13 1977

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of The Pacific Telephone and Telegraph Company, a corporation, for telephone service rate increases to cover increased costs in providing telephone service.	Application No. 55492 (Filed February 13, 1975; amended April 19, 1975 and January 16, 1976)
Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, inter-company settlements, contracts, service, and facilities of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.	Case No. 10001 (Filed November 12, 1975)

(Appearances are listed in Appendix A.)

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O P I N I O N

INTRODUCTION

The Pacific Telephone and Telegraph Company (Pacific) originally filed Application No. 55492 on February 13, 1975. After the decision in Pacific's previous request for rate relief, Decision No. 85287 dated December 30, 1975 (____ CPUC ____), Application No. 55214, Pacific filed, on January 16, 1976, a substantial amendment to Application No. 55492, taking into account the adopted results in Application No. 55214 (the early history of Application No. 55492 is reviewed in our order denying motion to set public hearings, Decision No. 84938 dated September 30, 1975).

Application No. 55492, as amended, requests rate relief for a 1975-1976 test year in the amount of $119.6 million. In this decision we are awarding rate relief totaling $12.8 million. This amounts to a revenue increase of 0.5 percent of total intrastate operating revenue.

As this application was originally conceived, it contained an alternate, and lower, request for rate relief associated with an estimated saving resulting from a proposed directory assistance charge plan, filed by Pacific in accordance with our previous order in Decision No. 85287, supra. After a large amount of public testimony on this particular issue, we determined that because of the scope of the issues raised, it should be transferred to another proceeding, and accordingly, on April 20, 1976 we instituted an investigation on our own motion into directory assistance charges (Case No. 10085). Later in that case, we issued Decision No. 86082 dated July 7, 1976 which limited the scope of the investigation to eliminating systematic abuse of directory assistance services, and stated that we would not further consider a plan of charging subscribers for directory assistance usage after the usage exceeded so many calls per month. Since this entire issue will be disposed of in Case No. 10085, no further reference need be made to it here.

Sixty-three days of public hearings were held in various locations throughout the State before various members of the Commission and Administrative Law Judge Meaney during various dates in 1976 between February 2 and October 28. The matter was submitted on October 28 subject to various brief filings, the closing briefs on the various rate issues being due December 31, 1976. Various interim decisions were issued on specific subjects during the course of the case, which will be reviewed herein as necessary to discuss particular subjects.

Pacific sought no increase in rate of return in this proceeding. In Decision No. 83162 (Application No. 53587) dated July 23, 1974 (___ CPUC _____) Pacific's rate of return was determined to be 8.85 percent. In our third interim order in this present proceeding (Decision No. 86593 dated November 2, 1976, ____ CPUC _____) we reduced Pacific's authorized return by 0.007 percent because of service considerations, and Pacific is contesting this result. Regardless of the outcome of that contest, we indicated in Decision No. 86593 that this reduction could be terminated when the service problems are cured. We will determine rates for 8.85 percent and then indicate what reductions are being made to account for the 0.007 percent reduction, so that we may act to eliminate the reduction at the appropriate time.

Also central to the final disposition of rate levels in this proceeding is the question of how to compute federal income taxes. The issues were elaborately discussed in our most recent Pacific decision (No. 85287 dated December 30, 1975 in Application No. 55214, and in the California Supreme Court opinions cited therein. The issue has been decided in another pending proceeding (Decision No. 87838 dated September 13, 1977). The adopted results herein reflect the use of test year normalization of accelerated depreciation and ratable flow through of the investments credit (increased to 10 percent for 1975 and 1976 by the Tax Reduction Act of 1975) for federal income taxes, and test year flow through of accelerated depreciation for

State of California income taxes. Rates determined here will be subject to refund because the test year normalization question is still outstanding, with Decision No. 87838 under appeal by various parties.

A major issue in this proceeding is whether there should be any change in the formulas we use for allocating costs, revenues, and rate base between interstate and intrastate operations. This issue is the subject of supplementary hearings and will be disposed of in a supplementary opinion and order. The rates determined here will also be subject to refund depending upon the outcome of this issue. For the purpose of this order, we will follow our past separations practices.

The staff performed an elaborate study of the Bell System license contract (payments by Pacific to AT&T for the performance of various services, including Bell Laboratories and Western Electric product development). Delays in the development of data also caused us to set supplementary hearings on this issue, and our rate orders herein are also subject to refund pending its resolution.

I. MONITORING PRACTICES

Before proceeding to rate relief, rate design, and service considerations, we will discuss various issues raised in connection with monitoring of telephone calls. In our fourth interim order in this matter (Decision No. 86594 dated November 2, 1976) we dealt with the problems of monitoring of telephone conversations between two or more customers by plant maintenance personnel for the purpose of repairing lines, and ruled that in all such cases a beep tone shall be used. No further discussion of this particular issue is necessary.[1/]

1/ Decision No. 86594 also dealt with single message rate timing (SMRT) for residential telephone service. We granted petitions for rehearing on the SMRT issue, but our orders granting such rehearing specifically left our ordering paragraphs concerning plant maintenance monitoring in full force and effect.

Background

This is by no means the first time that we have considered monitoring problems in detail. In order to understand our disposition of the issues raised here, we must include a brief review of our past actions.

Our jurisdiction over this matter stems from Section 7906 of the Public Utilities Code which reads:

> "7906. Privacy of communications; investigation. The Public Utilities Commission shall regularly make inquiry of every telephone corporation under its jurisdiction to determine whether or not such corporation is taking adequate steps to insure the privacy of communications over such corporation's telephone communication system."

In 1964 an investigation was commenced (Case No. 7915) because certain telephone utilities were offering to their subscribers monitoring equipment which was under the control of the subscribers and not the telephone utilities, for the purpose of training and observing employees in their duties. In Decision No. 69447, issued July 27, 1965 (64 CPUC 526), we generally reviewed our attitude toward monitoring equipment furnished to subscribers for the purpose of monitoring conversations between an employee of a subscriber and an outside caller of the subscriber.

We found, inter alia, that subscribers were unable to insure, and were unwilling to attempt to insure, that monitoring equipment would not be used for purposes other than those allowed by the authorized conditions of service. Therefore, we required that any such equipment furnished to subscribers would be equipped with an automatic toning device of the same type as specified by the Federal Communications Commission (FCC) for notice of the use of recording devices in connection with interstate and foreign message toll service.

That investigation was reopened, and after 27 additional days of hearing in 1966 we issued another decision (Decision No. 73146 dated October 3, 1967, 67 CPUC 528). In this extensive opinion we considered, among other things, whether any monitoring, "service observing", or "recording practices" of any nature should be employed by public utility telephone corporations in the conduct of business, and whether any service observation should be conducted without the requirement of notice. We considered extensively the different types of equipment used by telephone utilities and other businesses for monitoring purposes and different methods of giving notice to the customer that such monitoring is taking place. The purposes and methods of various types of monitoring were explored at length.

Utilities and others took the position that monitoring of employees is an essential tool necessary for maintaining proper service to customers. The American Civil Liberties Union argued that no monitoring should be employed for any purpose, even with a beep tone or other warning device. Various unions advocated that monitoring should never be permitted without an audible warning device. Some of the telephone workers unions advocated restrictions on monitoring. The suitability of various substitutes for monitoring was considered.

Thus, in that extensive investigation we considered all facets of monitoring both by telephone corporations and by telephone corporation subscribers. In Decision No. 73146, supra, we found:

> "1. Monitoring by telephone utilities and business subscribers is useful in the training of employees, assists in promoting the efficiency of operations and helps to improve the quality of service to the public.
>
> "2. Notice of monitoring by a beep tone tends to destroy the usefulness of monitoring and decreases the use of monitoring equipment.

"3. Adequate means other than monitoring are available for the purposes of training employees, promoting efficiency of operations and improving the quality of service to the public.

"4. This record contains no quantitive and convincing evidence that substantial decreases in efficiency of operations or of quality of service to the public have occurred since February 16, 1966.

"5. The use of monitoring equipment has not been permitted since February 16, 1966.

"6. Some monitoring equipment was used without prescribed notice by business subscribers as late as April 15, 1966, and was in place and capable of being operated as late as June 24, 1966.

"7. Public utility telephone corporations are unable to insure, or are unwilling to insure, that monitoring equipment will be used by subscribers in accordance with prescribed tariff conditions.

"8. Monitoring equipment as herein defined gives no notice to any party to a communication that the communication may be or is being monitored.

"9. The use of monitoring equipment without an audible warning tone is advocated generally by executives, managers, some employees of telephone corporations and of business subscribers to telephone corporation services, and by some members of the public.

"10. The use of monitoring equipment is resisted generally by the telephone industry labor unions, employees represented by such labor unions and by some members of the public.

"11. All parties to a communication should be advised of all persons who monitor, record, or otherwise intercept such communication so that each of such parties may determine the degree of communication privacy desired.

"12. No telephone corporation or subscriber to the service thereof or any governmental agency can determine for a party to a communication the degree of privacy such party desires.

"13. The privacy desired by a party to a communication can only be determined by giving appropriate notice to such party that the communication is being monitored, recorded, or otherwise intercepted.

"14. This record contains no convincing evidence to change the findings and conclusions of Decision No. 69447.

"15. It is a reasonable condition of service, and it is in the public interest in promoting the privacy of communication to require that all monitoring equipment (as herein defined), which is used to monitor any communication over any part of a public utility network, shall give appropriate notice of monitoring to all parties to such communication unless such monitoring is essential to the actual operation, maintenance and construction of the communication circuitry or to national defense or to law enforcement or to the health and safety of the public and individuals.

"16. Such notice of monitoring by recording of communications should be given by the 'beep' tone prescribed by the Federal Communications Commission or by marking telephone instruments from which communications may be recorded as hereinafter prescribed.

"17. Notice of the monitoring or otherwise intercepting, except recording, of communications should be given as hereinafter prescribed.

"18. Exceptions to the requirements of notice of monitoring and the limitations on monitoring, as hereinafter prescribed, are reasonable.

"19. It is reasonable to require telephone corporations to promote the privacy of communication by forbidding the divulgence of information pertaining to a monitored communication or the benefiting by those not entitled thereto from such information.

"20. The rules, practices, equipment, appliances, facilities and service of telephone corporations in California are unreasonable and improper in that they do not adequately or sufficiently insure the privacy of communications over the public utility networks of such corporations.

"21. Section 7906 of the Public Utilities Code, set forth in Decision No. 69447, indicates that it is the policy of the legislature that communications over public utility telephone systems be private.

"We conclude that, under Section 761 of the Public Utilities Code, Decision No. 69447 should be affirmed and the rules, practices, equipment, appliances, facilities and service of telephone corporations in California should promote the privacy of communications as ordered herein."

Our order in the decision prohibited monitoring without notice. It prescribed the methods of giving notice (one method being an automatic tone warning - in other words a beep tone). It also established exceptions to the "notice" requirements, in the following specific instances.

(1) Monitoring, recording, and interception of communications by telephone corporations when required by law enforcement and national defense agencies under enabling laws and legal safeguards.

(2) Monitoring, recording, and interception of communications by telephone corporations when any of said activities may be required to identify and eliminate the source of lewd or harassing calls of which a subscriber has complained to the telephone corporation.

(3) "Administrative monitoring" when performed by telephone corporation employees to provide the utility with an overall evaluation or index of the quality of telephone corporation service furnished by a telephone corporation office or work group to subscribers without reference to the performance of individual employees; without identifying individual employees or subscribers; and without the making of any notation or any written record of the contents, substance, purport, effect, or meaning of any conversations which may have been heard during said administrative monitoring, except as specifically required for administrative monitoring.

(4) "Supervisory monitoring" of telephone traffic and plant operations when performed without the making of any written notation or any record of the contents, substance, purport, effect, or meaning of any conversation which may have been heard during said supervisory monitoring.

(5) Monitoring, recording, and interception of communications when performed by telephone corporation employees to prevent the perpetration of fraud upon or loss of revenue by the telephone corporation when performed without the making of any notation or any record of the contents, substance, purport, effect, or meaning of any of said communications, except as absolutely necessary to prevent such fraud or loss of revenues.

(6) Interception of communications by telephone corporation employees who are engaged in the actual operation, maintenance, and construction of the communication circuitry of the telephone corporation when performed without any written notation and any record of the contents, substance, purport, effect, or meaning of any communication which may have been intercepted.

Decision No. 73146 is still our basic order concerning monitoring. The only modification to it has been in the fourth interim order in this present proceeding (Decision No. 86594 dated November 2, 1976). This change was occasioned by the fact that the evidence showed that, upon the request of a customer, a conversation on his telephone line is very occasionally monitored for repair and maintenance. We ordered that Ordering Paragraph 2.C(6) of Decision No. 73146 be modified to require that, except for computer data transmissions, a beep tone would be used whenever such maintenance monitoring was to take place.

In our present proceeding, no further contentions are raised concerning monitoring by subscribers. The issues here involve entirely monitoring by telephone corporations for the purpose of "supervisory monitoring" or "administrative monitoring" as defined in the order above. As the order shows, these two types of monitoring are exempt from the requirements of a beep tone provided that no written notations of conversations are made. TURN, in effect, invites us to reexamine our conclusion in Decision No. 73146 relative to supervisory and administrative monitoring. We believe that some of the evidence offered is duplicative of the efforts by the many parties in Case No. 7915; however, we believe that certain issues must be addressed. These issues break down into two basic categories: (1) problems of constitutional law and privacy of communication, and (2) practical and administrative considerations.

Statutory Considerations

TURN argues that Pacific's monitoring practices violate state and federal statutory requirements.[2/] This assertion is not borne out by the plain language of the statutes involved, and, contrary to TURN's claims, there is no post-1966 legislation which has the effect of overturning our previously reviewed decisions.[3/]

2/ State statutes regulating wiretapping are not in conflict with federal law. (People v Conklin (1974) 12 Cal 3d 259, 114 Cal Rptr 241; appeal dismissed, 419 US 1064, 42 L ed 2d 661, 95 S Ct 652.)

3/ Compare Footnote 15, infra.

The federal statute concerning wiretapping and eavesdropping, 18 US Code § 2511, contains the following exception:

> "(2)(a) It shall not be unlawful under this chapter for an operator of a switchboard, or an officer, employee, or agent of any communication common carrier, whose facilities are used in the transmission of a wire communication, to intercept, disclose, or use that communication in the normal course of his employment while engaged in any activity which is a necessary incident to the rendition of his service or to the protection of the rights or property of the carrier of such communication: Provided, that said communication common carriers shall not utilize service observing or random monitoring except for mechancial or service quality control checks."

Service observing and administrative monitoring fall within the proviso of this section.

Regarding state law, California's anti-wiretapping statute, Penal Code Section 631, after setting out the acts which constitute wiretapping in paragraph (a), contains the following language in paragraph (b):

> "(b) Exceptions. This section shall not apply (1) to any public utility engaged in the business of providing communications services and facilities, or to the officers, employees or agents thereof, where the acts otherwise prohibited herein are for the purpose of construction, maintenance, conduct or operation of the services and facilities of such public utility, or (2) to the use of any instrument, equipment, facility, or service furnished and used pursuant to the tariffs of such a public utility, or (3) to any telephonic communication system used for communication exclusively within a state, county, city and county, or city correctional facility."

This Penal Code section does not, of course, remove our jurisdiction to take necessary action to guarantee the privacy of telephonic communication under Public Utilities Code Section 7906. The previously discussed Commission cases on this subject, as we have seen, resulted from our jurisdiction under this Section.7906.

Constitutional Questions

We deal here with whether supervisory and administrative monitoring, in their present form, pose constitutional problems under the Fourth Amendment to the U.S. Constitution[4] or the First Article of the California Constitution.[5]

The exact methods of such monitoring are described in detail, infra, under the heading "Practical Considerations". Here we are concerned with the effect upon the customers, many of whom are unaware of monitoring practices.

We find that the practice of supervisory and administrative monitoring of voice telephone connections between a user and one or more telephone company employees, under conditions where the telephone user can be overheard by the monitor, without adequate information that such monitoring is liable to take place, is a violation of privacy guarantees under both of the above-mentioned constitutional provisions.

4/ "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized."

5/ "All people are by nature free and independent and have inalienable rights. Among these are enjoying and defending life and liberty, acquiring, possessing, and protecting property, and pursuing and obtaining safety, happiness, and privacy."

By virtue of his or her training, the operator or other telephone employee receives adequate warning of the fact that a small percentage of calls are monitored. Our constitutional problem therefore concerns the user.[6/]

We will first consider the U.S. Constitution. Most of the cases cited in the briefs of Pacific and TURN on this point are not of much assistance, since they concern searches and seizures in criminal investigations, where the issue is introduction of evidence under the "exclusionary rule",[7/] or problems regarding the legitimate proprietary right of a telephone company to protect its system against unlawful abuse.[8/] None of the fact situations in any of the cases cited squarely deal with the issue we are faced with here, because none of them fall under the statutory exceptions to wiretapping discussed above, and therefore the courts had no reason or basis to consider constitutional problems relating to statutory exceptions in favor of supervisory or administrative monitoring. Nor do any of our own three previous opinions on the subject discuss this issue in detail.[9/]

6/ Alleged effects on service standards from the use of monitoring are dealt with, infra, under "Practical Considerations".

7/ People v Avers (1975) 51 CA 3d 370, 124 Cal Rptr 283; People v Superior Court (Freeman) (1975) 14 C 3d 82, 120 Cal Rptr 697; Halpin v Superior Court (1972) 6 Cal 3d 885, 101 Cal Rptr 375.

8/ U.S. v Clegg (1975) 509 F 2d 605; U.S. v Beckley (1965) 259 F Supp 567. In Huff v Michigan Bell Tel. Co. (1967) 278 F Supp 76, the issue was the phone company's monitoring of a phone in an employee lounge used for personal calls with the company's assent.

9/ The American Civil Liberties Union, a party to Case No. 7915, argued on brief in that case that all administrative and supervisory monitoring, with or without any warning of its presence, was unlawful. Our findings and order in Decision No. 73146 (67 CPUC 528) should make it clear that we rejected this contention, as we again reject it here.

In Griswold v Connecticut (1965) 381 US 479, the U.S. Supreme Court stated (p. 484) that specific guarantees in the Bill of Rights have "penumbras", and, specifically, that the Fourth Amendment included in its penumbra, a right to privacy, even though such language was not included in so many words in that amendment.

It is also clear that a physical trespass is not necessary to constitute an invasion of privacy. In Katz v United States (1967) 389 US 347, the petitioner was convicted of transmitting gambling information across state lines by telephone. Evidence had been gathered by attaching an electronic listening device outside the telephone booth from which the calls were made. The Supreme Court reversed the conviction, stating, inter alia, that because the Fourth Amendment protects people rather than places, the Amendment's reach cannot turn on the presence or absence of a physical intrusion into any enclosure.[10/]

With these cases in mind, we return to our Finding 13 in Decision No. 73146:[11/]

> "The privacy desired by a party to a communication can only be determined by giving appropriate notice to such party that the communication is being monitored, recorded, or otherwise intercepted."

This finding was not applied to telephone corporations. Finding 18 provided for exceptions. The exceptions, specifically set out in the order, are supervisory and administrative monitoring by telephone corporations, and certain other categories not relevant here (see quotation of the order, above, pp. 9-10). A review of this finding, and the arguments made here, convinces us that there is no

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10/ Thus the court specifically ruled that the "trespass" doctrine of Olmstead v U.S., 277 US 438, and Goldman v U.S., 316 US 129, no longer controlled.

11/ The complete findings of this decision are quoted at mimeo. pp. 6-9 above.

constitutional warrant for an exception to a requirement of notice to the customer in favor of telephone corporations.

Pacific makes a strong argument to the effect that neither an expectation on the part of the customer of privacy, nor any unreasonable invasion thereof, is involved in service observing. Pacific's opening brief states:

> "Protection of 'private' communications is as important to Pacific as to anyone. Pacific has a deeply felt obligation to protect the privacy of telephone communications in order to assure public confidence in the telephone system. However, no invasion of a private right is involved in service observing. Only exchanges between a Pacific employee in the normal course of business and a customer calling the company for information or assistance are subject to service observing. The conduct subject to service observing is not personal and private communications, but is impersonal and of a business nature. There is no case anywhere in the United States that sustained an invasion of privacy claim based upon an individual's inquiries to telephone company employees about telephone service. There is simply no expectation of privacy involved. The employee knows that he or she is subject to being observed in the normal course of business. . . . The customer is not calling a particular employee of the telephone company; he is calling 'the telephone company' -- whether that means an operator or an operator and her supervisor; a business representative or a business representative and an assistant service operations manager."

The above quotation is a fair statement of the underlying rationale for the exception (in favor of telephone companies) to the requirement that information be provided to a telephone user that

some monitoring is taking place.[12/] We believe this rationale cannot pass constitutional muster, since it is not for a telephone corporation, or even this Commission, to decide for each telephone user that he expects no privacy when he talks to an operator. Pacific overstates its case in its brief in saying "there is simply no expectation of privacy involved". Query whether the average telephone user suspects that at any time he is talking to an operator he may (however infrequently) be overheard by a supervisor, without warning.

We agree with Pacific's argument that the nature of the information in a customer-employee call is not in the same "personal" category as in a customer-customer call, and that a customer does not call a particular operator or service representative. For this reason we believe that the same strictures that exist for customer-customer calls[13/] need not be applied to customer-employee calls, and we reject any contention that supervisory or administrative monitoring, per se, is repugnant to the Constitution. The right to privacy is not absolute, and constitutional guaranteesof privacy are protections against unreasonable invasions, and may be weighed against other considerations (Roe v Wade (1972) 410 US 113, 153-154). It is reasonable to inform telephone customers of the limited use of

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12/ We note with interest that this is in essence the same argument advanced in Case No. 7915 by gas and electric utilities, airlines, and various other business and nonbusiness organizations. While we rejected this contention for such organizations, we in effect accepted it for telephone companies.

13/ Compare, for example, our discussion of test-board monitoring in our fourth interim order herein (D.86594, November 2, 1976).

monitoring so that they recognize that their privacy, when conversing with a telephone company employee, is not absolute, and to allow the practice of supervisory and administrative monitoring to continue in order to maintain quality of service. The information provided should be sufficient to allow the customer to understand the extent of his privacy.

We find that each telephone book in the State should carry, on the page where the table of contents begins, a boxed item to be printed in a least ten point boldface type, explaining supervisory and administrative monitoring, substantially in the form set out in the order in this decision. We also find that each telephone corporation should, within the 1978 calendar year and occasionally thereafter, educate the public concerning monitoring practices by appropriate bill inserts.

Because of the less personal nature of the information, we do not believe that a beep tone is necessary or that each individual call monitored must be specifically identified by beep tone or otherwise. This, in our opinion (as discussed in more detail hereafter) would destroy the value of monitoring, and, as we have said the public also has a legitimate interest in maintaining service standards.[14/]

14/ One other method deserves mention. This is to require a beep tone all the time during every customer-employee conversation, whether or not monitoring is actually taking place. Thus, an operator or other employee would remain unaware of which call is monitored. This alternative was not explored during the hearings and there is no direct information regarding its cost; however, Pacific's witness Morse indicated the cost of requiring a tone warning on all monitored calls would include a $3.9 million capital expenditure (Exh. 96). We believe it would be a serious case of "overkill" to require this, since it would create the impression that all or most customer-employee calls are monitored, when in fact, administrative monitoring is performed on an estimated 0.031 percent of all operator-handled calls, and the estimate for supervisory monitoring, based on the best information available to the Commission, is approximately one percent or less of all operator-handled, business office, and repair calls. It should be well noted that operator-handled calls are, in turn, a small percentage of total calls.

At the expense of repetition, we emphasize that we deal here only with constitutional requirements. Whether other considerations mean that we should additionally regulate monitoring is discussed infra.

We recognize that any warning may result in occasional misunderstandings, and some effort and expense, not previously required, will be necessary to answer questions of customers. Such expense and effort, either on our own behalf or that of a telephone utility under our jurisdiction is, in our opinion, well worth it. Our constitutional responsibilities and those of the utilities we regulate, are paramount, and take precedence over the expedient practice of ignoring the fact that the vast majority of telephone users live in ignorance of the very occasional (less than one percent) monitoring of operator-customer calls.

Our holding is not an implied finding that the above quoted federal and state statutes, insofar as they except administrative and supervisory monitoring, are repugnant to constitutional requirements. Those statutes simply define conduct which constitutes unlawful and punishable wiretapping. That is the extent of their purpose.[15/] An exception from their strictures in favor of certain monitoring practices (which still may be the subject of other legislation or regulation) is not constitutionally objectionable.

Finally we come to consideration of Article I of the California Constitution. Because of its recent adoption, no great body of law surrounds it. However, it is clear that the California "privacy" right is also certainly not absolute and exists, like the

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15/ Cf. Penal Code § 630. The enactment of § 631 in 1967 does not limit the exercise of this Commission's power to regulate certain monitoring of public utilities of their officers or employees. (Opinion of Legislative Counsel, 1967 Assembly Journal 2513.)

federal right, to prevent unreasonable incursions into privacy (White v Davis (1975) 13 Cal 2d 757, 765, 120 Cal Rptr 94; cf. Armenta v Superior Court (1976) 61 CA 3d 584, 132 Cal Rptr 586, and Loder v Municipal Court (1976) 17 Cal 3d 859, 132 Cal Rptr 464.) We hold that the practice of supervisory and administrative monitoring, without the dissemination of adequate information explaining the practice to the telephone customer, is offensive to Article I of the California Constitution on the same basis as discussed previously for the federal Constitution, and that to meet state constitutional standards, the same method as discussed above is acceptable.

Practical Problems

We must first describe the monitoring practices so that the issues are clearly understood.

Supervisory Monitoring. Within the last few years Pacific has been introducing electronic traffic offices. These offices have, for the most part, replaced the old "cord board" offices in urban areas. In such an office a two-person modular unit rather than a switchboard is used. Operators have in front of them a keyboard and a display panel. The display panel shows the calling person's telephone number, and the number of the called party can also be shown. Monitoring of an operator, in this kind of setup, can be done from a remote console which is essentially a duplicate of the operator's console. An operator is unaware, at any particular time, whether he or she is being monitored in this fashion. The record is not clear how much remote monitoring is carried out in a cord-board office, but apparently it is less frequent. The new type of office is known as the Traffic Service Positions System (TSPS).

The increase in remote monitoring has not replaced other types of service observation. In traffic departments, monitoring is done "without notice" (as described above, from a remote console)

and "with notice" at the employee's work positions or from central locations within the same work center by either local operating managers and, in the case of operator services, by service assistants who are non-management employees. In fact, all of the monitoring done in repair centers and business offices is "with notice" at the employee's work position or from locations within the same work center.

Pacific's witness, Richard G. Morse, staff director for operator services, indicated that the number and frequency of observations on a particular operator vary based upon the performance and experience of the employee. He stated that in a typical office, approximately one hour of call observation is obtained on each operator per month. The observers, he said, take only enough observations to obtain a representative sample of each employee's performance. No customer-to-customer calls are monitored.

Administrative Monitoring. Administrative monitoring is a random statistical sampling of a small percentage of the contacts between customers and employees, performed by Pacific's service inspection organization. Its purpose is to measure the overall quality of service by an office or a work group. This type of monitoring does not include the identity of any employee. Administrative monitoring is performed on operators, business employees, and repair services employees. Only about 0.031 percent of all operator handled calls are subject to administrative monitoring. As in the case of service observing, absolutely no customer-to-customer contacts are monitored.

Claimed Speedup. TURN criticizes remote monitoring, as part of a speedup system which results in a degradation of service. It is pointed out that in a cord-board office an operator was expected to handle 20 calls in a half-hour period but in the TSPS offices the expectation is 35 to 40 calls. Some of TURN's

witnesses testified that the speedup had affected customer service. Fewer "rings" are allowed in completing long distance calls; the practice enforced, at least in some offices, is to allow the telephone at the distant location to ring five or six times at the most and then disconnect and ask the customer to try later (Transcript 1217). Another operator complained that they were under pressure to be very brief in finding out whether a child caller was in any sort of difficulty (Transcript 1364).

Another operator explained the apparent speedup in the handling of emergency procedure. According to this operator, she was formerly allowed to stay on the line in an emergency call to a police department but now she is required to leave the line as soon as a conversational exchange takes place. She mentioned specific instances in which she had been reprimanded for remaining on the line (Transcript 1252). (The telephone company practice submitted to the ALJ at his request indicates that in an emergency situation, once a party has answered, the operator must determine that conversation is proceeding satisfactorily before leaving the connection.)

The purpose of the presentation of this evidence was not only to indicate that a speedup has taken place since the advent of TSPS, but to show that remote monitoring is used in enforcing the speedup with undesirable results. One operator complained that such emphasis was placed on the number of calls taken that she could not stay on the line when someone appeared to be in difficulty (Transcript 1354-1355).

There were some complaints that operators, in the evaluation, were not given credit for other types of calls that consumed an unusual amount of time and therefore would lower the operator's average amount of calls taken. One example is a call to a foreign country where the calling party does not have the telephone number and it is necessary to obtain a directory assistance operator in a foreign country (Transcript 1361).

One problem connected with going off the line in an emergency call before a "satisfactory" conversation is established has to do with the consolidation of central offices. Some offices now cover several cities and if a person calls and simply says "give me the police" and is injured or too excited to say where they are, they could possibly be connected to the wrong police department. If an operator goes off the line the person in danger would have to hang up and replace the call. It was pointed out, however, that at least in a TSPS office, the operators have display buttons which, when pushed, will tell the operator what number the person is calling from. (Transcript 1374.)16/

TURN believes that the speedup is aggravated by the use of remote monitoring. Some operator witnesses introduced by TURN testified that other operators had suffered adverse medical effects from pressure and tension of the remote monitoring. (This evidence was entirely hearsay and the Commission has no way of determining how much of any alleged medical effects were due to monitoring as distinguished from, other job pressures or personal problems.) These operator witnesses did comment that they felt more pressured as a result of remote monitoring and in their opinion this affected their job performance.

TURN also questions whether the remote monitoring results in the training that is supposed to emanate from it. One operator introduced by TURN stated she had never received any training as a result of remote monitoring, and another stated that the sessions were very brief and uninformative.

16/ Evidence on this subject is further reviewed in TURN's opening brief, beginning at page 13.

Two witnesses who had been service assistants, and thus responsible for operator training testified that although a certain amount of time is alloted for such training, due to other duties most of this time was spent on other matters. One of the witnesses complained of too many changes in practices resulting in confusion while training operators.

In summary, TURN's witnesses generally tended to agree that remote monitoring did not identify the training needs of the employees and any usefulness in that direction was outweighed by increased tension among the operators from never knowing when they were being monitored.

Written Notations of Monitored Calls

TURN also argues that an undesirable side effect of monitoring is the practice of some service assistants of writing down certain things operators may say to customers in order to use such information for retraining and also for disciplinary purposes. Supervisory monitoring of telephone traffic and plant operations, as performed here without notice to the subscriber, is only allowed when performed "without the making of any written notation or any record of the contents, substance, purport, effect, or meaning of any conversation which may have been heard during said supervisory monitoring". (67 CPUC 553.)

TURN introduced Exhibits 100 through 106 which show that the order of the Commission was violated by making brief quotations which later were used to show discourteous treatment. For the most part, these consisted of improper remarks which might have been overheard by the customer or language which would indicate the operator followed improper procedures. For example, Exhibit 106 indicates that an operator was discovered engaged in a personal conversation with someone connected to her TSPS board. She told this party to "hold on a minute" after which she took five calls from customers and returned to her personal

conversation. In Exhibit 100 the operator was quoted as saying "I hate this bullshit" (although the customer was apparently on hold at the time and therefore did not hear it).

Exhibit 103 shows that a directory assistance operator was asked for the number of a bank at a certain address and the operator (improperly) replied "I can't give address information, however, the main office telephone number is...".

In Exhibit 104 the operator said, "will you keep quiet" in any angry voice to the customer (the operator was attempting to talk to another operator to complete the call). In Exhibit 105, an operator, having been given a party with an unusual surname to be called said, "Quack, quack", to the customer, who replied, "What's that?"

TURN points out that various violations of this sort were the subject of Communications Workers of America v Pacific Telephone & Telegraph Company and General Telephone Company of California (1971) 72 CPUC 78 and, in spite of this, violations continue. TURN recommends that the Commission take strong action regarding this phase of the problem.

Business Office Monitoring

The above methods describe monitoring in the traffic offices. In business offices (as well as repair offices) all monitoring is performed at the employee's station (i.e., with notice) by use of an open transmitter, which involves a supervisor plugging in at the station and keeping the transmitter open, thus assuring the customer of at least some notice (see the "notice" provision Decision No. 73146, 67 CPUC 528, 552-553). So that there is no misunderstanding, now or in the future, we have interpreted, and do interpret our order in Decision No. 73146 to require such an open transmitter for business or repair department monitoring.[17/]

17/ The company witness describes business office monitoring at Transcript 3896 et seq.

While business office-to-customer conversations are not in the same personal nature as customer-to-customer conversations, the information involved is sometimes more personal than when a customer deals with the traffic department. For example, a person requesting telephone service will describe the layout of rooms in the house and something of the general calling patterns in order to establish what service best meets the subscriber's requirements. There is, however, no purpose in terminating or further restricting the "on-station" monitoring for the simple reason that, unlike a traffic office, a business or repair office must keep written records of the calls in order to serve the customers (the customer need not be directly quoted, of course). Thus no particular "privacy" would be achieved by terminating business or repair office monitoring.

We return to our discussion of traffic department monitoring.

Alternatives Suggested

TURN recommends that the Commission terminate remote monitoring. It claims that various alternatives would do the job better.

NOMIO. First, it points to Pacific's NOMIO ("No More Internal Observations") program. This program was introduced in 1969 at Pacific's Fremont directory assistance office. This was intended to be a job enrichment program and to lead to better performance through a relaxed atmosphere (see Exhibit 84 and Transcript 3731 et seq.). The operator's skill level was divided into three phases. When an operator reached the third phase (a relatively high level of experience and efficiency) there was to be no unannounced monitoring for that operator. Exhibit 84 explains that the underlying philosophy behind NOMIO was to use internal observations more effectively and to develop a more individual method of training of operators.

TURN also recommends an "operator identification" number which would allow a customer to identify an operator giving unsatisfactory service. TURN believes that any initial problems which might be caused by questions from the public by instituting such a system would disappear with proper educational information disseminated to the public.

Floor Supervision. This is self-explanatory. Supervisors circulate throughout the office. TURN feels this is an advantageous method because in addition to the correction of improper practices, the supervisors would be able to help the operators with problems. One TURN witness claimed that the mere presence of a floor supervisor within a reasonable distance would discourage misconduct and discourtesy (Transcript 3485). TURN realizes that this would mean only hearing the operator's side of the conversation but claims that this is all that is necessary since an operator has certain standard responses that he or she must make to customer information or requests for assistance.

Monitoring at the Operator's Station. This practice is currently employed by Pacific[18/] and consists of the supervisor monitoring the operator by plugging in at the operator's position. Thus the supervisor can hear both ends of the customer-operator conversation. TURN does not seek to terminate this kind of monitoring because it believes the supervisor could better evaluate the operator and assist and train the operator than when remote monitoring is used. For example, a supervisor can watch the manual operation of the keys by the operator and assist the operator in becoming more efficient in using the console.

18/ As discussed above, this is the exclusive method used in business and repair offices. Such offices do not hire new employees in large numbers. Additionally, in the repair offices, persons do not work at fixed stations and therefore cannot be monitored from remote consoles.

Costs of Monitoring

Lastly, TURN points to what it claims to be a cost saving by way of the elimination of remote supervisory monitoring. In response to TURN's data request, Pacific compiled certain information regarding the cost of supervisory and administrative monitoring (Exhibit 111). This exhibit does not furnish a breakdown by different types of monitoring (that is, remote and otherwise) and shows a total cost in excess of $3 million for supervisory monitoring and slightly in excess of $1 million for administrative monitoring of operator services. TURN disagrees with this estimate and, based upon the testimony of five of its own witnesses and one telephone company witness, claims that it would be conservative to estimate that service assistants spend approximately 60 to 65 percent of their time doing supervisory monitoring and that management spends 15 to 20 percent of its time doing supervisory monitoring. Multiplying this by the number of persons involved, and taking the above percentages of the total figure, TURN claims that the total expense is in the neighborhood of $10 million. (It is emphasized that all the foregoing figures include all types of supervisory observations and not just remote monitoring.)

Pacific's Evidence

Pacific first stresses that the Commission has extensively looked into monitoring before, but nevertheless the Communications Workers of America and TURN, again are requesting changes in the Commission's position in this regard. Pacific points out that the issues have been previously adjudicated and have resulted in the Commission's already strong orders concerning supervisory and administrative monitoring (see discussion under "background" above). Pacific maintains that the elimination of supervisory and administrative monitoring would mean poor service and would contribute to higher revenue requirements.

Pacific first emphatically denies the assertions of TURN's witnesses that supervisory monitoring is basically a disciplinary tool, stressing that it is "invaluable" for training purposes. One witness from the traffic department testified that upon seeing an operator handling a certain kind of call incorrectly, she would take the operator off the board and conduct a training session. Additional training sessions could be conducted if necessary. Other telephone company witnesses testified to the time they spend training operators as a result of observations. One Pacific witness from operator services testified that she identified, through supervisory observations, a certain group of operators needing additional training, and as a result she initiated a coaching group and designated a service assistant to work with them and a manager to insure that the training took place (Transcript 3727-28). As a result, she said, 27 of the 29 operators involved were successful in improving their performance to required levels. The various witnesses for Pacific from Traffic and Commercial testified that the follow-up training resulted from the use of supervisory observations.

Pacific also stresses the need for supervisory monitoring to maintain quality of telephone service. Testimony of the witnesses varied a great deal on how many customer complaints would be received, but one witness testified that in the past five weeks she received 35 customer complaints; 3 for held-up lines, 10 for cutoffs, 5 for abusive language, and 13 for various kinds of rudeness or discourtesy (Transcript 3729). Another witness testified that while performing supervisory monitoring, she personally observed operator discourtesies and cutoffs (Transcript 3753).

In summary, Pacific's witnesses testified that remote supervisory observing helps in discovering violations of secrecy of communications, employee discourtesies, cutoffs and held-up lines, and incorrect procedure during emergency calls. Similarly, Pacific's

witnesses testified that, in the business and commercial departments, they could become aware of and correct representatives who furnished a customer with incomplete information concerning the requested installation, which sometimes save the customer money.

In response to the testimony of a union member who testified that monitoring would have adverse effects on Pacific's meeting its EEOC requirements, Pacific presented the testimony of a San Diego supervisor who stated that she annually prepares an appraisal on each of her employees, and that without the results of a remote supervisory monitoring such evaluations would only be prepared with great difficulty. She stated that the information available from monitoring aids in preparing appraisals and helps employees in obtaining upgrades and transfers. She denied that minority operators react any differently from operators as a whole to remote supervisory monitoring.

Similarly, another Pacific witness who stated that composition of her work force was approximately 20 percent minority, testified that on the basis of her evaluations, which included information from remote monitoring, she was able to loan 21 people to various departments in higher rated jobs. She explained that the benefit of such lending is that the operators learn more about these higher jobs, which helps them qualify for them.

Pacific's witness Richard G. Morse, the staff director for operator services, testified that the data from supervisory observations aid the company in meeting the EEOC requirements for an objective annual performance appraisal on each employee. He stated that a recent study conducted in 13 operator services offices showed that an average of 7.3 percent of the employees were moved to higher rated jobs through an upgrade and transfer plan within a 12-month period. Supervisory observations, he said, were used to evaluate work performance in each case.

Pacific denies that the alternatives suggested by TURN will do the job. One of Pacific's supervisors testified that visual monitoring or floor monitoring tend to make some employees more nervous and as a consequence some employees who perform well when observed remotely have problems on visual observations. This witness also pointed out that in remote monitoring, since a duplicate console is available to the monitor, the operator's ability to handle the position effectively can be checked, whereas in visual monitoring it is difficult to determine the accuracy of the operator's keying (Transcript 3615).

Most importantly, Pacific stresses that visual monitoring and other forms of monitoring "with notice" do not deal with the situation presented with a certain type of employee who would tend to perform well only when he or she is being observed. Pacific points out that the union itself, in the past, has opposed a return to putting more supervisors on the floor instead of remote monitoring. Floor supervisors can only hear the operator's side of the conversation. Pacific also reminds us that this would lead to the necessity for a large increase in the amount of floor supervisory personnel.

Regarding the suggestion of a "numbering system" - that is, a system in which an operator gives her number to the customer - Pacific's witness Morse stated that experience in both the business office and operator services indicate customers do not usually remember the name or the number even when it is announced and that an operator could give out the wrong number and go unchecked. This, in his opinion, would generate more labor problems than it would solve, especially since Pacific employs 14,160 operators as of August 1976 (Transcript 3903).

Pacific's response to the NOMIO suggestion is simply that after the program was tried, the service indexes (measurements of performance) were unsatisfactory and consequently the program was discontinued. The witness on this subject (a manager in the office where NOMIO was tried) stated that after the discontinuance the service indexes improved. Apparently, during NOMIO, while the internal monitoring results indicated that the quality of service was satisfactory, the official results derived from the administrative monitoring were not satisfactory. This witness stated, additionally, that she took tone-of-service observations for operators that were in "phase three" of NOMIO and it became apparent to her that some of the operators had accuracy deficiencies that were not being corrected.

In answer to TURN's suggestion that if remote monitoring is to continue it be done with a beep tone, Pacific's witness Morse testified that a beep tone would defeat the purpose of administrative monitoring since it would destroy the objectivity of the sample and therefore give the company a "worthless measurement of overall service provided to the customer". (Exhibit 96, p. 26.)

Similarly, regarding supervisory monitoring, an occasional beep tone interrupting the call sequence would cause customer confusion. He stated it would also remove the objectivity of the supervisory monitoring sample.

> "The result would not accurately reflect the employees work since human nature being what it is, an employee would not react to a call in the same manner with the addition of a beep tone. The beep tone is an interruption and could result in numerous questions from the customer. There would be an increase in costs for the handling of calls since the time spent for calls would increase. Monitoring without the tone serves as a tool to deter employees who are inclined to abuse customers. This deterrent would be lost with a beep tone and consequently customers would likely be subject to more abuses." (Morse, Exhibit 96, p. 27.)

Mr. Morse said that an actual survey convinced him that discovery of discourtesies increased on a "monitoring without notice" basis. It is his opinion that there is a percentage of Pacific's employees, however small, who are not able to refrain from being discourteous, and he is convinced that without remote supervisory monitoring the problem could increase. He stated:

> "If the company did not have this tool, or could not use the data for disciplinary purposes, I feel this small number of undesirable employees would become much greater." (Exhibit 96, pp. 21-23.)

The company further points out that in TSPS offices, the problem of discourtesy is magnified due to the fact that there may be as many as 200 operators on duty at such an office at any one time, and that without supervisory monitoring without notice, it would be virtually impossible to establish responsibility for discourtesies.

Lastly, regarding a "one-way" beep tone which would be heard only by the customer, this would cause questions by the customers and slow down processing of calls, and also the customer's question would make the operator aware of the monitoring. Lastly, even without the questioning, the method of establishing a one-way beep tone consists of putting the beep tone on the circuit to go both ways but blanking it out by filtering it from the operator. This method also filters out certain sounds within the normal voice range, thus putting the operator on notice anyway (Transcript 3355-56).

Pacific disagrees to a major extent with TURN's interpretation of the "disciplinary" exhibits (100-106). Pacific points out that the previously quoted vulgarity in Exhibit 100 and the word "stupid" in Exhibit 102 were uttered by the operator when not talking to a customer and, therefore, there was no "conversation" quoted in violation of Commission rules. It describes the other exhibits as "borderline cases" regarding the Commission's

rules and says that if anything the exhibits are good examples of why Pacific, for the sake of union relations as well as operator development, should have greater latitude in the use of notations concerning the nature of particular employee-to-customer contacts.

The Staff's Presentation

The staff introduced no independent evidence on this issue.

Regarding monitoring of the traffic offices, the staff is basically concerned with violations of the Commission's orders not to make any notation of the conversation. It analyzes the "disciplinary" exhibits and states that these exhibits show on their face that there are violations of the Commission order previously quoted. The staff brief says:

> "Maintaining privacy of communications in this age of telephony and electronic wizardry is an all or nothing proposition. CPUC issued rules stating even portions of conversations observed during remote supervisory monitoring were not to be recorded or divulged, and the above documented examples show that PT&T in its operating practices has not always followed the letter or the spirit of those CPUC rules."

The staff points out that one Pacific employee testified that she wrote down as much as she could regarding an operator's violations in order to have as many details as possible and that she was given no guidelines on this practice from management. On the other hand, other Pacific employees apparently understand the problem. Pacific's witness Eich testified that if she overheard an operator call a customer "stupid" she would mark a check sheet that the operator was discourteous. She testified that the Commission rules did not inhibit her ability to do her job supervising operators. (Transcript 3668-3669.)

To assure more uniform compliance, the staff recommends that the Commission prohibit making of any notations during supervisory monitoring. The staff suggests using a check list for evaluating customer contact performance. Such a form could be similar, the staff says, to the check list form now used by Pacific in business office monitoring (Exhibit 88, p. 3). The staff also recommends that we put Pacific on notice that further violations will result in a contempt action.

Discussion

We believe that TURN's evidence and the staff's evidence blend two problems which should be dealt with separately. The first is whether there is any undesirable speedup in operational services, and the other is whether there are problems related to monitoring which should be the subject of our orders.

We believe the testimony indicates, aside from monitoring, that although official Pacific traffic operating practice (with certain exceptions discussed hereafter) is reasonable, certain supervisors, or perhaps certain local managers, have taken it upon themselves to go the instructions one better in order to improve the volume of calls handled.

The most serious discrepancy regards emergency calls. Traffic operating practice calls for the operator to determine that a conversation is proceeding "satisfactorily" and then cut out. It is further required that if the operator cannot ascertain which of several towns should receive a fire, police, or other emergency call the operator should remain on the connection "until it is evident that the right location has been reached". There is some testimony to indicate that at times, operators have been admonished for following this procedure and have been instructed to leave the line immediately after the connection, in an emergency call, has been established. Regardless of whether such pressure results from remote

monitoring or other types of supervision, it is undesirable and should cease immediately. Pacific should take the necessary steps to upgrade its training of local managers and supervisory personnel to assure scrupulous adherence to official traffic operating practice regarding emergency calls.

The next area of concern is the time the operator should wait for the called party to answer. We have reviewed the evidence concerning long distance calls to foreign countries and consider Pacific's practices reasonable. Regarding domestic operator-handled long distance calls, traffic operating practices require the operator to wait about 30 seconds, the practices explaining that 30 seconds equates to 6 or 7 rings. The operator is then to disconnect and ask the calling party to replace the call. The operator has an option "based on operator judgment" to continue ringing beyond the 30 seconds if it is expected that the telephone maybe answered or the calling party requests it. Testimony reveals that one operator was apparently told to wait only five rings, not to exercise any option, and to then release the call and ask the party to replace it.

Assuming this to be true, we consider the action of any local manager or supervisor to speed up company-wide standards to be a degradation of service. Five rings is not a sufficient time to wait for a called party to answer. Again, Pacific should upgrade training standards of local managers and supervisory personnel to insure that there is no pressure placed upon operators to exceed standards adopted by the company. We also believe this instruction needs clarification in order that the operator's responsibilities be clearly understood. Does "operator judgment" refer to the time of day, that is, the traffic load at any one point? Should an operator be more liberal in allowing a call to ring in an off-peak hour than in a peak daytime period? Would it be more appropriate to require the operator, after six rings, to request the

calling party whether they wish to have the called telephone ring longer before automatically disconnecting at 6 or 7 rings and if so, should the additional time be specified so that an operator understands his or her responsibilities? We will order Pacific to clarify the instruction on this subject.

Another problem was complaints from operators that in judging whether their work load was satisfactory (in the TSPS office an operator is supposed to handle 35 to 40 calls in a half hour), little weight is given to a nonstandard call that takes a considerable period of time, and that some operators have had warnings placed in their personnel records or had received poor personnel ratings without any qualitative as distinguished from quantitative analysis of their performance.

We believe that the evidence in this case shows individual and isolated examples of overly hardnosed supervision, and not a general degradation. Thus, at this time, we should leave specific staffing ratios and the exact number of calls an operator is expected to answer, to the collective bargaining process. The evaluation of an operator's personal performance varies, depending upon the policies of the local manager, and the personalities and intelligence of both the supervisor and the operator. For us to enter blanket orders regulating staffing ratios, the amount of calls an operator is expected to handle, and methods of supervision is dangerous since it will impose rigid rules which may not work for every situation, and may ignore the introduction of new equipment which makes productivity gains possible.

However, we admonish Pacific and other telephone corporations that it is their responsibility to provide qualitative as well as quantitative service, and that they should avoid adopting rules or supervisory techniques that will lead to a general breakdown of operator morale and result in an evaluation by companies of their service solely based upon sheer quantity of service rendered. We note that we have allowed Pacific to institute a recording which is played before the customer is connected to the directory assistance operator in order to cut down on directory assistance volumes. As will appear elsewhere in this decision, we are allowing this procedure to continue. This innovation has permitted Pacific to reduce by attrition the size of its directory assistance operator force. We believe it would be preferable, if necessary, to increase the operator personnel on the "traffic" side to maintain quality of service, rather than to save 100 percent of the wage reduction achieved by the attrition on the directory assistance side.

While we firmly believe that operators should be graded qualitatively as well as quantitatively, we also believe that a specific order to this effect is inadvisable at this time. Disputes between operators and supervisors as to their personnel grades are better left to collective bargaining, because in the grievance process (as is well illustrated by the exhibits dealing with grievance matters) there is a more ready and more appropriate source of justice where the employees can handle the matter on an informal basis and be represented by a union official without worrying about formal filings of complaints and rules of evidence. Besides, it would add grossly to the work of this Commission to entertain a volume of "grievance" complaints based upon the violation of a Commission order directed particularly at the relationship between a supervisor and his subordinate. (This is not to say that we will shirk our duty in entertaining complaints directly related to unlawful monitoring or failure to follow our monitoring rules; cf. discussion infra, mimeo. pp. 41-43.)

Pacific and other telephone corporations subject to our jurisdiction are warned, however, that if traffic operating practice is such that it contributes to a general and substantial lessening of service, we may act in the public interest.

For the present, we believe that Pacific should generally review its training of local managers and supervisors to insure that quality of service is not sacrificed to volume, and to assure that such personnel understand that they have no authority to impose de facto traffic operating practices conflicting with company rules.

We now come to the problem of whether, aside from privacy considerations, we need regulate monitoring as suggested by TURN or the staff.

The evidence does not convince us that, as a general rule, remote monitoring makes operators nervous or otherwise interferes with their ability to perform. While some operators testified that remote monitoring bothered them,[19/] one supervisor testified that her employees preferred remote monitoring to having a lot of floor supervision with supervisors standing around watching them. We are convinced that the psychological factors vary so highly from one person to another that any blanket rule that we would adopt would do as much harm than good. The exact rules of supervision in this

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19/ A few of these witnesses also testified that other operators were so upset by fear of monitoring that they suffered psychological problems or became alcoholics or dope addicts. This is unacceptable hearsay even under our liberal rules, and in any event, psychological problems vary highly from one individual to the next. This is not a proper subject for lay opinion.

regard are therefore best left to the collective bargaining process. The fact that the present union contract does not contain any clause or clauses relating to monitoring does not mean that collective bargaining is not the more appropriate format for handling this matter.

There is no convincing evidence that there is a reduction in quality of service which results from remote monitoring or any other kind of monitoring. While several operators testified to their problems with remote monitoring, the witnesses were from a few offices. The more likely inference to be drawn from this evidence is that, in the individual offices, there are instances of overly aggressive supervision which is best dealt with by the grievance machinery.

We believe that supervisory and administrative monitoring are valuable tools in maintaining quality of service, and the elimination of the practice (or rules that would make monitoring valueless) would work a reduction in service quality. Pacific, being a very large corporation, must hire employees for its traffic department in large numbers. Even the best preliminary screening procedures will not eliminate all those who do not have the skills or the temperament to be good operators. Hearing only one side of the conversation (the operator's) does not furnish a supervisor with adequate evaluative information.

We agree with Pacific's witness Morse that monitoring such persons "on notice" (however effective it may be in the business office sector where there are more experienced employees) is unsuitable as the sole tool for measuring operator performance in the traffic sector. Nor do we accept TURN's argument that it is basically new employees that need to be weeded out and that the experienced employees usually perform satisfactorily. Pacific logically points out that while some people are slow starters and improve gradually, others come to a new job highly motivated and then, over the course of years, get bored and restless and become a problem.

The differences in performance from one employee to another in this respect lead us to reject NOMIO as a substitute for remote monitoring. There is no guarantee that once an operator reaches the "Phase III" level contained in the NOMIO system, his or her performance will not suffer thereafter. The evidence shows that, at least in the long run, NOMIO's value was questionable.

We believe that TURN's arguments as to cost savings are speculative. Elimination of remote monitoring might save some money. More likely, however, is the probability that extra floor supervision would be necessary and, at best, there will be a trade-off in expenses from one kind of monitoring to the other.

Actually, the "grievance" exhibits (100-106), are a very good advertisement for remote monitoring. It is hard to imagine that any of the operators would have made some of the asinine remarks attributed to them had they known that monitoring was in progress. Thus, without monitoring their conduct would have gone undetected and probably would have continued.

Violations of Commission Rules

As previously mentioned, our rules which exempt supervisory monitoring from requirement of notice to all parties to a communication that monitoring is taking place, also require that the monitoring be conducted "without the making of any written notation or any record of the contents, substance, purport, effect or meaning of any conversation which may have been heard during said supervisory monitoring". We agree with TURN that some violations have taken place, and at least some of the time, the specific quotations have turned up subsequently as testimony, or a summary thereof, at a grievance hearing requested by the employee. For example, in Exhibit 100, the notation made at the time of the observance was that the operator "called the customer a name". Later, at the hearing, it was stipulated that the word used was "stupid".

The direct purpose of our rule was to govern notations made at the time of the observance. However, we do not believe that the above quoted rule means (1) that no record whatsoever of an operator's conduct may be made, or (2) that if an operator filed a grievance and raises the issue of his or her conduct, that the operator's improper language, if remembered by the supervisor, may not be quoted at a subsequent grievance hearing. (We see no reason to quote the customer, as was done in Exhibit 103).[19a/]

We interpret our rule to mean that at the time of the observance, there may be no quotations, and descriptions of the conversation must be as general as possible. This apparently imposes no hardship on supervisory personnel. Pacific's witness Eich, when she was asked how she would handle such language, indicated that she would merely place on her review sheet that she heard the operator use improper language or address a customer rudely, or words to that effect. Certainly there are not so many operators swearing at customers that it would be impossible for a supervisor to recall later with adequate accuracy what the operator said if a supervisor made a general notation to the effect that an operator used vulgar or profane language with a customer. While a strong argument may be made that the quotation of a brief expletive or vulgar language on the part of the operator ought to be considered outside the rule, we believe that once it is decided that something may be quoted at the time of the observance, there will be difficulty in deciding what may be quoted and what may not, and the rule will break down.

19a/ We must distinguish between what protection is appropriate for the operator and for the customer. If an operator initiates a grievance, the language used by the operator is placed in issue. It would be unjust to interpret our rule as a "gag order" forbidding a supervisor from stating at a grievance hearing what the operator said, when the operator has placed the propriety of his or her conduct in issue. Furthermore, to quote the operator's improper language at such a hearing does not necessitate a quotation or close paraphrase of the customer.

The staff suggests that a check list format for the supervisor's use during monitoring should be required, which would remove the temptation to quote the operator or the customer. Such a format is apparently used with success for business office monitoring (see Exhibit 88, page 3). We believe this is a worthwhile suggestion and will order the development and use of such a form within six months of the effective date of this decision.

We are aware that these strictures make it difficult, although not impossible, for Pacific and other telephone corporations to use information gathered by way of remote monitoring for training and, when necessary, disciplinary purposes. We have noted this problem previously. In Communications Workers of America v Pacific Telephone and Telegraph Company and General Telephone Company of California (1971) 72 CPUC 788 we stated:

> "The Commission did not specifically forbid the use for disciplinary purposes of information that had been obtained through supervisory monitoring. The Commission is aware that by forbidding written notations and records and by forbidding disclosure to any person (which includes the employee whose conversation was monitored) the Commission has made the use of supervisory monitoring for direct disciplinary purposes difficult. However, telephone corporations have adequate means of observing employee performance by means other than supervisory monitoring, including monitoring with prescribed notice. In the opinion of the Commission, it is not necessary to sacrifice for ease of employee discipline the principle that, if the privacy of a communication is being violated, notice should be given of the violation of that privacy."

Indeed, the problems in the case cited and in this case are similar. We admonish Pacific that we will act in the public interest if the limitations that we have prescribed regarding the use of information obtained through lawful monitoring are not followed in the future.

The adoption of a check list form and proper training should prevent more violations similar to those reflected by Exhibits 100 to 106.

Future Monitoring Matters

Monitoring is a complex subject that needs special attention of the Commission. We undertook to decide certain issues within the framework of this application for a rate increase and the associated investigation (Case No. 10001) because certain immediate problems seemed to present themselves. However, we now rule that in the future, if further monitoring matters appear to need resolution, the aggrieved parties should proceed by way of petitioning to reopen Case No. 7915, or by filing an independent complaint. In addition to the amount of time necessary to hear detailed evidence regarding monitoring, we note that many of our rules on monitoring affect not only telephone corporations, but also other business customers who use certain monitoring equipment pursuant

to our rules (see the list of appearances in Case No. 7915) and who are not ordinarily parties to a rate increase proceeding. When considering a subject as involved as monitoring, it is always possible that the evidence introduced will convince us that monitoring rules affecting other parties besides telephone corporations need to be modified. Hence, a reopening of Case No. 7915, if necessary, is the more appropriate way of handling this subject.

We rule that we will not entertain, in the future, investigations into monitoring problems within the framework of an application for a rate increase.

Monitoring and Other Telephone Companies

All the direct evidence taken concerned Pacific's monitoring practices, but we must consider constitutional questions relative to supervisory and administrative monitoring conducted by other telephone company respondents herein. We hold that when any telephone company performs administrative or supervisory monitoring, without using one of the methods provided for notice under our rules, it must give the telephone user information of this practice in the same manner provided for Pacific, in order to meet constitutional privacy standards (cf. discussion above, mimeo. pp. 13-20).

II. OPERATING EXPENSES

A summary of staff and company estimates for the test year is contained in the table which follows.

The Pacific Telephone and Telegraph Com.

SUMMARY OF EARNINGS

Twelve Months Ending June 30, 1976 Estimated

Line No.	Item	Total Company Operations: Staff * Estimate	Total Company Operations: Utility Estimate	Total Company Operations: Adopted	Intrastate: Adopted
		(Dollars in Thousands)			
1	Operating Revenues	$3,440,543	$3,433,911	$3,433,911	$2,679,504
2	Uncollectibles	33,796	33,367	33,753	25,455
3	Revenues After Unc.	3,406,747	3,400,544	3,400,158	2,654,049
4	Deprec. Represcript. Eff.	-	5,142	2,560	709
5	Restore Service to Norm.	-	13,534	-	-
6	Wage Annualization	-	3,326	-	-
7	Decisions & DA Rec. Eff.	104,522	100.556	104,522	97.365
8	Total Operating Revenues	3,511,269	3,523,102	3,507,240	2,752,123
9	Operating Expenses				
10	Maintenance	752,940	752,567	752,940	575,171
11	Traffic	278,534	281,927	278,534	218,928
12	Commercial	294,310	299,161	285,708	241,995
13	Revenue Accounting	49,531	49,531	49,531	42,894
14	Bal. G&O Sal. and Exp.	142,359	149,440	142,529	111,957
15	Operating Rents	30,550	31,334	30,550	24,981
16	Gen. Service and Lic.	40,440	50,028	40,219	31,029
17	Relief and Pensions	278,570	282,328	278,570	218,817
18	Bal. Other Opr. Exp.	6,290	13,000	9,838	7,721
19	Subtotal	1,873,524	1,909,316	1,868,419	1,473,493
20	Depreciation & Amort.	461,077	483,966	471,560	375,126
21	Property & Other Taxes	184,187	183,808	184,187	144,550
22	Social Security Taxes	63,872	64,468	63,872	50,171
23	State Income Tax	31,323	31,122	31,431	21,695
24	Federal Income Tax	237,266	211,032	232.729	171,321
25	Affiliated Interest Adj.	(2,793)	(785)	(2,793)	(2,222)
26	Miscellaneous Adjusts	166	40,634	166	132
27	Decisions & DA Rec. Eff.	54,167	50,452	54.167	47.834
28	Net Operating Expenses	2,902,791	2,974,013	2,903,740	2,282,100
29	Net Operating Revenues	608,478	549,089	603,500	470,023
30	Rate Base				
31	Account 100.1	8,983,882	9,009,023	8,973,249	7,042,206
32	Account 100.3	4,635	5,178	7,735	5,453
33	Materials & Supplies	38,162	38,162	38,162	30,530
34	Working Cash	93,004	128,656	94,790	74,780
35	Less: Depr. Resrv.	1,876,267	1,889,497	1,882,044	1,472,511
36	Less: Def. Tax Resrv.	453.129	448,762	450,371	358,495
37	Subtotal	6,790.287	6,842,760	6,761,521	5,321,963
38	Affiliated Interest Adj.	(49,006)	(42,184)	(49,006)	(38,498)
39	Rest Serv & CCFT Proform	(1,968)	13,515	(1,968)	(1,553)
40	Decisions & DA Rec. Eff.	35,958	32,797	35,958	22,909
41	Total Rate Base	6,775,271	6,846,891	6,766,505	5,304,821
42	Rate of Return	8.98%	8.02%	8.92%	8.86%
43	SMRT 5th Interim Order Net	-	-	(7,323)	(7,333)
44	Adj. Net Oper. Revs.	-	-	596,177	462,690
45	Adj. Rate of Return	8.98%	8.02%	8.81%	8.72%

(Red Figure)

* Staff Opening Brief

Before turning to the discussion of various individual accounts, we must consider two recasts of estimates Pacific added to its results of operations which affect its expense levels generally. The first recast has the effect of annualizing a test-period wage increase; the second, according to Pacific, is for the purpose of restoring certain expense levels to what Pacific considers normal.

Annualization of Wages ("Column M")

Pacific added a "Column M" to its results of operations designed to annualize its test period wage increase, which was the result of collective bargaining, in the amount of $79.3 million, effective August 3, 1975. Also included is a $13.8 million salary increase for certain management employees, effective January 1, 1976.

The staff did not directly contest the reasonableness of the increase, but argued that annualization of either wage increase is inappropriate. The staff argued that wages should be considered only to the extent they will be realized during the test period and that to annualize a mid-test year wage increase violates the principle of weighting and produces an atypical result of operation.

Pacific argues that if it is to have the opportunity to earn the 8.85 percent rate of return previously found reasonable, wages must be annualized. Such annualization, according to Pacific's witness Bennett, should include increased costs associated with improved fringe benefits for management and non-management employees ($4,608,000) effective January 1, 1976 and for pensions ($3,585,000) effective January 1, 1976 (Transcript 2195-2205). Pacific emphasizes that it has been paying increased wages for non-management employees since August 3, 1975 and will continue to pay that level of wages throughout the period when rates

authorized in this proceeding will be in effect. The effect of failing to annualize wages, according to Pacific, is that Pacific's expenses for the test period and for the future will be understated.

The staff's position is essentially that the wage increases presented here follow a typical pattern and therefore are included in the staff's trending for each of the various accounts. Staff witness Amaroli testified that the staff examined each of the items annualized by the utility and determined that expenses such as wages, fringe benefits, and postal increases are not extraordinary and therefore should not be annualized (Exhibit 38, p. 14-GAA).

The company counters by pointing out that the staff inconsistently annualizes the rate increase from Application No. 55214 which was effective in the middle of the test period, but not the wage increase. Both such changes "go beyond" the test year, according to Pacific.

The staff argues that the inclusion of known rate changes authorized for a test year recognizes past test years and the revenue requirement found reasonable by fully considering the rate changes on a pro forma basis. According to the staff, failure to recognize previous decisional effects on revenues of rate changes would be to ignore known revenue requirements that were satisfied with prior decisions and thereby risk duplicating satisfaction of the revenue requirement.

We believe that the staff's exhibits show the wage increase to be included in the trends of other accounts. There is no separate account know as "wages". Wages are allocated to accounts such as maintenance, traffic, etc. There is nothing atypical about the wage increase presented here and therefore there is no need to annualize it when such increase is included in the estimates based on trends, nor where estimates are based on budgeted amounts that provide for wage increases occurring regularly on an annual basis. In General Telephone Company of California (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 incur in 1968, we should avoid including expenses that we know were not incurred."

The "Column M" adjustment proposed by Pacific will not be included.

"Restoration of Expense Levels to Normal Operations" (Column "L")

Another ratemaking recast proposed by Pacific was a "Column L" included in its proposed results of operations which, according to Pacific, is necessary to restore operations to normal. This involves Pacific's budget management and budget views over certain portions of 1975 and 1976 and is discussed at length under the heading "held orders" in our third interim opinion in this proceeding (Decision No. 86593 dated November 2, 1976; see especially the table entitled "Pacific's Budget Views - 1975, 1976", mimeo. p. 12 of that decision). Pacific, through its witness Bennett, states its rationale for the proposal as follows:

"When we took the extraordinary and stringent cutbacks last summer, we eliminated new hirings thus producing a gradual decline in work force through normal attrition. We also stopped basic training activities. In addition we cut an already tight budget, and throughout all aspects of our operations we accepted a greater risk that our established service objectives might not be met. All of these items if continued too long will build up to a point where critical conditions below service objectives begin to appear. Further-

> more with declining work force and current economic conditions, turnover of employees is reduced so that experience and productive efficiency are at levels that on the average cannot be sustained for too long a period. It is necessary that Pacific receive revenues sufficient to remove these restraining conditions in order to assure continued reasonable and adequate service." (Exhibit 11, p. 16.)

For all accounts, the recast amounts to $34.3 million. Maintenance and plant additions are the most heavily affected areas.

Pursuant to a data request, Mr. Bennett furnished Exhibit 127, which shows the actual recast amounts funded for the test year - $4.2 million in maintenance, commercial (nonadvertising), and traffic, and $7.1 million in plant additions.

Mr. Bennett's rebuttal testimony states that without this adjustment, test-year expenses are not representative of funds necessary to provide good service for current and future customers (Exhibit 187, p. 8).

Pacific has certain self-imposed levels of service and candidly admits "it is uncontroverted that Pacific is not providing objective level service in all of its service measurements to its California customers". (Opening brief, p. 35.) Pacific's argument at the time it presented evidence for the interim order was that this was due to justifiable forecasting errors stemming from atypical growth in the northern California sector. The staff argued, and we agreed at least in part, that the pileup of held orders, discussed in our third interim order was due not only to forecasting problems but also to Pacific's parsimonious budget management. We found that because of such budget control, Pacific failed to meet its public service obligation regarding the level of held orders for its northern sector (see Decision No. 86937 dated February 1, 1977, which modified our Third Interim Opinion and Order, Decision No. 86593).

The staff also argues that this $34.3 million adjustment does not include, for the most part, items that fall within the test period. Pacific has maintained its previous estimate (Column A) reflects abnormally low operating levels and thus Column L must be included for ratemaking purposes. Pacific also argues that with a declining work force and current economic conditions, the turnover of employees is reduced and therefore experience levels and production efficiency are at levels that cannot be sustained for too long a period.

The city of San Diego argues that Column L is nothing more than an attempt by Pacific to collect $34 million in rate relief that was denied in Decision No. 85287 (December 30, 1975, Application No. 55214).

The Column L recast is not a proper adjustment. As the staff points out, less than ten percent of this amount is budgeted for the test year. The staff's trending, using twelve-month moving totals, was based on recorded data from December 1971 to December 1975 with the last two months of 1975 deleted because they were unusually dry (which would have caused abnormally low maintenance expenses for that period). The staff's trending is a reasonable estimate of future expense levels.

For the maintenance account, we adopt staff witness Carlson's basic estimate.

Nothing in this discussion is intended to relieve Pacific from its obligations covered in our previous orders in this proceeding to restore proper service levels to the Northern District.

The Western Electric Adjustment

Pacific also makes an adjustment (Column I) to its results of operations "to recalculate the prices paid to Western Electric to adjust Western's rate of return on sales to Pacific to the rate of return allowed to Pacific" (Bennett, Exhibit 11, p. 11).

This adjustment produced a sharp controversy and a great deal of evidence and testimony, as well as extensive arguments on brief that can only be discussed here in bare outline form.

Although Pacific does not agree with the Western Electric adjustments made in previous Commission cases and approved by the California Supreme Court, it does not here contest the basic adjustment, but rather argues in favor of an interpretation that would have us raise the Western Electric rate of return to Pacific's 8.85 percent rate of return in a year when Western Electric makes a rate of return less than Pacific's.

The "Western Electric adjustment" involves our adopting certain adjustments to Pacific's plant and expenses to establish lower prices than those actually charged Pacific by Western Electric (a wholly owned subsidiary of AT&T) on the theory that Western Electric should be entitled to "no greater rate of return than would be reasonable for a regulated utility". (City of Los Angeles v Public Utilities Commission, 7 Cal 3d 331, 342; 102 Cal Rptr 313; emphasis added.) The court has not only approved this adjustment but reversed us when we sought to depart from it (City of Los Angeles v PUC, supra). The adjustment is succinctly reviewed in the City of Los Angeles opinion, beginning at page 343:

> "We extensively considered the Western Electric adjustment in Pacific Tel. & Tel. Co. v. Public Util. Com., supra, 62 Cal. 2d 634, 659-662. We set forth the commission's findings as to the corporate affiliation of Pacific, Western and American, as to the dominance of the Bell

System in providing telephone service, and as to its advantage in its integrated position of being researcher, designer, engineer, manufacturer, distributor, installer, repairer, junker, and operator of 80 percent of the telephone business in the entire continental United States. Those findings were not disputed by Pacific. We concluded: 'The determination of the commission in the present case that Western is entitled to no greater return on its sales to Pacific than Pacific is entitled to earn on its operations, and that American should not be permitted through the corporate instrument of Western to subject Pacific's ratepayers to the burden of providing a greater return, is based not only on extensive findings made by the commission on the subject but also on the methods and principle theretofore followed by the commission...and as the commission expressly found herein, produces a fair and reasonable result.' (62 Cal. 2d at pp. 661-662.) We rejected Pacific's contention that it was error for the commission to omit 'to include a finding of fact as to the reasonableness or prudence of Pacific's purchases from Western and payment of the prices charged, ...' (62 Cal. 2d at p. 661.)

"We thus determined that, where it appears that a utility enjoys the dominant position shown by the commission's findings, it may not through the use of corporate instrumentalities obtain a greater rate of return than the utility would be entitled to in the absence of the separate corporate entities, and it was not determinative whether the prices charged by one affiliated corporation to another might be considered reasonable. In other words, the utility enterprise must be viewed as a whole without regard to the separate corporate entities, and the rate of return should be the same for the entire utility enterprise.

"We see no reason to depart from our holding. A corporation should not be permitted to break up the utility enterprise by the use of affiliated corporations and thereby obtain an increased rate of return for its activities. In the light of the dominance of the Bell System and its integrated position, we again reject the view that a finding of the reasonableness or prudence of Pacific's purchases from Western would warrant termination of the Western Electric adjustment.

"There has been no substantial change since our prior decision as to the dominance of the Bell System or as to the relationship between Pacific, American, and Western. Accordingly, Western must be considered part of the utility enterprise, and its prices should be adjusted to reflect no greater rate of return on its sales to Pacific than Pacific is entitled to earn on its operations. This result cannot be avoided on the basis of a finding that Western's prices were reasonable when compared to other manufacturing enterprises."

Pacific's argument here is that this treatment must work both ways.

"Western is not treated as a manufacturer separate and apart from Pacific, and is not permitted to earn a rate of return commensurate with such a manufacturer's risk because of the integrated structure of the Bell System and Pacific's affiliated relations with Western (City of Los Angeles, supra, pp. 344-45). Since this entire utility enterprise is precluded by the adjustment from earning returns commensurate with a manufacturer's risk in those years when the integrated structure of the Bell System allegedly shields it from those risks (when the manufacturer earns above Pacific's allowed rate of return) the adjustment must likewise be applied to the entire utility enterprise in those years when the integrated structure of the Bell System does not shield it from such risks and it experiences lower earnings." (Pacific's opening brief, pp. 41-42.)

In other words, the Western Electric adjustment should be applied to Pacific's results of operations for the test period here to raise the Western Electric return to 8.85 percent since Western Electric's return fell below that figure; that to do so will correctly represent the future period in which the rates in this case will be in effect. Pacific points out that the staff witness on this subject, Mr. Sekhon, testified that Western Electric's portion of the combined rate of return of the entire utility enterprise was only 4.4 percent in 1975 and 4.6 percent in the first half of 1976, and that it appears such low earnings will continue beyond the test period.

Pacific argues that the Western Electric adjustment ignores the risk of Western Electric operations because of the corporate structure of the Bell System and since this is the case these risks must be ignored in both directions to be fair.

The staff, having determined that the Western Electric rate of return for the test period would be less than Pacific's last authorized rate of return of 8.85 percent, did not add the effects of a test year adjustment to plant added in 1975 and 1976; however, as stated in the staff brief, the adjustments based upon previous years, when Western Electric's return exceeded Pacific's, remain in effect (Exhibit 158, p. 1). The Western Electric effect on plant and expense in this test period, based upon adjustments to surviving plant from prior years is $49 million of rate base, and $2.8 million of depreciation expense.

The staff's argument is that the Western Electric adjustment does not exist for the purpose of guaranteeing Western Electric a minimum return, and to follow the suggestion of Pacific would do just this. The city of San Diego and TURN concur with the staff on this issue.

We reject Pacific's contention. We have reviewed carefully the language in the Supreme Court opinion quoted above and see nothing to indicate that this decision, or any other decision, requires us to adopt a "reverse" Western Electric adjustment whenever Western Electric's rate of return is below Pacific's for the test year. While Pacific's argument is tinged with plausibility, it overlooks the underlying purpose of the Western Electric adjustment, that is, to keep the ratepayer from ultimately paying for dealings between affiliates which would result in unreasonable earnings to the unregulated entity. This does not mean, at the same time, that we should save and hold harmless Western Electric and in effect guarantee it a minimum return on what is sold to Pacific by making an upward adjustment in any year when Pacific's return exceeds Western Electric's.

The price comparison study furnished by Mr. Clinton of AT&T does not alter our determination on this issue. The staff's adjustment is reasonable based upon Western Electric's prices. We note that the evidence shows that Western Electric does not offer volume discounts for large orders (which would presumably favor a large company like Pacific) and that our previous Western Electric adjustments have not adjusted rate base to compensate for this type of price structure.

We conclude that Pacific's upward Western Electric adjustment reflected in Column I of its results of total California operations should not be included in the adopted results.

Directory Assistance Recording Adjustment

Earlier in this proceeding we allowed Pacific to begin using a recording which is played before a calling party is connected to the automatic call director which eventually connects the caller to a directory assistance operator. The service questions relative to this device are discussed elsewhere, and as will appear, we are allowing Pacific to continue its use.

The staff's original estimate of the expense effect of this recording is based on earlier data than the company's estimate contained in Exhibit 227. Revisions to Exhibit 257, the comparison exhibit, provide the staff's updated figures, using the adopted 10 percent California Corporation Franchise Tax (CCFT) rate. This exhibit shows an annualized total company expense savings of $12.8 million, and a total company balance net revenue effect of $7.1 million as a result of using the recording on a continuing basis. This translates into an intrastate expense savings of $15.8 million and an intrastate balance net revenue effect of $6.7 million. The staff's updated estimate is adopted since it includes a CCFT calculation based upon our adopted CCFT rate of 10 percent (see discussion beginning at page 111).

Advertising Expenses - General Considerations

Advertising is actually one account of the commercial expense category (see Exhibit 162). We will deal in this section solely with advertising and discuss other commercial expenses in the next section.

Before commenting on the individual issues, we observe generally that the evidence and testimony submitted is of such quantity and complexity as to be out of all proportion to the dollars involved. Granted, this issue is important from a standpoint of principle; nevertheless, considering the size of some items, we urge that in future Pacific matters, the staff, the company, and the interested parties plan ahead and, without conceding important issues, attempt to develop the necessary information so that the presentation on advertising can be more concise, especially on the minor items. In this proceeding, certain information requested by the staff was slow in forthcoming, and at times erroneous. The staff, for its part, submitted

recommendations from two different witnesses which in part conflicted, (concerning institutional advertising), and a further recommendation from staff counsel.[20/]

Staff counsel infers that the difficulties experienced are due to lack of Commission guidance. There is plenty of Commission precedent on advertising (although it is certainly easier to state principles and rules than to apply them). It should be unnecessary to have almost total disagreement over each and every facet of advertising. We have previously made it clear that

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20/ Staff counsel argued on brief that we simply disallow all promotional advertising. Such a practice might as easily harm the ratepayer as help him, since it would be arbitrary in the extreme to disallow advertising expenses and at the same time allow, for rate-setting purposes, the additional revenues associated with those very expenses (compare the discussion of the staff's recommendation regarding design line telephones in our most recent Pacific rate decision, Decision No. 85287 (Application No. 55214), December 30, 1975). If both the revenues and expenses associated with advertising are always disallowed, then the ratepayer loses the benefit of successful advertising campaigns, the additional or incremental revenues from which tend to keep rates down. An argument similar to staff counsel's was made in City of Los Angeles v PUC (1972) 7 Cal 3d 331, 351; 102 Cal Rptr 313, 328, to which the court replied: "It is contended that since Pacific is a monopoly with captive consumers, any advertising except that of informing the public of emergency services is calculated to and does no more than create a good public image, and as such is institutional advertising which is not allowable as an operating expense. Advertising which is properly classified as informative results in more than a mere fostering of goodwill. It should result in reductions in operating costs and more efficient service to the ratepayer. The commission could properly conclude that expenditures for such purposes are reasonable operating expenses, and in the absence of a showing that the amount allowed for informative advertising was primarily directed for other purposes, the allowance of the commission must be upheld."

institutional advertising (which tends primarily to build the image of the company) will not be charged to the ratepayer. Several recent cases have explained our current policy on advertising. Staff witness Dade's testimony (Exhibit 37 p. 10-4) contains a fair summary of what these recent cases classify as allowable advertising (assuming a reasonable limit): (1) advertising that provides a net increase in revenue or net decrease in expenses;[20a/] (2) advertising which instructs customers how to obtain or use their service more efficiently or economically, or advises them of legal or rate matters as required by this Commission, or promotes safety; and (3) advertising for recruiting employees or protecting utility property.

Pacific states, on brief, that it does not disagree with the above statement.

> "Thus, the issue is not the standard under which Pacific's advertising expenditures are to be allowed; but simply whether the facts in the record in this proceeding demonstrate that Pacific's advertising expenditures in the test period were reasonably directed toward accomplishing the agreed on purposes of allowable advertising." (Pacific's opening brief, pp. 58-59.)

As we said regarding Pacific in Decision No. 83162 (Application No. 53587) dated July 23, 1974:

> "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 ratepayers who cannot understand why a simple telephone call cannot be put through without problems. What is less understood is that advertising generates

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20a/ But in judging the value of such advertising, we will determine whether it causes an unnecessary increase in peak traffic which, in turn, causes excessive increase in plant.

> 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. Although the staff criteria for determining the proper allowance to be accorded advertising expenses have merit, we must be careful when applying them to individual items of expense to consider the many kinds of telephone users and the uses, both good and bad, to which telephones are put."

See also our general discussions on advertising in Pacific Gas and Electric Company (1975) __ CPUC ____ (Decision No. 84902, Application No. 54279); Pacific Gas and Electric Company (1976) __ CPUC _____ (Decision No. 86974, Application No. 54976), and Southern California Edison Company (1973) __ CPUC ____ (Decision No. 81919, Application No. 53488).[21/] Our methods of handling advertising were generally found reasonable in City of Los Angeles v Public Utilities Commission (1972) 7 Cal 3d 331, 351, 102 Cal Rptr 313, 328 (see Footnote 20, supra).

Institutional Advertising

Pacific made a voluntary disallowance of $791,000 for expenditures in this category while the staff's recommended disallowance was $1,123,250. Later, Pacific conceded that an additional $38,000 might be disallowed for Bell System Family Theater tune-in ads. Three items remain as sources of dispute: (1) Disneyland exhibit, (2) Museum of Science and Industry display, and (3) "essay ads".

21/ Recent decisions of ours concerning gas, electric, or heat utilities must also deal with Public Utilities Code Section 796(a) regarding disallowance of advertising which encourages gas, electric, or heat consumption.

Disneyland and the Museum of Science and Industry may be considered together. The staff recommends a total disallowance on the basis that both exhibits primarily exist for corporate image building purposes, and because, since these exhibits are constantly changing and Pacific's share is a minor amount of the total, it is too time-consuming to calculate the small percentage that should be charged to the ratepayers. Pacific points out that notwithstanding such difficulties, we have calculated an apportionment in the past and have allowed that part of these exhibits which are instructional or informational to be allowed as expenses.

We deal here with amounts too small to have an effect on rates. The total Disneyland exhibit expense apportioned to Pacific, including salaries, amounted to $299,000. The Museum of Science and Industry apportioned total was $81,250. The evidence convinces us that these exhibits are primarily institutional, that because the exhibits are changed from time to time the portion to be borne by the ratepayers must be constantly reexamined, and that the necessary testimony and evidence on these items is unnecessarily detailed, considering the amount of dollars involved. The day or two that a rate proceeding is delayed to consider these issues could easily cost the company far more than it gets back from including these expenses. The most important factor, however, is that any view of the evidence shows these items to be primarily institutional.

We will adopt the staff's recommended 100 percent disallowance. This is not to be regarded as a precedent in handling other items of small size. We deal here with special factors which complicate the presentation of this issue out of proportion to its size, and with the fact that, generally, it is our desire to streamline our consideration of advertising.

AT&T Print (essay ads). As mentioned above Pacific, in the course of the proceeding, acceded to a disallowance of $38,000 for print advertising concerning the Bell System Family Theater. However, the company contests the staff's recommended $107,000 disallowance for the "essay ads" which had as their subject various historical themes concerning the development of the Bell System and the advantages in having an integrated communications system. While these ads are of high quality, and may, of course, generate some business, an inspection of them (Exhibits 135 and 136) readily shows them to be primarily aimed at enhancing the corporate image. They should not be charged to the ratepayer.

Bell System Television is the final institutional category. The company accedes to the staff's 100 percent disallowance ($598,000) on the basis of our holding in Decision No. 83162 (mimeo. p. 51):

> "Although we have no doubt that some of this money is beneficial to sales, we are of the opinion that this entire category of Bell System TV is used to enhance the general corporate image of the Bell System and therefore properly belongs within the expenses that the shareholders should bear, just as charitable contributions do."

AT&T Exhibits. A third category of exhibit material (test year amount $194,000) consists of Pacific's share of the expenses of exhibits at trade shows. These exhibits are for the purpose of stimulating the use of equipment available from operating companies. This category is basically promotional and not institutional; however, Pacific did not connect these sums to any showing of an increase in net revenues. It is therefore not allowable.

Unidentifiable Advertising. A small amount of the company's mathematical total was unaccounted for ($42,000). Since the company bears the burden of proving the reasonableness of expenses, this amount is disallowed.

Promotional Advertising

The various advertising campaigns which can be considered promotional (noninstitutional) produced the greatest controversy.

Before analyzing these campaigns we shall consider the suggestion of staff witness Dade that major promotional advertising for specific equipment be categorically disallowed in future applications. The witness testified:

> "The staff believes that major promotional campaigns for specific items should be charged to the manufacturer or supplier who can then add the expenses to the price of the promoted product. The staff believes that a utility should always purchase its products from a manufacturer or supplier who has the lowest price, assuming all other things are equal (i.e., quality, service, etc.). There will always be a question whether a utility obtained the lowest price when it buys from an affiliated company that does not include the major advertising and marketing expenses in its products like most other competing suppliers or manufacturers. When the affiliated company, rather than the utility, absorbs the major advertising and marketing expenses, the amount of expenses is controlled by the market place. If an affiliated company then spends too much on promoting or marketing its product, the product will become too expensive to sell and, if it does not spend enough marketing the product, there will be little demand for the product."

We reject the proposed blanket disallowance because we believe that the difficulty in isolating advertising costs in this manner would be great, and the time spent on such an approach would be out of proportion to its value to the ratepayers.

We can adequately, and more specifically, control the problem the staff witness raises through the examination of Pacific's individual advertising campaigns, including those for equipment, and by making appropriate disallowances when we are convinced that, in a specific case, Pacific has failed to purchase a product at a reasonable price.

Should a Trend be Used? Because of problems in analyzing the company's advertising estimates and the difference between the estimated and recorded amounts, staff witness Dade proposed as an alternative to an account-by-account analysis for promotional advertising that a ratio be used, which would be based on the fact that in the last rate proceeding (Application No. 55214), advertising (Account 642) amounted to 0.15 percent of gross operating revenues. The company objected to this because it claimed this percentage was unusually low. The staff witness conceded that advertising is not really a "trendable" account and suggested it for this proceeding only.

While there are problems with the material furnished by the company to the staff (due to mistakes and not to any desire to conceal facts or evade discovery) we believe we have sufficient information to consider the campaigns individually and will not employ the suggested ratio. Advertising cannot be trended like maintenance or traffic because advertising needs vary greatly from year to year.

"Plan Ahead" Campaign. The purpose of advertising in this category is to generate sales of optional residential equipment by 15 percent and save expense by reducing installation visits. The staff prepared a study that showed Pacific loses money at the current cost of the equipment because increase in demand for such equipment would cause new equipment to be furnished at current cost. The staff claims that Pacific's use of embedded costs of the equipment is inappropriate. The company states that it is erroneous to use only the cost of currently purchased equipment because as

Pacific's witness Sullivan documented only a small portion of residence equipment furnished is purchased new. No new Princess sets were bought; all were from refurbished stock. For rotary dial 500 sets, only 10 percent were new, and about 67 percent of Trimline phones were reconditioned. Pacific also contends that the staff's analysis overlooks certain cost savings from the campaign.

We believe Pacific was imprudent in advertising so heavily in this area when cost studies show the equipment advertised (primarily residential extensions) are not profitable even on an embedded cost basis. We will allow $405,000 (50 percent) on the basis that one goal of the campaign was to reduce installation expenses.

Design Line. Cost factors concerning Design Line (decorator phone sets) were discussed in detail in our most recent rate order (Decision No. 85287 dated December 30, 1975 in Application No. 55214). The preponderance of the evidence indicates that, because of costs which should rightfully be attributed to Design Line, the campaign has been, and continues to be, a money loser. We agree with the analysis of the staff in this respect (staff's opening brief, pp. 27-28) and believe that for this test year, allowance of the Design Line advertising estimate is unjustified.

Supplemental Residence Market Campaign. In the second half of the test year (Pacific's advertising budget is managed on calendar years) the Design Line and Plan Ahead campaigns were combined into one campaign under the name "supplemental residence market campaign". We will treat that part of this campaign attributable to "plan ahead" as we have treated the "plan ahead" campaign and disallow the portion attributable to Design Line promotion (based on Exhibit 207).

Business Market Advertising. The objectives of this campaign were to (1) reduce losses of the dial PBX and key telephone system installations to competitors; and (2) generate sales of new product and service offerings.

The staff witness pointed out that there was a large discrepancy between the estimated amount for the test year and the recorded amount.

Pacific contests the staff's proposed disallowance on the basis that staff witness Dade's cost-effectiveness analysis compared the budgeted expenses with recorded sales revenue to reach his result that the campaign should be disallowed. Pacific points out that Mr. Dade's own testimony (Exhibit 163, p. 17) shows the campaign generated $1,019,000 gross revenue in the test period or about $2,038,000 on an annual basis.

Although the campaign generated $1,019,000 in gross revenue, we were presented with no convincing showing of profitability. We will therefore allow only the $307,000 for minor media in this category on the basis that Pacific, as an operating telephone company, is justified in expending this sum to make the business customer aware of its offerings in this area. The "competition campaign", included in this general category, will be disallowed on the basis that the $150,000 in advertising generated only $11,000 in gross revenue on an annual basis.

Long Distance Toll Stimulation. In Decision No. 85287, our last rate decision for Pacific, we allowed 50 percent of the expense for this campaign on the basis that the effect was most likely the equal stimulation on intrastate and interstate toll calls. Pacific claimed that the present toll campaign generated $10 million in net intrastate toll revenues. It developed that the company witness forgot to subtract the expense for the campaign. More importantly, Exhibit 207, Chart L, shows that interstate and intrastate toll "dial before 8" volumes have similar increases and decreases despite "intrastate" campaigns, and we have no other information which convinces us that a campaign can be conducted which can really stimulate intrastate toll calls without having at least a similar effect on

out-of-state call volumes (which benefits American Telephone and Telegraph Long Lines Department). We will again allow 50 percent of the amount spent for this item.

Yellow Page Advertising. This consists of advertising in order to attract yellow page customers, and to hold onto existing yellow page customers by running "look in the yellow pages" advertisements. The staff made no disallowance to this account (No. 132) in this proceeding. Pacific's evidence shows that spending $1.2 million "saved" $10.6 million in revenues which would otherwise be lost. This amount may be allowed for this proceeding, although we note that Pacific's most recent survey on how much money is saved is now four years old. For us to continue allowing these amounts, we expect more recent data in the future.

A summary of our allowances and disallowances for advertising follows.

SUMMARY OF ADVERTISING EXPENSE

Item	Utility Estimate 3/	Allowed By Staff	Adopted
Account 642, Advertising			
Mass Media Campaigns			
AT&T Print (newspapers and magazines)	$ 917,000 1/ 2/	$ -	$ -
Bell System Television	-	- 4/	- 3/
Directory Assistance Campaign	1,000,000	640,000 4/	650,000 3/
Long Distance Stimulation	3,400,000	1,700,000	1,700,000
Competition Campaign (Business Marketing)	500,000	-	-
Business Marketing	620,000 4/	-	-
Design Line Telephone	600,000 4/	-	-
Plan Ahead and Supplemental Residence Marketing Campaigns	810,000	-	405,000
Minor Media, Salaries, and Other Expenses			
Residence Marketing	730,000	250,000	307,000
Business Marketing	788,000	- 7/	307,000
Directory Assistance	80,000	- 7/	80,000
Long Distance Stimulation	117,000	58,500	58,500
AT&T Exhibits	194,000 5/	-	-
Disneyland Exhibit and Salaries	171,000 5/ 6/	-	-
California Museum of Science & Industry	16,250	-	-
Unidentified Advertising	42,000	-	-
Total Account 642	$9,985,200	$5,110,000 8/	$3,507,500
Account 132, Prepaid Directory Expense			
Yellow Pages	$1,784,000	$1,784,000	$1,784,000

Notes:

1/ Does not include $38,000 utility voluntarily disallowed for advertising to promote Bell System Television.

2/ Utility voluntarily disallowed $598,000 for Bell System Television.

3/ Does not include $350,000 directory assistance recording advertising which is included in directory assistance recording program adjustment.

4/ Includes minor media advertising which could not be broken out separately.

5/ Does not include $128,000 utility voluntarily disallowed for Disneyland.

6/ Does not include $65,000 utility voluntarily disallowed for California Museum of Science & Industry.

7/ Staff included this estimate under mass media.

8/ The staff developed a total figure based on a percentage of operating revenue. This figure is therefore not the sum of the above figures.

Suggested Changes to Accounting for Advertising

The staff Finance Division witness on this subject recommends that Pacific be ordered to segregate its accounting on advertising as follows to eliminate the confusion on this issue:

"a. Institutional - The primary purpose of this type of advertising is to promote goodwill or to create a favorable corporate image. As a policy matter, and consistent with prior Commission practices, the staff believes that such charges should not be allowed for rate-making purposes.

"b. Informational - The primary purpose of this type of advertising is to instruct customers in the use of the services offered or to provide information regarding the various services offered.

"c. Promotional Sales - The primary purpose of this type of advertising is to promote sales of products and services.

"d. Long-Distance - This type of advertising which is designed to stimulate toll usage.

"e. Other - This type of advertising consists of items such as legal notices, employment advertising, Yellow Pages, life line, etc."

The witness also recommends the inclusion of pre- and post-campaign costs (surveys) to advertising rather than sales expense.

The staff recognizes that the Uniform System of Accounts does not encompass this treatment, but regards this as supplemental information not in conflict with it.

We agree that Pacific should furnish us its advertising costs on this basis (except for survey costs, etc. which we regard as sales expense and not advertising), and we will order such information to be provided us. But at least as important is an accurate campaign-by-campaign breakdown, since trending for this account is inappropriate. Pacific should furnish with its direct

evidence on advertising (or sooner, if it is available), campaign-by-campaign details of expenses and revenues. While we do not trend advertising, recorded information on identical or similar campaigns in the recent past is useful for comparison purposes. Regardless of whatever accounting use the staff may have for a media-by-media breakdown of advertising (television, radio, print, direct mail, etc.) this cannot by itself help us analyze the expenses devoted to a particular campaign.

Other Commercial Expenses

The staff proposes a $7 million adjustment to commercial expense. This adjustment is proposed on the ground that Pacific imprudently raised its service index for "business office accessibility" from an objective of 88.8 in 1974 to 93.6 for the test period. The business office accessibility index is a Pacific service objective which measures the percent of times a subscriber gets through to a customer service representative at the business office. We do not have a level of service established for this index in our General Order No. 133 (defining telephone utility service standards). The expense for Pacific to add personnel to business offices in sufficient numbers to raise the index to 93.6 amounts to $7 million.

Pacific raised this service objective to come in line with Bell System service expectations, although in the opinion of Pacific's witness on service, an 88.8 index level provided adequate service to Pacific's customers. Further, early in 1975 Pacific's management felt the 93.6 index objective was higher than it needed to be. Before that, in late 1974, AT&T suggested to Pacific that it seek to raise its objective to the 93.6 level.[21a/]

21a/ The above facts are interesting in the context that while Pacific's management decided to raise a particular service index it thought adequate (and to fund an additional 350 customer service positions) Pacific, at the time, had a company policy of deferring rural orders for primary service which cost more than $2,000. The dramatic and unreasonable rise in held orders resulted in Decision No. 86593 (11/2/76; Third Interim Order herein) wherein we reduced Pacific's rate of return 0.007 percent until such time as Pacific demonstrates a return to normal for held orders.

Should we adopt the staff's proposed adjustment? Obviously, we are concerned about having good telephone service for California's ratepayers. Generally, Pacific provides good network service. We do not believe that the staff or TURN has shown that the only objective, or even the principal objective, of raising this accessibility index was additional sales. However, Pacific's own witness indicated that Pacific had considered its "old" accessibility index satisfactory. Additionally, the record does not otherwise demonstrate (as by way of a customer survey or customer complaints) that the old index was inadequate.

This extra expenditure, apparently adopted by Pacific at the urging of AT&T management, does nothing but improve statistics without eliminating any real service deficiency; therefore, such expenditure should not be charged to the ratepayers.

Traffic Expense

The staff developed a total estimate of traffic expense of $276,534,000. From this basic estimate it deducted $13,215,000 as a result of the effect of the directory assistance recording, and an additional $2,600,000 resulting from the effects of Decision No. 85287 (the staff and the company agree on this last figure). The staff's adjusted estimate was thus $262,719,000.

Pacific's original estimate was $281,927,000 but the effects of previously discussed Column L and Column M recast this figure to $286,903,000.

We believe the staff's basic estimate (before adjustments) is reasonable. It was based upon 12-month moving average trends and appears to reflect the long-term growth.

We also believe that the $13 million expense reduction for use of the directory assistance recording should be included. For reasons that will be discussed in the service portion of this decision, we are allowing the use of this recording to continue. We regard this as an extraordinary one-time adjustment that has the effect of depressing the volume of directory assistance calls.

License Contract Expense

Although supplementary hearings are continuing in this proceeding on the subject of License Contract expense, the present evidentiary record is fully developed on some staff proposed adjustments so that we can make decisions on them. These adjustments are in addition to our previous traditional license contract adjustment.

This traditional adjustment consists of two parts. First, there is a 6.04 percent factor to adjust the license contracts downward by the portion that is deemed identifiable investor related expenses. The staff and the company agree on the percentage (although the company does not necessarily accept this adjustment in theory).

The second part of the traditional adjustment is a 7.25 percent factor to eliminate unidentifiable investor related expenses. Pacific acceded to this adjustment in its original filing but later in the case decided to challenge it. Considerable evidence and testimony was introduced both by the company and the staff on this subject. A review of it indicates that it may be interwoven with the other proposed adjustments that are the subject of the supplementary hearings.

Antitrust Lawsuits. The staff proposed a disallowance of $495,000 for Pacific's allocated share of AT&T License Contract expense related to defending antitrust lawsuits. Of that amount $429,000 ($238,000 for in-house and outside legal fees, and $191,000 for administrative support activity) is specifically identifiable test year expense relating to defense of the continuing United States Justice Department's divestiture suit, the balance is for the defense of various other antitrust lawsuits. The staff's rationale is that defending antitrust lawsuits is inherently a matter beneficial only to Bell System shareholders in that the corporate structure or alleged management misconduct is defended, and no benefit accrues to Pacific's ratepayers.

We believe a 50 percent disallowance is appropriate. It is obvious that the ratepayers are hardly the sole beneficiaries of a successful defense of such a suit. It is not possible for us to determine, this early in the suit, that there is no benefit whatsoever to the ratepayers in defending it. The complaint filed by the Justice Department in this matter (U.S. v AT&T, et al., U.S. District Court for the District of Columbia, Civil No. 74-1698) is generally worded and includes the possible breakup of the operating companies into independents. While arguments may be advanced that independent, but interconnected, companies would function as well, other equally strong arguments may be made that in a system covering almost the entire United States, cost savings and efficiency flow from some form of centralized management. We will keep watching developments in this suit to see if it is necessary to reevaluate this percentage at a later date.

The staff has not demonstrated that the balance of its proposed adjustment is reasonable. The detail of the remaining expense in this category has not been itemized and we are cognizant that lawsuits are items or expense that must be met. Unless it is shown that particular suits are a result of imprudent corporate management, or are only of benefit to the shareholder, it would not be fair to adopt a disallowance of the associated legal defense expense in ratemaking. In future proceedings the staff should be more specific in its reasons for urging disallowance of antitrust defense expense. Some of the expense is undoubtedly investor-related; that is why we continue our traditional adjustment to License Contract expense for unidentifiable investor-related activity.

AT&T Marketing Department. The staff proposes a disallowance of $4,314,000 from License Contract expense for Pacific's share of AT&T Marketing Department expense. It is pointed out that AT&T Marketing Department expense has increased 98 percent over the 1974 level. Whether this is the result of terminal equipment competition we do not know. However, we are of the opinion after a review of the evidence that most of the AT&T Marketing Department's effort is

directed toward promoting and servicing Western Electric's interests. There may be some portion of the activity that benefits Pacific, but we cannot quantify that amount of expense which benefits California ratepayers. When engaged in ratemaking, we must be circumspect in allowing charges from affiliated companies. The utility must convince us that such expense is reasonable. In view of the staff's findings, and Pacific's failure to rebut the staff's showing or otherwise justify this expense, we are disallowing $4,314,000 from License Contract expense related to AT&T Marketing Department activity.

Who, one may ask, should bear the expense of Marketing Department activity? This activity is of primary benefit to the Bell System's manufacturing affiliate, Western Electric. Western Electric should perhaps logically absorb this expense. Since in reality it does not, we can only make a ratemaking adjustment, which in effect imputes that expense to Western. Whether expense allocation within the Bell System will change is, we suspect, largely dependent on the outcome of the U.S. Justice Department's divestiture suit.

Bell Telephone Laboratories PBX Development. The staff proposes a $453,000 disallowance to License Contract expense for Bell Telephone Laboratory (BTL) work related to the development of PBX systems. It is staff's contention that the research and fundamental development activity conducted in this particular BTL project is of a nature that would primarily benefit the Bell System's manufacturing affiliate, Western Electric. Pacific conceded that this activity could result in "new hardware developments" (Tr. 5717).

Pacific contested the staff's assessment. Pacific's witness testified that the BTL projects in question are essentially "exploratory engineering studies", and are thereby not directly related to product development.

We are of the opinion that some of the $453,000 in question supports activity that can very likely result in the development of new products, or improved products. While such products may eventually

benefit telephone users, the first beneficiary will be Western Electric, in that it will profit from sales to the Bell System subsidiaries. Our dilemma is that we cannot quantify how much of the $453,000 expense is related to product development. Product development related expense should not be borne by Pacific's ratepayers by an automatic pass-through of such expense in the License Contract. Rather, it should be absorbed as a portion of product price. If Western Electric paid for all fundamental research and development activity, the result would be that when a Bell System affiliate bought a Western Electric product it would pay, as a portion of the price, the overhead cost of research and development. And, to the contrary, if a Bell System company bought a non-Western Electric product, it would contribute to the research and development of other manufacturers. Given the existing arrangements, Bell System subsidiaries, such as Pacific, may pay for a good deal of Western's research and fundamental development activity whether or not it buys all its equipment from Western Electric. This is a troublesome situation. Staff refers to this problem, in the ratemaking context, as the "regulator's nightmare".

We are of the opinion that Pacific has not demonstrated that the $453,000 in question is a reasonable expense for us to allow for ratemaking. We are not convinced that the activity in question, either in whole or in unquantifiable part, is not product development oriented. In future proceedings we would expect to see more detailed information presented to describe such activity. Given the evidentiary record now before us, we have no choice but to disallow this expense.

Bell Telephone Laboratories Fundamental Research. Staff proposed a disallowance of $553,000 to License Contract expense for BTL fundamental development activity related to Business Information Systems (BIS). Pacific describes this activity as exploratory, and conducted to assist operating companies in making economic decisions relative to application of computer technology to the telephone business. Although we have some reservations and doubts concerning the BIS program in general, we find that Pacific has adequately justified this expense.

Basking Ridge, New Jersey, Building. Staff proposed a $672,000 disallowance to License Contract expense which represents one-half of Pacific's annual allocated share of the return on 195 Broadway Corporation's new Basking Ridge, New Jersey, building. The staff's adjustment is based on the fact that the Basking Ridge, building was occupied (or used and useful) for only half the test period. Consistent with test period ratemaking, the staff's proposed adjustment is reasonable and will be adopted.

Purchase of Land in New York City. An adjustment of $252,000 is proposed by the staff because 195 Broadway Corporation purchased land in New York City (for $18.5 million) for which it has no immediate plans, rendering it inappropriate for treatment as land held for future use. $252,000 represents the return on investment expense for this land allocated to Pacific for the test period. Pacific's response to this proposed adjustment is that as of mid-test period (January 1976) this expense will not be allocated through the License Contract. We will weigh the adjustment by adopting half of it, or $126,000.

TELSAM Project. Staff counsel proposed an adjustment of $180,000 for Pacific's share of expense for the TELSAM project ("Telephone Service Attitude Measurement"). This activity is billed outside the License Contract, and is conducted by a research firm which surveys operating company customers concerning their satisfaction with telephone service. It is staff counsel's contention that this activity has nothing to do with Pacific's meeting our General Order No. 133 service standards and, accordingly, is only a public opinion indicator. Although staff raises legitimate questions surrounding this expense, we find that it is closely enough related to service that the expense is appropriate for ratemaking. The amount is relatively minor and its expenditure may aid in identifying service deficiencies.

Federal Tax Rate. Staff counsel proposes an adjustment of $1.3 million to License Contract expense. This reflects the difference between the current effective federal income tax rate for AT&T and the 48 percent statutory rate as used in computing Pacific's allocated share of return on AT&T's General Department investment. Tax expense is an element considered in order to arrive at a net return on AT&T's investment used to render License Contract services. An effective rate of 5.12 percent would be experienced by AT&T during the test period, whereas AT&T uses a 48 percent rate to calculate allocated tax expense. The use of the 48 percent rate results in nonexistent tax expense being allocated to Pacific. Pacific contends that the effective tax rate of the Bell System (based on a consolidated return) is inappropriate for calculating the General Department's tax expense, because the relatively low effective rate results primarily from extensive plant investment made by the operating companies.

We are of the opinion that the Bell System's effective tax rate (based on its consolidated return) is the appropriate tax rate to apply in calculating the tax component of return on investment expense incurred between affiliated Bell System entities. This is because the General Department, as part of the Bell System, has the

mutual benefit of the low tax rate (regardless of why it results), and to apply or impute the highest or statutory rate ignores that benefit. In ratemaking when we review expenses between utilities and their affiliates, we must deal with reality and allow reasonable expenses. The 48 percent tax rate is unrealistic and unreasonable. We adopt the effective tax rate of 5.12 percent.

Executive Department Salaries

The staff's unadjusted estimate for this account is $2.8 million, which is $84,000 less than the company's estimate. The staff had later data available to it when it made its estimate and we are convinced that the staff's unadjusted figure is appropriate.

The staff took its unadjusted figure and subtracted $170,000 to disallow executive salaries which exceed $100,000 annually. To this the staff added another $30,000 disallowance for certain salary increases paid to 23 other high-level executives not earning over $100,000 a year. This latter adjustment was made on the ground that there have been excessive executive salary increases in the past several years. TURN supports these salary disallowances.

Staff witness Amaroli relied heavily on public salaries, particularly in state government in California, and TURN apparently relied on the difference between Pacific salaries and these California state government salaries exclusively (see TURN's opening brief, p. 31). The staff witness pointed out that Pacific did not demonstrate any loss of executives to other companies, and he mentioned that Pacific, in his opinion, competes with no one for the executives in their employ except possibly other telephone businesses, which may not be of a size and nature to truly be competitive at the higher levels (Transcript 5145).

Pacific argues that staff's position was at first founded on a Commission decision involving Pacific Gas and Electric Company (PG&E) in which the Commission disallowed all executive salaries in excess of $100,000 (Decision No. 84902 dated September 16, 1975, Application No. 54279, ____ CPUC ____). However, Pacific points out that the Commission reversed itself regarding this determination in another PG&E decision, No. 86281 dated August 24, 1976 (____ CPUC ____, mimeo. p. 34):

> "In Decision No. 84902 dated September 16, 1975, the Commission disallowed executive salaries to the extent they exceeded $100,000 per year. Based on this recent decision the staff estimates are $88,000 less than PG&E's. PG&E made an extensive, uncontroverted, presentation in support of the reasonableness of the salaries it pays executives. We are convinced by applicant's showing and arguments and will not adopt the staff's adjustment of executive salaries."

The staff witness was of the opinion that the problems encountered by PG&E executives are more difficult to solve than those faced by Pacific's executives. The witness stated that he had read the PG&E decision but not all of the evidence connected therewith (Transcript 5140).

Pacific's Exhibit 196 is a detailed review of the salaries paid to its board chairman, president, and highest-paid vice president, compared to large west coast firms for the year 1975. In all three of the categories Pacific's salary is below the median. Pacific's board chairman is paid $18,000 a year more than PG&E's, Pacific's president's salary exceeds PG&E's president by $5,000, but Pacific's highest-paid vice president makes $8,000 less than PG&E's highest-paid vice president. The tabulations in the exhibit would indicate that Pacific's top-level salaries are in line with other similarly situated corporations of equivalent size.

While it is true that Pacific and other utilities operate within a regulatory climate which removes some of the risk, for an executive this can add as many problems as it eliminates. We also understand very well that Pacific is part of the Bell System and therefore certain decisions are made for it. However, this still leaves us with a very large corporation serving six million people in a service area larger than PG&E's. While a gas and electric company currently experiences problems regarding environment and the supply of fuel not directly experienced by telephone corporations, a telephone company on the other hand offers a far more complex inventory of products and services to the public. It cannot be categorically stated that gas and electric company executives experience more difficult problems than telephone company executives.

We believe that comparing Pacific with other corporations of approximately equal size and complexity, such as was done by the company, is more appropriate than the staff's and TURN's very strong reliance on California state government salaries. It is well known that state government and other governments have budgetary problems peculiar to government

and that government salaries are traditionally lower than those in the private sector. Pacific would be totally unsuccessful in competing for talent were it to adopt salary ranges based upon surveys of governmental agencies.

We accept the staff's $30,000 adjustment based upon certain rapid rises in executive salaries. We reject its disallowance of all salaries above $100,000 in this proceeding, on the same basis that we did in the PG&E case cited above. This does not mean that in the future we might not return to a disallowance of executive salaries above a certain level if we are convinced from a proper showing that such a disallowance should be made.

"Stockholder Visit Program"

This program consists of periodic visits to selected California shareholders to discuss with them current events with regard to Pacific and the Bell System and to answer any questions they might have relating to their stock and the future of the company's business (Transcript 4310-4311). Pacific's witness Mr. Henderson claimed that this not only benefited the company and the investors, but its ratepayers as well.

Staff witness Amaroli testified that the program is an investor-related activity and should not be borne by the ratepayers (Exhibit 38, p. 6-GAA).

We have reviewed the briefs and the evidence in this matter. This is quite obviously a program that should be borne by the stockholders. Any benefit to the ratepayer is incidental. The staff's downward adjustment of $220,000 to Account 665 for expenses associated with this program is adopted.

General Legal Expenses

This recommended disallowance has to do with legal work performed for Pacific by the law firm of Pillsbury, Madison & Sutro of San Francisco. Certain matters handled by this firm are billed on a detailed basis. During 1966 Pillsbury, Madison & Sutro ran a test at which time all lawyers assigned to Pacific's legal matters billed their time separately for each item. The resultant summary of services, in Pacific's opinion, showed that the work performed was necessary and the billing was reasonable. Pacific therefore directed that Pillsbury, Madison & Sutro resume the "time-saving use of the 'general' category for the billing time of those PM&S attorneys regularly assigned to Pacific's legal affairs". (Exhibit 195, pp. 12-13.)

The staff points out that without detailed billings, there is no way to determine how much expense should be disallowed for legislative advocacy, for antitrust-related work that the staff feels should be more properly borne by the shareholders, and for other matters that might be the responsibility of the shareholders rather than the ratepayers. The staff recommends a $1 million disallowance (representing the amount of the legal expense for which there is no detailed billing).

Pacific countered by submitting affidavits of the Pillsbury, Madison & Sutro lawyers performing the general legal services, describing their duties. Pacific objects to the staff investigation on the basis that the staff witness (Amaroli) is not a lawyer but an electrical engineer and therefore cannot perform a qualitative analysis of Pacific's legal needs.

We believe the staff's adjustment should be adopted. Pacific is missing the point. The staff witness did not attempt to second-guess Pacific on its legal needs but simply to add up the amount of legal work which should correctly be billed to the

ratepayer. We assume that an electrical engineer is at least as good as a lawyer at arithmetic. Without the detailed billings, he could not make the necessary investigation. A large amount of money thrown into a "general" category in order to save the expense of detailed billing may well be appropriate for a nonregulated corporation, where no decision has to be made about whether the customers or the stockholders should foot the bill. Such a corporation exists in a competitive area, and if it passes too many costs on to its customers, the customers may go elsewhere. The staff witness pointed out that another large law firm, Lawler, Felix & Hall of Los Angeles, which performs legal services for Pacific, clearly and sufficiently detailed its billings (Exhibit 38, p. 7-GAA). The staff believes there is no reason why Pillsbury, Madison & Sutro cannot do likewise. We agree. We are not specifying the exact detail necessary. We think it would be appropriate for officials of the company, the law firm, and the staff to work together to see if sufficient detail can be furnished without causing unnecessary expense.

Meanwhile, we believe it inappropriate to burden the ratepayers with this sum when Pacific has failed to carry its burden of proof that such matters should necessarily be billed to the ratepayers rather than to the stockholders.

Regarding the itemized billing from Pillsbury, Madison & Sutro, staff disallowed only $6,000, associated with legislative advocacy. This staff disallowance is appropriate.

Other General Office Salaries and Expenses

The staff's estimate for this item (Account 665) is $195,000 less than Pacific's. The staff used later recorded results to trend this account. The staff's figure is acceptable (this adjustment is before the "legislative advocacy" disallowance which is included in this account, discussed immediately hereafter).

Legislative Advocacy Expense

Pacific made a disallowance of $104,000, but the staff recommends a figure of $202,000. We believe the staff's evidence shows that Pacific failed to include in the disallowance certain support activities. The staff's figure is adopted.[21b/]

Dues and Donations

Pacific stipulated to accept the staff's estimate of $270,000 as correct for this traditional disallowance.

Charitable Work Performed by Pacific Executives "On Loan"

The staff excluded $360,000 for the test period. Pacific loaned executives to do charitable work, which causes an expense, according to Pacific, of $282,000 for the time of the executives loaned for more than four weeks, and $81,000 of in-house coordinators on charitable campaigns. Pacific objects to the $81,000 being disallowed because it does not have to hire anyone to replace such people. Nevertheless, these employees are not directly engaged in work which is productive as far as the ratepayer is concerned, and therefore the ratepayer should not pay for it. The staff's disallowance is accepted.

Local Community Affairs Activities of Customer Operations Managers

Staff recommends disallowing $392,000 regarding this item. Customer operations managers attend community affairs such as rotary clubs and chambers of commerce. They also go to city council meetings and meetings of other public bodies. We believe only a 50 percent disallowance is appropriate here. While some of this activity may be nothing more than "establishing the corporate presence", the evidence also showed that this activity is vital in order that the local managers be aware of community growth patterns and developments for planning purposes. Not

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21b/ The sums mentioned should not be equated with amounts reported to the Fair Political Practices Commission, which include certain funds considered by us under legal expenses and other categories.

everything the telephone company needs to know about future growth trends is going to appear in the local newspaper.

Business Information System (BIS) Expenses

This is a Bell Telephone Laboratories (BTL) research program begun in 1967. The expenses for it have grown steadily, and Pacific's share has been as follows:

PACIFIC'S ALLOCATED SHARE OF BIS

Year	Amount (Millions of $)
1967	$0.6
1968	1.5
1969	2.8
1970	3.8
1971	4.4
1972	4.7
1973	4.9
1974	5.6
1975	6.9
1976 (estimated)	8.0

The test period expense for this item was $7.5 million (Exhibit 187, part 1). Staff witness Amaroli proposes a disallowance of $6.1 million.

BIS expenses are incurred under an agreement between the Bell System operating companies, including Pacific and BTL. Neither AT&T nor Western Electric participate in this agreement. Each company is represented on a BIS Advisory Board which determines project priority, and each company may use any of the projects developed, or reject such projects, as is necessary in its own operations.

The purpose of the research and development performed under this contract is to assure that continued advances in electronic data processing and business information systems may be utilized, and to provide efficiency in the design of systems and programs through a centralized development organization (Bennett, Exhibit 187, p. 2).[22/]

22/ The BIS agreement is Exhibit 67 in this proceeding.

Pacific's witness Bennett stated that his studies (which were not introduced as documents) indicated a saving, since the inception of the BIS of $40 million because Pacific does not have to develop its own products. The witness stated that in making his study he assumed that Pacific would perform the development of such products alone at one-half the total BIS cost estimated for each project (Exhibit 187, p. 8).

These projects mostly have lengthy time frames (anywhere from two to eight years) including trial by one of the operating companies and release of a full "project package" for implementation and changeover from existing methods to the new method.

The attachments to Exhibit 187 (witness Bennett's rebuttal testimony on this issue) contained a detailed breakdown of BIS projects. We will mention a few as examples.

1. Administration of Design Service (ADS)

   This is a system of handling and processing of service orders for special services. It was the subject of a field trial by Pacific in 1973 and was made fully operational in mid-1976.

2. Coin Telephone Operational and Information Network (COIN)

   This provides data support for coin telephone operations including prediction and scheduling of collections. It was installed in the fourth quarter of 1974 and is fully operational. According to the exhibit, "expansion has high priority".

3. Maintenance Inventory Control System (MICS)

   This is intended to provide computerized optimum stock levels for spare parts. A field trial was performed in 1975 and full implementation of it was begun in the second quarter of 1976.

4. Total Network Data System (TNDS)

Intended to provide "complete mechanization of data for administering central office equipment and trunking operations". This project has several sub-parts listed in the exhibit, five of which are operational in Pacific's system.

The exhibit indicates that the estimated cost saving flowing from the mentioned projects are as follows: ADS (combined with another project not covered above), $1,900,000, COIN, $3 million, MICS (combined with two other projects), $350,000, and TNDS (total saving from all the various sub-parts), $13,700,000.

Not all of the projects turn out to be valuable to Pacific. The exhibit lists the status of 52 separate projects. Some of them are completed and in use. Some are in the process of development and are assigned various priorities. A few have either been discontinued or are indicated as of no relevance to Pacific's operation because some other system is the equivalent.

The staff's brief mentions that there are eight BIS projects for which Pacific contributed its share of expense but will not be used by Pacific. Five of these projects were discontinued by BTL and the three others were completed but will not be used by Pacific. The expenses connected with these projects amount to $2.6 million for the discontinued projects and $7.3 million for those which are completed but will not be used by Pacific, totaling $9.9 million. (It should be well noted that this is not a test year figure but a total figure over several years). The staff also pointed out that Pacific's witness Bennett stated there are now six additional BIS projects in developmental stages which Pacific may or may not use when they are operational.

The staff argues that the continuing BIS expenses were the subject of some critical commentary from AT&T's "Executive Policy Committee" in 1972. Exhibit 68 contains a memo with the following comment from the minutes of the Executive Policy Committee:

> "Mr. Felker presented Bell Laboratories alternatives to the recommendations presented to the EPC (Executives Policy Committee) by Mr. Owens and Mr. Quirk on October 2. Both alternatives contemplated continuing the 1973 OTC budget for BIS at the proposed level of $47 million pending further study. The Committee, however, continued in its view that expenditures beyond the level of the current year are unsupportable and that a significant reduction - to the degree that it can be sensibly accomplished - is desirable."

The Executive Policy Committee had apparently proposed reducing a total BIS budget from $47 million to about $25 million.

On cross-examination, Pacific's witness Bennett stated that there was an investigation into the benefits of BIS in 1972 entitled the "BIS Priorities Project Report" submitted to AT&T's Executive Policy Committee. According to Mr. Bennett, Mr. Owens, a member of the Executive Policy Committee, was in charge of the investigation, which was instigated at the behest of the operating company presidents and the president of AT&T. The report came to the following conclusions: (1) Centralized BIS development has not produced the desired results; (2) There is no reason to believe that takeover of BIS by regular laboratories will result in producing better results than their predecessors; (3) OTC's (operating companies) are capable of developing BIS programs designed in size to fit their own needs; (4) Some locally developed programs have been widely used by other OTC's; (5) If left unchecked, BIS expense will continue to expand in ever-increasing amounts; (6) The time is right for remedial action before regulators intervene; (7) BIS work should be limited to selected projects.

The recommendation to reduce the BIS expense level was not adopted, pending further study. The staff cites this as an example of AT&T thinking of itself first and the operating companies afterward. The staff is of the opinion that its recommended adjustment will accomplish what AT&T failed to achieve through its voluntary reduction. Staff witness Amaroli testified (Exhibit 38, pp. 8-9 GAA).

> "Pacific prepares a comprehensive study on each BIS program before incorporating it into its California operations. Witnesses Albert Carlson, J. S. Sekhon and I have all studied the BIS program and we have agreed that Pacific's ratepayers should assume the cost of those BIS programs which are used, or are being developed for Pacific's use during any portion of the test period. We do not believe that Pacific's ratepayers should assume any BIS developmental costs for programs which are not currently used or useful to Pacific during the test period.
>
> "As to the BIS programs that have been excluded, Pacific has not demonstrated that it adequately reviews programs to be developed or that such programs are needed by Pacific. Pacific has not demonstrated that it makes certain AT&T does not charge for programs that have no value to Pacific. Pacific has not demonstrated that it has a review process to evaluate the progress of each program being developed and that it cancels its participation in programs that do not appear justified."

The staff witness determined which project would be used and useful to Pacific during the test period by asking Pacific for data requests on the projects available and whether Pacific planned to use them (Transcript 5197). In view of the history of BIS, the staff is of the opinion that it is not enough to simply trend expenses for BIS.

Pacific is critical of the staff's approach on the basis that it is a hindsight test. Pacific states that when dealing with research and development, if the expenses are incurred in good faith for projects which were feasible when entered into, and which were reasonably calculated to produce foreseeable benefits (i.e., cost savings) to Pacific's ratepayers in the test period or in the future they should be allowed. Pacific stresses that its showing, particularly Exhibit 187, clearly establishes that the projects were entered into in good faith and were reasonably calculated to produce foreseeable benefits to California ratepayers in the future. Moreover, Pacific states that its BIS showing establishes already existing savings benefits of a considerable magnitude. Pacific's total BIS expenses (since the inception of BIS and not just for the test period) through June 30, 1976 were $39 million. The projects which Pacific has already implemented or plans to implement within the next few years produce an estimated annual savings in excess of $67 million (Exhibit 187, pp. 7-8; also Exhibit 187, part III).

The staff noted that Pacific does not approach outside vendors respecting BIS projects. The company denies this, stating that BIS has worked closely with outside vendors in procuring hardware and services which those vendors could provide associated with BIS projects (Exhibit 187, pp. 9-10).

In research and development, one must expect that not all of the projects will turn out to be of value. While the staff argues that Pacific and AT&T may be able to perform its research and development of this sort better by having the operating company do more of it themselves, or by more heavily using outside companies, there is no hard evidence to this effect, and this argument remains speculative.

However, we note (1) that a certain percentage of the projects are not suited for possible use by Pacific, even at their inception, and (2) this item has been growing rapidly, and out of proportion to growth in other areas, in spite of the misgivings of some AT&T executives. Because of these factors, a $2.5 million downward adjustment to the total estimate for the test year is warranted.

We also wish to point out that we deem it inappropriate to simply trend BIS expenses into the future to keep pace with other accounts, and Pacific's expenses generally. Moreover, we are critical of Pacific for supplying only general information regarding the test year cost savings. More specific evidence based upon actual studies will be necessary in the future if we are to be convinced that the amount allowed in this proceeding should not stand as a "ceiling" on BIS expenses, or perhaps that a lower amount should be allowed.

We also expect, in the future, a better breakdown from Pacific on estimated savings which are actually of benefit during the test year versus those savings which will occur after the test year in the "near future". We will not rely on "trends" for BIS.

We will require Pacific, in future rate increase applications, to submit as part of its direct showing a breakdown of BIS projects in a form similar to that attached to Mr. Bennett's rebuttal exhibit on this subject (Exhibit 187) together with, as mentioned, a more detailed breakdown of the estimated cost savings.

Lastly, we are mindful of the "license contract" payments made to AT&T, which have a variety of purposes. We intend to insure that there is no overlap between BIS and the license contract. Those expenses which are part of BIS, in our opinion, should not receive any support from the license contract and if it is shown that license contract funds are used for this purpose, any such license contract payments should be disallowed.

"Bell System Savings Plan"

Bell System management employees are eligible for a deferred compensation plan in which the particular Bell System company (in this case Pacific) matches the amount the employee defers from his paycheck up to three percent of his annual salary. Staff counsel recommended on brief that this be disallowed on the basis that management employees are paid at or above the median level compared to 29 other large corporations, and because management employees are nonunion and therefore this was not negotiated.

Pacific points out that this suggested disallowance was not brought up during the hearing and there is no evidence to support it, and that Exhibit 71 is only a comparison of the top salary rate of certain levels of Pacific's managers and does not support the adjustment.

This proposed adjustment is inappropriate. Assuming we were to find that Pacific's management employees were overpaid, we would take care of the matter by disallowing the salary expense rather than making a specific disallowance directed at one certain fringe benefit. This particular type of savings plan is used in one form or another by many corporations and there is nothing unreasonable about it. In any event, the record does not justify the disallowance. The staff's testimony concerning management level salaries was directed to disallowing certain top-level salaries over a certain amount. The staff's own Exhibit 37 states that Pacific's wage and salary levels for management employees and non-management personnel are reasonable.

We note, however, that the company, given the opportunity to use investment tax credit (ITC) for an employee savings plan, chose not to do so. In Pacific's next rate increase application we will review whether certain employees should have the opportunity to participate in such a "plan" while others do not.

Meal and Entertainment Expense

Staff counsel also proposes on brief an adjustment in the amount of $222,000 in this category for "groups of non-PT&T employees over and above the cost of one such person". The staff claims that this is really a public relations fund. There is no evidence to support the staff contention since this disallowance was suggested the first time on brief. It will be rejected for this proceeding without prejudice to the staff to pursue the matter in a future proceeding.

Certain EEOC Expenses

Also proposed by the staff on brief is an adjustment for Pacific's expense related to settlement of a 1973 consent decree between the Bell System (Pacific being a party respondent) and the Equal Employment Opportunity Commission (EEOC). The proposed disallowance amounts to $336,000. TURN apparently recommends a similar adjustment (see TURN's brief, pp. 34-36).

We are of the opinion that we should not allow test period expense for payments to employees, pursuant to the EEOC consent decree, to compensate for Pacific's past discrimination hiring and promotion practices. Although the consent decree is not a finding of guilt, but for the consent decree Pacific would not have incurred the expense. Pacific, as any utility, has the burden of showing expense reasonable for ratemaking. We are simply not convinced that the payments to employees pursuant to the consent decree to compensate for alleged discriminatory practices are reasonable ones to pass on to ratepayers. The U.S. Supreme Court has reached the same conclusion in NAACP v FPC 48 L. Ed. 2d 248, p. 292 (1976). We emphasize that our disallowance is limited to the penalty payments to employees, and does not include amounts connected with litigation of EEOC problems, administration of EEOC programs, or compliance with the consent decree.

Clearing Accounts

The Finance Division recommended certain changes be made regarding the treatment of Pacific's clearing accounts. After some evidence was taken, Pacific and the staff arrived at a compromise which is set out in Exhibit 174. The staff therefore requests that we order Pacific to proceed as follows:

> "Pacific shall revise Sheet 3 of Form A 4556, a report on Revenue, Expenses, Net Plant and Working Capital, to break out the wage payments now shown under the caption 'other' into Traffic, Commercial, Accounting and Other. This segregation will represent actual wage payments booked during the month. That portion of wage payments shown in account categories which come from clearing accounts will be based on a one month once a year study of clearing account clearances."

This is a reasonable procedure and we will enter such an order.

III. REVENUES

Revenue Estimates for the Test Year

The revenue estimates for the test year are developed for interstate toll revenues, intrastate toll revenues, local service revenues, and miscellaneous revenues. From these categories an estimate of uncollectible revenues is subtracted in developing the final revenue estimate.

For interstate toll revenues, the staff's estimate of $767 million exceeds Pacific's by $14 million. Most of the difference results from the fact that although Pacific annualized the revenue effect of Decision No. 85287 (December 30, 1975,

Application No. 55214) it did not annualize the revenue effect of a recent FCC interstate rate increase granted in February 1976 (after Pacific filed its amended application in this proceeding).

For intrastate toll revenues, the staff developed an estimate of $948 million. The staff annualized the effects of Decision No. 85287 and then added $4.3 million for annualized toll revenue resulting from single message rate time (SMRT). The final result of changes to SMRT is discussed below. The staff then also added $82 million for the effects of Decision No. 85287 to toll rate increases.

The staff's original base estimate of local service revenues is $1,565,375,000. The staff added to that estimate an estimated annual revenue effect, after settlements, of the SMRT rates authorized in Decision No. 83162, amounting to $29,987,000. Then $14,295,000 was subtracted due to the elimination of 6 MMU and $254,000 was subtracted as the result of the use of the recording on directory assistance calls (this is not the direct effect, which is discussed elsewhere; this is an amount resulting from the fact that as local calling volumes decrease, the proportion of interstate usage increases. See Exhibit 143, p. 2 for a description of this settlement process). Lastly, the staff added the effect of an increase in the SG-1 PBX within the test period, estimated by the company to be $1.2 million. The resulting staff estimate is $1,582,013,000, compared to the company estimate of $1,568,257,000, a difference of $13,756,000.

The company criticizes the staff development, pointing out that the staff has historically overestimated revenues when compared with actual results. In Exhibit 12, Pacific sets forth the past reliability of Pacific's revenue estimates, showing the December view of the following year from 1965 to the present, as follows:

PACIFIC TELEPHONE AND TELEGRAPH CO.
TOTAL OPERATING REVENUES
(millions of dollars)
( ) = negative amount

Dec. View of	Year	View	Actual	Actual/View View Miss	Actual/View Percent Miss
1965	1966	1405.0	1423.2	18.2	1.3
1966	1967	1540.1	1519.4	(20.7)	(1.3)
1967	1968	1631.0	1674.2	43.2	2.6
1968	1969	1860.6	1899.1	38.5	2.1
1969	1970	2041.8	2032.7	(9.1)	(0.4)
1970	1971	2212.1	2200.5	(11.6)	(0.5)
1971	1972	2455.9	2357.2	(98.7)	(4.0)
1972	1973	2620.3	2623.7	3.4	0.1
1973	1974	2874.8	2894.2	19.4	0.7
1974	1975	3257.8	3217.1	(40.7)	(1.2)
Oct. View 1975	Test Year	3433.9	3403.3	(30.6)	(0.9)

The above figures, except for the October 1975 view, are from Table C-1, page 5 of Section C, Exhibit 12. The October 1975 figures are set forth or can be calculated from figures in the "Exhibit Accompanying Rebuttal Testimony Actual Results vs. Estimates of Hamish Bennett" of Exhibit 187. The amounts are total operating revenues before uncollectibles per footnote in Exhibit 12, Section C.

Pacific's revenue estimates are based on a combination of a "bottoms-up" forecast (that is, from information obtained from various offices in the field) and a "tops-down" for administrative forecast of telephone activity. This is the method that Pacific has used in the past.

Pacific points out that the staff witness on local service revenues, although he had six months' recorded data for his estimate available to him failed to realize that these actual results showed that revenues for the test period would be considerably less than estimated even by Pacific. Notwithstanding these results, Pacific points out, Mr. Newman continued to use a strict trend analysis.

Pacific makes a similar criticism of the testimony of Mr. Franklin regarding toll service revenues, that is, that insufficient weight was accorded to six months of actual test results available to him.

We are convinced from a review of Pacific's estimating procedures versus the staff's, that we should adopt the company estimates for revenue. The company gave sufficient weight to current information, and historically the company's estimates have been quite accurate, especially since 1972. These company estimates are subject to a recast which results from our final disposition of residential and business SMRT. This is discussed below.

Single Message Rate Timing Adjustment

Our fourth interim order in this proceeding (Decision No. 86594 dated November 2, 1976) dealt inter alia with SMRT. We granted rehearing, and have now issued our opinion on rehearing on this subject, Decision No. 87584, dated July 12, 1977 (fifth interim order).

In compliance with Ordering Paragraph 2 of Decision No. 87584, Pacific provided the estimated annual revenue effect for the test period resulting from the ordered rate changes. We have modified the revenue effects for our adopted California Corporation Franchise Tax rate of 10 percent. As a result both Pacific's total company and intrastate net revenues decrease by $7.3 million. Neither company nor staff estimates anticipated the reduction, and therefore rate levels are set to prevent a shortfall in revenues from SMRT modifications.

Changes in the Revenue
Effect of Decision No. 85287

Decision No. 85287 dated December 30, 1975 in Application No. 55214, granted the last general rate increase to Pacific, in the amount of $65.2 million. In their respective revenue estimates for the test year in that application (1975-1976) both Pacific and the staff annualized the revenue effect of the Decision No. 85287 increase (65.2 million) on a 1975-1976 test period basis, because proper ratemaking requires that known revenue increases be annualized and included in the test period.

However, regulatory complications developed. The city of San Diego petitioned for the rehearing of Decision No. 85287, contending that we failed to include approximately $15 million of known revenue in our adopted estimated results of operations in that decision (which, if San Diego prevailed, would result in our reducing the amount of the increase authorized in that decision). Further, complicating matters, we issued, after rehearing San Diego's contentions, Decision No. 86541 (dated October 26, 1976) which reaffirmed our original determination that Pacific was entitled to $65.2 million of rate relief.

San Diego filed a timely petition for a writ of review with the Supreme Court. Thereafter, on February 8, 1977, we reopened Application No. 55214 to reconsider San Diego's position, advising the Supreme Court that we were reexamining the matter and requesting the court to hold its consideration in abeyance pending our reconsideration. Finally, on September 7, 1977, we issued Decision No. 87827 wherein we found our previous decisions were in error to the extent that $7.5 million of increased yellow page advertising rate revenue (increased in 1974 by Decision No. 83162) should have been included in our adopted results of operations in Decision No. 85287, in effect reducing revenue requirements by $7.5 million.

Pacific petitioned for rehearing of our latest decision, as has San Diego. We denied both petitions on November 22, 1977 by Decision No. 88145. The ordered refunds and rate reductions were stayed by timely petitions for rehearing and our decisions denying rehearing.

Hearings on most results of operations issues in this proceeding were concluded in November 1976 and our action with respect to reducing the revenue requirement of Decision No. 85287 was taken in 1977. What effect does our determination that rates should be reduced by $7.5 million have on our adopted results of operations herein? Both Pacific and the staff, as mentioned above, assumed a revenue increase of $65.2 million from Decision No. 85287 and adjusted their respective revenue estimates accordingly for Application No. 55492. Yet, we found after submission and subsequent decision that, in effect, a revenue increase of $57.7 million was reasonable instead of $65.2 million. We acknowledged this ratemaking ramification of our action in Decision No. 87827 as follows:

> "The $7.5 million rate reduction ordered herein will be recognized in our decision or revenue requirement in Application No. 55492 by acknowledging that for the test period PT&T's revenues will be $7.5 less than estimated [by Pacific and staff]."

But for the fact Pacific and San Diego are continuing to appeal the issue, and the fact that we have stayed the $7.5 million rate reduction pending action by the Supreme Court, we would for ratemaking consistency reduce our adopted revenue estimate herein by $7.5 million. At such time as the Supreme Court may determine the $7.5 million rate reduction proper we will, by a supplemental order in this proceeding, authorize an increase of $7.5 million. If the Supreme Court determines our rate reduction was improper, no subsequent order need issue. We are of the opinion we should not adjust downward our adopted revenue estimate by $7.5 million because such a ratemaking adjustment may be premature. We could make the adjustment and order rates subject to refund, but the fact is Pacific has not incurred the revenue loss, (because, as mentioned, the rate reductions were stayed) and possibly may never incur it depending on the Supreme Court's determination. We try, as a matter of policy, to set rates subject to refund only when it is unavoidable. Increasing rates incrementally by $7.5 million subject to refund with respect to this item are avoidable.

Staff's Proposed Revenue Adjustment for Discounts to Management Employees

The staff proposes an upward adjustment to Pacific's intrastate revenues of $2,053,000 in order to compensate for the amount of revenue estimated to be lost during the test period because of telephone discounts, or, as they are called, "concessions" to management employees. Exhibit 71 is a company response to the staff's data request on this subject and estimates a revenue loss (both inter- and intrastate) of $2,585,000 due to these concessions. TURN essentially supports the staff position in this regard.

The staff's reasoning is that it is the Commission's business to discourage concessions which promote usage and which therefore increase long-term costs of plant expansion. At the same time, the staff proposes this adjustment only for management (nonunion) employees.

Pacific defends these concessions on the ground that it insures that Pacific's employees can be contacted at all times in emergency situations and for immediate answers to technical questions necessary to the safe and proper operation of the plant. Pacific points out that the staff witnesses who testified regarding the reasonableness of Pacific's expenses, including management expenses and fringe benefits, did not challenge the reasonableness of the management telephone concessions (Exhibit 38).

This is not the first time this subject was explored on the record. More complete evidence on these concessions was submitted in Application No. 55214, of which we took notice during the course of the hearings in the present proceeding. The company represented that there had been no substantial change from the concession situation in Application No. 55214 to the present time.

In Application No. 55214 it was shown that the total concessions to management and non-management employees, including concessions to retired persons with over thirty years of service, amounted to almost $10 million. There are various classifications of discounts. The amounts involved, and the classifications, break down as follows:

PACIFIC TELEPHONE AND TELEGRAPH CO.
EMPLOYEE TELEPHONE DISCOUNTS

Employee Class	Management	Non-Management	Pensioners
Classes A, D, & P	$1,309,000	$ 626,000	$4,202,000
Class B	723,000	-	-
Class C	578,000	2,202,000	-
Total	$2,610,000	$2,828,000	$4,202,000

The grand total of the above is $9,640,000. Exhibit 112 in that application explains that there is no breakdown of the amounts involved by classes of management (i.e., top-level executives vs lower-level management). The "classes" in the above table are explained in Exhibit 112 as follows:

1. Class A applies to all employees with 30 years or more of service, management employees at district level and above, and certain supervisors whose duties require them to be on call at any time. The concession is 100 percent on residence exchange service, toll service not in excess of $20 per month, and a reasonable amount of message unit service.
2. Class B applies to supervisors (other than those qualifying for Class A) whose duties require them to be on call at any time. The concession is 100 percent on residence exchange service excluding message units.
3. Class C applies to all other employees. The concession is 50 percent on residence exchange service excluding message units.

4. Class D applies to a bona fide second residence for those persons eligible to Class A or P. The concession is 100 percent on residence exchange service and a reasonable amount of message unit service.

5. Class P applies to pensioners. The concession is the same as Class A.

We question both the company rationale for such liberal discounts and the staff's theory of why they should be disallowed.

It does not follow for the staff to argue that management concessions alone should be the subject of a revenue adjustment and then to say that the reason for this is it is in the public interest for us to eliminate concessions that promote usage. If eliminating excessive usage is the target, then the adjustment should be across-the-board since there are many more non-management than management employees. This would not be an interference with collective bargaining since we would have made no order that directly tells Pacific not to give any of its union employees a discount. The staff's argument really seems to be aimed at an adjustment for management salaries. If this is what the staff wishes, then it should argue in favor of a disallowance to management salaries on the ground that they are excessive. We would then make the appropriate disallowance without telling the company which particular fringe benefit, if any, should be trimmed.

As for Pacific's argument that these discounts help proper operation of the telephone plant, the discounts for management employees do not seem to be specifically set up to accomplish this objective. Looking at the classifications listed above, under Item 1 there appears to be no firm definition of a "reasonable amount" of message service, nor do we have any information regarding how much of Item 1's Class A Discount is attributable to employees who have specific responsibilities requiring them to use their

telephone for emergency and other legitimate business purposes. There are certainly many employees, even at high management levels, who seldom if ever deal with emergencies, or even operational problems, due to the nature of their particular functions. Companies in other industries, who are unable to offer direct telephone concessions for emergency purposes, handle the problem by simply allowing appropriate individuals to turn in expense accounts for business calls.

We believe the staff's objective of controlling usage by regulating "blanket" or categorical discounts to be justifiable, and that this should be the true objective of any regulation in this regard, rather than the indirect regulation of management's salaries. As we have stated, if overall management salaries are excessive, they should be dealt with by a straight disallowance in this area. Therefore, we should investigate discounts as a whole. However, we note that (1) we have not indicated in the past that we were interested in such an investigation; (2) this issue was raised late in the proceeding; (3) we relied partly upon material from Application No. 55214, concerning which there was no further development for the record in this proceeding. Therefore, we do not intend to make the revenue adjustment the staff proposes in this proceeding. We will investigate this matter fully in the next Pacific rate increase application, and we will require Pacific, in its next application, to furnish:

(1) Regarding the Class A Discount, a breakdown of the amount of classes by management.

(2) Also regarding the Class A Discount, a breakdown of how much of the amount is attributable to (a) management employees above the district level; (b) management employees at the district level; (c) supervisors required to be on call; and

(d) employees not in such categories who have more than thirty years service (subdivided into management and non-management personnel).

(3) For the Class D concession, the same breakdown as for Class A, and subdivided by persons eligible for Class A or Class P.

The above requirements are not all-inclusive and are not intended to preempt data requests or further orders of the presiding officer on this subject in the next rate increase application. We intend to explore this subject thoroughly.

We emphasize that it is not our objective to order Pacific to modify its discounts regardless of its commitments to its employees, but merely to decide whether there is a maximum total amount of such discounts reasonably chargeable to the ratepayers. For the present, we will simply state that unless good cause is shown, we believe that $10 million is the maximum that should be allowed in future rate proceedings for total discounts. We have a strong and justifiable interest in regulating usage in order to prevent peak-load problems, which in turn lead to the necessity to install extra plant.

We note that Pacific's tariff Schedule 42-T, which lists employee discounts, contains only part of the information furnished in Application No. 55214. We will order Pacific to file a revised schedule declaratory of the practices described in Exhibit 112 in Application No. 55214 which will include any significant changes since that exhibit was prepared.

IV. RATE BASE (INCLUDING WORKING CASH ALLOWANCE)

Adopted Rate Base Estimate (Table)

The company's total rate base estimate exceeds the staff's by slightly more than $52 million. There is no difference between the staff's and Pacific's beginning-of-test-year plant figure ($8,685,354,000) and the difference between the company's and staff's proposed adopted rate base is traceable to differences in estimates described below, chiefly allowance for funds during construction, depreciation expense and reserve, and weighted plant additions. The following table summarizes the adopted rate base.

PACIFIC TELEPHONE AND TELEGRAPH COMPANY
CALCULATION OF ADOPTED RATE BASE

Item	Dollars of Thousands
Plant as of 6-30-75	$8,685,354
Weighted Average Net Additions	303,189
Increase for Station Connections	1,721
Less:	
SMRT Adjustment	3,161
AFDC Adjustment for 8.5%	1,137
Allocation of Plant to Nevada	947
West Valley Coaxial	2,636
Station Apparatus Verification	9,134
WEIGHTED AVERAGE PLANT	8,973,249
Property Held for Future Use	7,735
Material and Supplies	38,162
Working Cash Allowance	94,790
Less Depreciation Reserve	1,882,044
Less Deferred Tax Reserve	450,371
SUBTOTAL	6,781,521
Affiliated Interest Adjustment*	(49,006)
CCFT Pro Forma	(1,968)
Decisions and Directory Assistance recording effect*	35,958
ADOPTED RATE BASE	6,766,505

*Discussed in other sections of this decision.

(Red Figure)

Interest and Taxes on Land

Staff witness Lee recommended that Pacific be ordered to stop capitalizing interest and taxes on land on which plant is being constructed. This land, according to the witness, should remain in Account 100.3 "for future use" until the construction is completed and then it should be transferred directly into Account 100.1 "telephone plant in service" (Exhibit 149 pp. 2-1, 2-2). This would result in neither interest nor property taxes being capitalized, but the investor would be compensated for the use of his capital in the land since Account 100.3 is part of Pacific's

rate base. Pacific does not object to the prospective adoption of the staff witness's recommendation provided that the land presently in Account 100.2 (a value of $3.1 million) is transferred to Account 100.3 and thus included in Pacific's rate base for this proceeding.

The staff witness also proposed the application of this principle for the interest on taxes and land from 1966 through 1975 (Exhibit 149, p. 2-2) which would amount to a total rate base adjustment of $2.7 million. Pacific objects to this treatment. We agree with Pacific that this should not apply retroactively. As Pacific points out in its opening brief, the land was not in Pacific's rate base at the time the interest and tax were capitalized; therefore, Pacific effectively would have received no return on that investment if the capitalized interest and taxes are now deducted from rate base.

Subscription Television Plant

As of November 3, 1964, Pacific's plant in service for furnishing subscription television signals totals $2.6 million. This was the result of a contract signed by Pacific and approved by the Commission in 1964. After Pacific began making the necessary installation, the voters of California repealed an enactment of the legislature which authorized Subscription Television, Incorporated to enter into business in California. The corporation thus ceased operations.

Pacific levied a termination charge of $1.4 million against the corporation pursuant to the terms of the contract. The net loss of $1.2 million was charged to Pacific's Account 171 at the end of 1964.

In our 1967 Decision No. 74917 (69 CPUC 53, 60-61) we adopted a staff recommendation that this $1.2 million be deducted from the rate base and this has been done in all subsequent Pacific rate proceedings.

In this present proceeding, Pacific's witness Bennett recommends that this $1.2 million deduction from rate base be discontinued, essentially because the gross revenue effect of past Commission disallowances for subscription television, through the end of the test period, has now exceeded the original loss.

Staff witness Lee, after considering Mr. Bennett's testimony, changed his earlier recommendation and advised the Commission to continue this deduction for another three years (see Exhibits 191 and 193).

We are convinced from the calculation of witness Lee in Exhibit 193 that this deduction should continue, although Mr. Lee may have slightly overstated the amount of the net gain to Pacific by using a year-end rate base. (The exact amount of this overstatement was not made clear in the record.) Because of the use of the year-end rate base, which may overstate the amount of the net gain, we believe the amount of time that a deduction should remain in effect is an approximate two-year period rather than three years.

West Valley Coaxial Cable Plant

The construction of this cable began in the late 1960's with an estimated completion date in the late 1970's. Certain changes were made recently due to technological advances. Staff witness Lee proposed that the balance of the West Valley Coaxial Cable construction remaining in Account 100.1, "telephone plant in service", Account 100.3 "plant held for future use" and Account 139 "other deferred charges" be transferred to Account 103 "miscellaneous physical property" a non-rate base account. The total rate base reduction under this proposal is $2.6 million.

Pacific did not contest this except for challenging the inclusion of $538,000 in Account 139. The basis for Pacific's objection was apparently that Account 139 was not a rate base account. Later, after consultation, Pacific reviewed its accounting and conceded that Account 139 is in fact a rate base account. We will therefore adopt the adjustment recommended by the staff.

Verification Transfer Problems

Pacific includes as a rate base item telephone plant which is the subject of inventory loss. Pacific's investment in Account 231 "station apparatus" is verified every two years. Commencing in 1974, with the authorization of the FCC staff, Pacific and other Bell System companies adopted the system of retiring the shortages by debiting Account 171, "depreciation reserve" and crediting Account 231 "other costs". Undepreciated amounts remaining in Account 231 from prior period verifications are charged to Account 608 "depreciation expense" over a 10-year period in equal annual amounts.

The staff recommends that the amount of the shortage be removed from rate base and placed in Account 138 "extraordinary maintenance and retirements". In Account 138 Pacific would recover its loss by amortizing the balance over an eight-year period as an expense. This would result in a rate base adjustment of $9.1 million (Exhibit 150). The staff's rationale is that Pacific should not earn a return on such plant, at the same time as it recovers its loss as an amortized expense.

The staff's proposed adjustment of $9.1 million is reasonable. The staff's recommended accounting and ratemaking treatment allows Pacific to recover its loss without permitting a double recovery by continuing to allow lost plant to earn a rate of return while it is being expensed.

Allowance for Funds During Construction

Pacific applied a 9 percent rate for allowance for funds during construction (also known as interest during construction). The staff used an 8 percent rate. The resulting difference between company and staff estimates for this item, based upon estimated results, is $2.3 million (Exhibit 37, p. 13-3).

The staff points out that Pacific made the change from 8 to 9 percent on its own, and its request to do so was later rejected by the Commission (at the Commission conference of February 3, 1976).

Pacific points out that because of increasing costs of debt, Pacific should have this 9 percent rate in order to obtain a reasonable return on its investment devoted to plant under construction. Exhibit 108 shows that the last three bond issues (all issued in 1974) have interest rates in excess of 9 percent. This exhibit also shows Pacific's total embedded cost in debt as 6.4 percent.

The staff points out (Exhibit 149, pp. 2-3) that the Commission recognizes an AFDC rate "somewhat less than the last authorized rate of return" on the theory that nonoperating plant should not earn as high a return as operating plant, so that there will not be less incentive to complete construction in the shortest time possible and transfer such properties to operating plant. Pacific states that this is not historically true, arguing that in 1968, Pacific's authorized rate of return was 6.3 percent but its authorized AFDC was 6.5 percent, and in 1970 and 1971, Pacific's authorized rate of return was 6.9 percent while its authorized AFDC was 7.5 percent.

We believe some upward adjustment in AFDC is authorized and will allow Pacific to use an 8-1/2 percent rate. It is uncertain whether interest rates will remain quite as high as they have been under current economic conditions, and considering Pacific's embedded cost of debt, we believe it inadvisable to allow a full 9 percent. We do not agree with the staff that our action at the aforementioned Commission conference is a bar to Pacific's insertion of this issue in the present rate increase case. Besides, over a year has passed since that Commission action. Raising the AFDC rate to 8-1/2 rather than 9 percent will accomplish the staff's objective of an incentive for the utility to complete plant under construction, since 8.5 percent is less than Pacific's authorized rate of return.

Canceled Projects

This involves the staff's suggestion that costs associated with canceled projects should be charged to Account 23, "miscellaneous income charges" unless Pacific demonstrates that a canceled project was viable and entered into in good faith, in which case the cost of the canceled project should be transferred to Account 138, "extraordinary maintenance and retirements" to be amortized to Account 609, "extraordinary retirements".

We do not believe that the staff witness on this subject (Lee) made clear how he would determine whether a project was "viable and entered into in good faith". Apparently, it is a hindsight test which would judge "good faith" based upon the end result rather than whether the company pursued the project in good faith from the beginning. We believe the test suggested is vague and difficult if not impossible to apply fairly.

We reject the recommendation. We also reject an apparently associated disallowance of $3.3 million which was the costs of canceled projects charged to operating expense accounts in 1975. The record does not show how staff witness Lee determined that any projects included in this proposed disallowance were not "viable or entered into in good faith" (Transcript 4986, 4988). Nor was it shown that the staff witness made any particular investigation into canceled projects in arriving at this proposed disallowance (Transcript 4986, 4989, 5298).

Depreciation Expense and Reserve

Originally there was only a 0.1 percent difference between company and staff estimates. These differences are outlined in the staff report on the results of operations, Chapter 14 (Exhibit 37). The staff methodology and results in this chapter (except as discussed below) are reasonable and are adopted.

During the course of the proceeding, the company presented extensive evidence (see in particular Exhibit 187 introduced on October 18, 1976) in favor of using new depreciation rates approved by the FCC and effective January 1, 1976.

The staff and the city of San Diego opposed their use because Exhibit 228, explaining Bennett's exhibit on this subject, was introduced on the last day of hearing. The staff further objects on the ground that this is a subsequent request for a rate increase without notice.

The "rate increase without notice" issue only presents itself if the company raises its request for total rate relief. This did not occur here.

We believe the new rates should be adopted as of January 1, 1976, their effective date (i.e., for half of the test year).

Weighted Plant Additions

The staff developed a factor of 46.83 percent to weight the gross additions to plant during the test period, by using an average of five years' recorded experience on plant additions. We have reviewed this method and are convinced it properly reflects conditions in a normal year of operation. The staff's factor is adopted.

The staff used a five-year trend to arrive at weighted plant additions (see Exhibit 37 pp. 13-1 through 13-4, and updated figures in Exhibit 214). The company apparently developed an individual estimate for the test year. Since the exact time of year when plant is placed in service is within the company's control and may vary from one year to the other, we consider the staff's five-year trending methodology more appropriate; therefore, the staff's estimate is adopted.

Plant Retirements

Again, the staff developed its figure, which exceeds Pacific's by $15.7 million, by a five-year estimate. We again believe this reflects a normal year of operation, and the staff's estimate is adopted.

Working Cash Allowance

The company estimate exceeds the staff's by $34.1 million. Most of this results from the differences in the estimates of the various expense items. Staff witness Ong took Pacific's lead-lag study and made some recalculations. First, he recalculated the San

Francisco payroll tax results because later results showed a greater number of lag days than was shown in the utility's study (146.75 days was the utility's original estimate; Mr. Ong's revised estimate is 156.91 days). This recalculation is reasonable and is adopted.

Mr. Ong also recalculated the lead-lag days for the amount of state and federal income taxes that are payable on various due dates. He stated (Exhibit 38, p. 7-HLO):

> "Both the Internal Revenue Service and the Franchise Tax Board permit utilities, upon petition to deduct the full year amount of ad valorem taxes from their quarterly tax payments. To date, Pacific has not availed itself of this deviation; but the staff is of the opinion that it should do so. This would reduce the working cash requirement by increasing the lag days in the payment of federal income taxes and reducing the lead days in the payment of California income taxes."

Pacific criticizes staff witness Ong's calculation of the federal and state income tax payments claiming that he did not investigate the impact on the Bell System consolidated tax liability of such a deviation; that he did not investigate the impact of consolidated tax liability on his recommendation that Pacific apply for the deviation; and that the Internal Revenue Service and the State Franchise Tax Board "might well refuse to grant a deviation to Pacific and/or the Bell System if it were applied for, and it is not established that Pacific, because of its participation in the Bell System consolidated tax statement, could individually even request a deviation". (Pacific's opening brief, p. 21.)

Pacific presented us with no direct evidence, such as legal opinions of the government agencies involved, or a refusal on the part of either agency to grant the deviation. We consider its criticism of Mr. Ong's recalculation to be based primarily on unsupported speculation. We will adopt witness Ong's methodology. If in the future Pacific applies for these deviations and is rejected, or if it can present us with hard evidence that the net effect of having these deviations granted to it would be more, rather than less tax liability, we will reconsider this issue.

V. TAXES AND RELATED ISSUES

Federal Income Tax Calculation

The final disposition of ratemaking for federal income taxes (accelerated depreciation and investment tax credit issues) has been determined elsewhere (Decision No. 87838 dated September 13, 1977[23/] in Application No. 53587 et al.). On November 14, 1977 Pacific filed herein a "Supplemental Memorandum Respecting the Need to Issue Rates Based Upon Normalization". We are setting rates by this decision based on normalization, although the application of the ratemaking treatment adopted in Decision No. 87838 covers the instant test period for the calculation of the prospective rate reduction. The rates authorized herein are, however, made subject to refund because should we again have to grapple with the question of the proper ratemaking treatment for deferred taxes, upon direction by a reviewing court, we could foreseeably adopt a ratemaking treatment different from that adopted in Decision No. 87838 (e.g., flow-through or the imputation of flow-through).

If on appeal it is found that our determination in Decision No. 87838 should not stand, and Pacific should continue to be afforded test year normalization, our order here would not be affected since it establishes rates on a normalization basis. If Decision No. 87838 (in its present form or as we might choose to modify it on rehearing) is upheld, appropriate rate refunds and reductions, encompassing this test year, will be made.

California Corporation Franchise Tax

The California Corporation Franchise Tax (CCFT) is a tax for the right to do business in California. It is based on the income of the preceding year, but for ratemaking purposes the Commission staff computes this tax on a current year basis consistent with other revenue and expense items.

As pointed out in the staff report, Pacific's CCFT liability is not solely dependent on its California operations. Since Pacific is part of the Bell System, the California Franchise Tax Board determines Pacific's liability with reference to a "combined report" of the Bell System (see Exhibit 37, p. 12-12 for a further discussion).

23/ The effective date of the order (10/3/77) was stayed by the timely filings of the petitions for rehearing.

The result of this determination is to make Pacific's tax liability greater or less than the statutory rate of 9 percent on its separate taxable California earnings.

Computation of the correct CCFT rate is important (1) to compute CCFT expense itself, and (2) to arrive at the correct CCFT factor which is part of the net-to-gross multiplier.[24/] The method of computation was the subject of considerable controversy between the company and the staff and the evidence and argument can be reviewed here only in bare outline form. Basically, each side contends that its CCFT rate more correctly reflects the rate of tax required under the combined report actually used for Pacific's tax returns.

Pacific developed a rate of 10.567 percent, arguing the effective rate has consistently exceeded the statutory rate, and that this rate correctly reflects the difference. Pacific's witness Bennett testified:

> "The effective rate of 10.567% should be used which results in a Net to Gross multiplier of 2.172. The effective rate has consistently exceeded the statutory rate which is allowed other California utilities in determining their Net to Gross multiplier. In my opinion it is patently wrong to suppose that new revenues will be taxed at only 1 or 2% when the statutory rate is 9% and when Pacific under the regulations calling for a combined report has for some time been liable for an effective rate of tax higher than the statutory rate. I find that the Staff's calculation denies us the opportunity to earn enough to cover taxes we will be liable for." (Exhibit 11, p. 21.)

(See also Mr. Bennett's testimony in Exhibit 187 on this subject, and Pacific's opening brief, pp. 13-14.)

The staff takes the position that we should adopt 10 percent (the statutory rate plus 1 percent) which, when tested against past experience, proves to compensate Pacific adequately. Staff witness Amaroli explained:

24/ Other factors of the net-to-gross multiplier are developed separately, infra.

"The utility's CCFT tax liability is determined using a three-factor formula as discussed on page 12-3 of this report. The 9% statutory tax rate does not apply to the separate California taxable income under this method, since the three factors from other than utility operations in California and other Bell System operations outside California serve to modify the taxable income when the return is filed. Both the utility and staff have developed tax rates using three-factor data for the calendar year 1974 tax return, filed in September, 1975. For that one year, a tax rate of 9.464% would have applied. However, the staff analyzed the tax rate requirement for a seven-year period and determined that, on the average, the use of a 10% tax rate would provide for the actual state tax liability.

"Table 12-B shows, for seven income periods, that application of the staff's 10% tax rate provides for actual tax requirements, generally with dollars to spare. Use of higher rates that result from Pacific's technique would make excessive provision for state taxes.

"Pacific has used its 10.567% incremental tax rate in developing the net-to-gross multiplier used to determine its requested $119 million revenue increase. Pacific developed this percentage by assuming that all Bell System requested revenue increases were granted effective on the first day of the test year being analyzed.

"The staff has used an incremental rate for California Corporation Franchise Tax to develop its net-to-gross multiplier. In this development, the staff considers only the incremental effect of California revenue increases. The resulting tax rate is 1.24% and has been used to determine the net-to-gross multiplier in Chapter 16. This follows past staff practice which has been adopted by the Commission." (Exhibit 36, p. 11-GAA.)

An examination of Table 12-B in Exhibit 37 (referred to by the witness) indeed shows that the statutory rate plus 1 percent has properly compensated Pacific for CCFT.

As stated above, the staff uses an incremental CCFT rate for its net-to-gross multiplier calculation. This is further explained in the staff report (Exhibit 37, p. 12-4, paragraph 15).

> "For determination of the additional CCFT liability which results when increased rates are granted to the utility neither the 10.567% rate requested by the utility nor the 10% (statutory rate plus 1%) used by the staff is appropriate. Since only one of the three factors changes, namely, the revenue factor, the impact of any increase only affects that one factor not all three and then further, only this utility's California intrastate revenues are affected by rate increases granted by this Commission. The Pacific Telephone and Telegraph Company in its last study for the 1974 tax year (prepared in 1975) had revenues representing 10.718% of Bell System revenues. In consideration of the above factors, the staff has determined that the proper incremental tax rate for any increase in rates granted by this Commission is 1.24%. This is the rate used by the staff for development of its net-to-gross multiplier in Chapter 16 of this report." (Emphasis by the author.)

We agree with the staff development of CCFT both for the estimation of the tax and for the computation of the net-to-gross multiplier.

Pro Forma Flow Through of CCFT. The staff's proposed pro forma flow through of CCFT follows the practice laid down in our two most recent Pacific rate orders (see Decision No. 85287 dated December 30, 1975, mimeo. p. 56, Application No. 55214). We will follow this practice again in this proceeding. The company may present further views on the subject in its next rate proceeding after the consolidated cases concerning the treatment of federal taxes are disposed of.

Accrued Vacation Pay Adjustment. The staff made this adjustment to Pacific's tax estimates because Pacific had apparently been unaware of an Internal Revenue Code provision that allowed it to take advantage of a deduction for accrued vacation pay, starting with its 1974 tax return. (The staff also was unaware of this potential deduction.) The Utilities Division (witness Amaroli) and the Finance Division (witness Lee) presented separate views on the amount of the adjustment. The Utilities Division amount is $5.5 million and is a straight adjustment based upon the tax effect for the test year. The Finance Division proposes a $6.4 million adjustment which, in addition to the test year adjustment, has the effect of refunding $934,000 to the ratepayer for three years (the assumed length of time that the rates for this case would be in effect).

We choose Mr. Amaroli's adjustment as correctly reflecting test year principles. Pacific did not act in bad faith or mislead the Commission in failing to take this deduction. As a matter of proper test year theory, Pacific and other utilities are sometimes awarded offset relief for unforeseen new expenses, but this does not mean that Pacific or any other utility may seek offset relief every time an expense level in a particular account shifts upward. If this results in the utility making less than its assigned rate of return, that is the chance it takes. Conversely, if a utility manages to save money through productivity gains or even windfalls, this does not mean that the commission which regulates it should step in each time and order what is in effect a refund. To regard each saving which the utility achieves as something which in every case should be in effect refunded to the ratepayer would discourage utilities from searching for ways to cut costs (cf. Public Utilities Code Section 456).

In any event, the Finance Division proposal does not result in effecting a true refund but rather in adopting an artificially low level for this item, which is not representative of future years, and therefore not a proper test year estimate.

Gross Revenues and Uncollectibles

The staff used a .950 percent rate which is reasonable and is adopted.

Federal Income Tax Rate

Both the staff and Pacific used the statutory 48 percent rate. This is reasonable and is adopted, since it is consistent with normalization ratemaking treatment of this expense.

VI. OTHER ESTIMATES AND ADJUSTMENTS

Certain other issues which are discussed briefly in the various exhibits concern minor amounts, or areas in which there is no substantial disagreement between the company and the staff. For brevity we will not discuss these matters separately. We have reviewed the evidence and believe that regarding such matters, the staff report (Exhibit 37) and the associated testimony result in reasonable estimates and adjustments, and for such matters, the staff estimates are adopted.

Net-to-Gross Multiplier

The net-to-gross multiplier is a factor used to compute the gross revenue to increase the net revenues by one dollar. The multiplier consists of (1) gross operating revenue, adjusted downward by the level of uncollectibles; (2) CCFT rate; and (3) federal income tax rate. These three factors are discussed separately above, and the net-to-gross multiplier is developed based upon our conclusions on these issues. This results in a net-to-gross multiplier of 1.966.

Separated Results of Operations

For this decision we again employ the so-called "Ozark" separations factors for allocating expense and plant between interstate and intrastate operations. The continued use of the Ozark formula is in issue in supplementary hearings in this proceeding (cf. the brief discussion of this problem in Pacific Tel. & Tel. Co. (_____ CPUC _____), Decision No. 85287, December 30, 1975, mimeo. pp. 37-29). Our rates herein will be subject to refund should we decide to modify our separations methods. The calculation of the rate increase necessary to produce an 8.85 percent rate of return on rate base is set forth below.

CALCULATION OF REVENUE INCREASE
BASED ON ADOPTED RESULTS OF OPERATION

Rate of return authorized in D.83162	8.85%
Rate of return adjustment in D.86593	0.007%
Adjusted authorized rate of return	8.843%
Rate of return at present rates	8.72%
Increase in rate of return required	0.123%
Adopted rate base	$5,304,821,000
Net revenue increase	$ 6,525,000
Net-to-gross multiplier	1.966
Gross revenue increase	$ 12,800,000
Settlement provision	($1,900,000)

(The total settlement provision includes an approximate $1,700,000 reduction for General Telephone Company, an approximate $100,000 reduction for Continental Telephone Company, and the effect on other companies combined is an approximate $100,000 reduction.)

Gross billing increase required	$ 10,900,000

( ) = negative figure

VII. RATE DESIGN

Introduction

We can shorten our discussion of rate design in view of the total relief awarded. Many interested parties appeared on this subject who were not totally opposed to an increase in various rates, but rather to the extent of Pacific's original proposal.

Many of the differences between Pacific's and the staff's proposals are traceable to the fact that the rate designs were intended to satisfy different revenue requirements. To bring the differences in opinion on rate design into focus, the ALJ ordered company witness Sullivan and staff witness Macario to furnish alternate rate design proposals at various levels.

Although the company and the staff disagree (as discussed below) regarding what level of increase should be the starting point for placing any of the increase into basic monthly business and residential service charges, there is general agreement that based on cost information, certain equipment costs should be raised. The exact amounts of the increases are in dispute.

We believe that, based on the record, and considering the amount of the total relief to be awarded, our basic approach to rate design in this particular proceeding should be to place as much of the increase as is reasonable into setting proper levels for various telephone equipment charges. Our adopted rate spread is designed to accomplish this.

Basic Residential Rates

Briefly, the company favors placing some percentage of any rate increase into basic monthly business and residential service charges on the basis that this service is currently offered at a loss.

The staff takes issue with Pacific's assumptions concerning costs of residential service, and argues that even if the Commission awards no rate relief, certain equipment costs should be redesigned (resulting in increases) and this should be offset by reducing basic residential rates five cents per month (see discussion of staff's zero-increase rate spread in the staff's opening brief, pp. 138-139).[25/]

The record clearly indicates that underpriced equipment should be the most important place to put any rate increase. However, the best evidence available does not support the staff's contentions concerning residential service.[26/]

25/ The staff's principal rate design exhibit (No. 167) is based on an assumed $22 million increase, which contains no increase for residential service. This does not mean that the staff advocates no such increase regardless of how much is awarded. The staff's alternate rate spread at the $50 million level, ordered by the ALJ, places $7.2 million into basic exchange rate increases.

26/ In view of the fact that we are awarding rate relief of $7.6 million, the discussion of a zero-increase rate spread might seem academic. However, the discussion is necessary because of outstanding issues concerning federal taxation, Bell System license contract, and interstate-intrastate separations methods, which could result in a downward rate adjustment.

The ALJ ordered the company to produce its view of costs relating to residential service. The result was Exhibit 113, printed on the following page along with the staff's version of the same cost and revenue background, Exhibit 212.

ESTIMATED AVERAGE REVENUE - BASIC RESIDENTIAL SERVICE

Company Version (Exhibit 113)

Service	A Basic Rate	B Fixed Cost	C Deficit (B - A)	D Avg Loc Usage	E Cost Local Usage (D X $.05)	F Deficit (C + E)	G Toll Usage	H Toll Cost	I Toll Net (G - H)	J Other Svc & Equip	K Other Svc & Equip Cost	L Other S&E Net (J - K)	M Total Net Deficit (F+I+L)
1MR (30 MU)	2.50	11.59	(9.09)	29	(1.45)	(10.54)	8.05	4.97	3.08	.34	.29	.05	(7.41)
1MR (60 MU)	3.75	11.59	(7.84)	45	(2.25)	(10.09)	10.13	6.28	3.85	.41	.31	.10	(6.14)
1FR	5.70	11.59	(5.89)	105	(5.25)	(11.14)	13.38	8.29	5.09	1.15	.93	.22	(5.83)

Staff Version (Exhibit 212)

Service	A Basic Rate	B Res. Cost	C Deficit (B - A)	D Avg Loc Usage	E Cost Local Usage (D X $.05)	F Deficit (C + E)	G Toll Usage	H Toll Cost	I Toll Net (G - H)	J Other Svc & Equip	K Other Svc & Equip Cost	L Other S&E Net (J - K)	M Total Net Deficit (F+I+L)
1MR (30 MU)	2.50	7.82	(5.32)	29	(1.45)	(6.77)	8.05	4.97	3.08	.34	.29	.05	(3.64)
1MR (60 MU)	3.75	7.82	(4.07)	45	(2.25)	(6.32)	10.13	6.28	3.85	.41	.31	.10	(2.37)
1FR	5.70	7.82	(2.12)	105	(5.25)	(7.37)	13.38	8.29	5.09	1.15	.93	.22	(2.06)

Each table starts with the basic monthly rate for 1MQ (30 message unit "lifeline"), 1MR (60 message unit), and 1FR (flat rate) residential service. Additions and subtractions from the basic deficit are made to allow for cost of local usage, toll usage, and other service and equipment (including optional equipment extensions, etc.) until a final deficit is calculated.

The staff criticizes the company development on the basis that (1) Pacific does not keep its books to specifically identify the plant and expense required to provide residential service (2) there was no "license contract" adjustment applied to the study, (3) expense for directory white pages was counted but revenues from yellow pages were not, (4) marketing expense for optional residential equipment was not correctly segregated, (5) Pacific used a 10.5 percent return on investment rather than the authorized 8.85 percent return (the 10.5 percent is used, correctly, for competitive terminal equipment offerings), and (6) there was no allocation of any of the plant to interstate operations.

The staff's recast is not a complete cost study; rather the staff took the information available from the company and attempted to correct above-listed problems (5) and (6). We agree that the staff's version is a more appropriate assessment of residential service, but the fact is that this still produces a net deficit. After a review of the evidence we are not certain that we have the necessary cost information to decide whether basic residential service is subsidized. The staff's recast was rebuttal and not intended to be dispositive of the issue.

However, it seems clear that at the "zero" level of rate relief no downward adjustment of basic monthly rates is appropriate. This is not to say that at some level of rate reduction, an adjustment would not be appropriate. We recognize that there are several large outstanding issues which may have a major effect on rates (taxes, license contract, and separations).

We conclude that at the adopted overall level of rate relief in this proceeding, basic residential rates should remain unchanged. This includes present extended area residential service under the "Salinas area formula" used in several areas.

Basic Business Service

While the increased revenue estimates of basic business service due to implementation of business SMRT are reflected in our last two rate orders for this applicant, the SMRT equipment was not immediately installed because of technical problems. Therefore, the actual billing increase to the business subscriber was not felt until 1976.

Because of this impact and the size of the overall rate relief awarded, we find it appropriate to reduce basic metropolitan service 50 cents per month, with similar minor reductions in other business line charges (see rate appendix).

At this time there is no SMRT for business service in rural areas. Therefore no corresponding reduction is made for rural business service.

Adjustment to Short-Distance Toll Rates

In the most recent preceding rate order for Pacific (Decision No. 85287, dated December 30, 1975, Application No. 55214), we increased toll rates by an estimated $37.3 million. This increase incorporated a major restructuring of toll rates by changing message timing from a three-minute initial period with one-minute overtime periods to uniform one-minute initial and overtime units. The one-minute timing system resulted in unanticipated significant increases for average duration, short-haul (generally under 50 miles) messages.

The staff proposes toll rate reductions of $8.0 million (Exhibit 167, p. 3-1), concentrating the reductions in the area of short-haul traffic. The proposal has the additional (and, in our opinion, desirable) effect of reducing the existing disparities between message toll and 3-MMU (multi-message unit) and 4-MMU rates (the 5-MMU tariffs are converted to toll by the order herein; see discussion below). We will adopt the staff's recommendation.

Centrex Rates

The briefs of the parties discuss several problems regarding Centrex costs, and methods of setting up proper Centrex tariffs. These matters should be deferred for consideration in the investigation of Centrex costs and rates (Case No. 10191).

Some protestants argued that since rate-setting methodology has not been finally determined, we should allow no increase in Centrex rates whatsoever until the end of our investigation. While incompleteness of evidence regarding rate-setting methodology intended for use at the conclusion of our Centrex investigation is not of itself a bar to an interim increase, we find that no interim increase should be ordered for Centrex basic rates or ancillary equipment as part of a general rate increase totaling only $7.6 million. Evidence concerning Centrex costs themselves is still being received elsewhere, and the weight to be accorded certain cost information already received in Case No. 10191 is now uncertain.[26a/]

Private Line Services and Channels

The staff generally agreed with Pacific's cost-based private line increases. The exception was Pacific's proposal for a 100 percent increase in local loop monthly rates.

Western Burglar and Fire Alarm Association vigorously opposes such a large increase, for the reasons stated in its brief. Such a large raise all at once would severely impact the cost of service in this field.

26a/ A motion by California Interconnect Association for an interim increase in Centrex rates was made in C.10191 and denied by the ALJ in a ruling filed October 7, 1977. This ruling correctly stated that any interim increase was more correctly the subject of A.55492 and C.10001 (this proceeding); however, the total size of relief awarded here makes an interim Centrex increase inappropriate for the reasons stated above.

Because of the relatively small size of the overall rate increase, this point is moot. No increase is necessary at this time; however, we will reevaluate these rates at the time of the next general rate increase for Pacific. We advise the alarm industry to convert to alarms which make use of voice grade circuits as rapidly as possible, since cost information indicates that in the event of a large general rate increase, a substantial raise in subvoice grade local loops would be appropriate.

Key Telephone Service

Based upon its initial rate increase request of over $100 million, Pacific sought a key telephone service (KTS) raise in rates of $28.3 million. The staff's original $22 million rate spread included an $11.4 million increase. This staff proposal represented a 7.6 percent increase, but the cities of Los Angeles and San Diego are critical of it on the ground that the total $11.4 million proposal amounts to half of the staff's rate spread (the staff argued on brief that KTS rates should be raised $11.4 million regardless of the size of the total rate increase).

The available evidence[27/] indicates that KTS rates do not pay the cost of the service and that a reasonable rate increase is warranted. The issue of whether it should be as substantial as proposed by the company or the staff is rendered moot by the overall size of the rate increase. We will authorize a KTS rate increase of $5 million, or 3.3 percent, which we believe to be consistent with the overall rate increase in this matter.

27/ The cities assert on brief that a full cost study was never presented. The results of cost studies were introduced, and a review of the record shows that apparently the cities never asked for the detail of it. The record does not show that the cities were deprived of any opportunity to obtain the work papers or other data on the results of the studies.

Mobile Telephone Rates

Allied Telephone Companies Association points out that the record indicates that by Pacific's own estimate mobile rates are not compensatory. Exhibit 172 shows 1976 estimated revenues as $1.5 million, while anticipated costs are $2.8 million.

Because of the total size of this rate increase, a major increase in mobile rates is unnecessary. Our order provides for increasing mobile telephone service rates in the amount of $0.4 million to be consistent with other rate changes. Pacific has proposed that the monthly rate for mobile service be reduced from $18 to $15 for both 150 megahertz (mhz) and 450 mhz service. We take notice of existing usage of these two frequency bands. The 150 band is overloaded; the 450 band is sparsely used. Accordingly, it appears appropriate to provide a basic rate differential to encourage greater usage of the 450 mhz band. In view of the channel congestion resulting from excessive holding times, we will also restructure the air-time usage charges to encourage short messages and shifts to off-peak usage. (The specific rates appear in Appendix B.)

Exhibit 172 also shows that the proposed IMTS (improved mobile telephone service) conversion would make mobile telephone service more compensatory. In addition, IMTS would provide substantially higher quality service and better utilize the radio frequency channels. In view of the improvements in earnings and service that result from IMTS, the order herein requires applicant to implement its IMTS plan within 24 months. We note Company witness Sullivan's testimony to the effect that Pacific was prepared to ask the Commission for a shift to IMTS in 1978 because of its greater dependability and lower operating cost (transcript pp. 5563-5565).

Because IMTS will require a major change of mobile station equipment, customers owning their own mobile stations should be given advance notice of the requirement for replacement or conversion of their equipment to the IMTS type automatic dial operation. Our order provides a three-year conversion period to allow customers to amortize their existing investment. Pacific will be ordered to give prompt notice of this conversion.

Telephone Answering Service

The staff proposed a rate increase for telephone answering service (TAS) tariffs to yield an increase of $1.6 million, with which the company concurs. The suggested increase amounts to an increase for each TAS customer line of approximately 95 cents per month. Based upon cost information available, full cost recovery would actually call for a 140.7 percent increase, while the staff's proposal results in an increase of 66.2 percent. The reason for limiting the increase is to avoid the harsh impact to the TAS industry in terms of customer demand.

Telephone Answering Services of California, Inc. (TASC) opposes such an increase because of inadequate service, and because of claimed impact on the demand for the service.

TASC introduced seventeen public witnesses who are owners or operators of TAS businesses. In summary, their testimony indicates (1) equipment is obsolete, (2) maintenance and repair is slow, (3) repair personnel are inadequately trained to repair the equipment, (4) there is an unreasonable backlog in installation requests, and (5) the company is indifferent to TAS problems. (See opening brief of TASC for a more complete review of service problems.) Exhibit 246, introduced by a TAS operator, shows a recap of repair calls for six TAS positions over a six-month period that indicates a need for excessive repair calls.

TASC also presented a rate witness, Mr. Stanley O. Sackin, who recommended a 20 percent increase (30 cents per month per customer line): Leo F. Goeller, Jr., a communications consultant, who testified to the outdated state of the equipment, and Burton H. Marcus, a marketing analyst, who testified to the effect of the proposed increase.

We agree that TAS is an essential public service. For example, it performs certain emergency functions not appropriately handled through police and fire channels. Rates should be held down as much as is reasonable to make the service available to as many persons and organizations as possible. We disagree, however, with TASC's analogy to "lifeline" residential rates. TASC is still a business, and we should not regard TAS rates as candidates for permanent substantial subsidy.

In view of the small overall rate increase, because of unsatisfactory service, and in order to minimize the immediate impact upon TAS customers, we will authorize rates which will result in a $500,000 increase (19 percent) and bring TAS rates up to 50 percent of cost. However, we caution TAS operators and TASC that we would be unable to accede to such a small increase, even considering service difficulties, if the total rate relief were greater. The available cost information shows that the staff proposal, if adopted, would have resulted in new rates which would cover 66.2 percent of costs, versus present rates which cover only 41.5 percent. Even with less than satisfactory service, we can go only so far in holding rate levels down. It should also be noted that the financial problems of the TAS industry are not due solely, or even primarily, to telephone rates. TAS's have experienced recent rent hikes and wage boosts. We will direct Pacific to improve service.

Since we regard TAS as an essential service, we consider updating of equipment to be a priority project. The staff report on rates and charges (Exhibit 167) makes the following comments:

> "37. It is also recommended that Pacific be required to improve the equipment offered the T.A.S. industry. The operational features and hardware of present T.A.S. equipment lag far behind the state-of-the-art of modern PBX, central office and operator equipment.
>
> "38. Present T.A.S. positions are cord, jack and plug switchboards utilizing toggle or rotary switches and electromechanical relays. Each position operates as an independent message center requiring manual operation of cords, line lamp scanning and ring signal counting on the part of the attendants. Flexibility is limited to the number of lines an attendant can reach at an adjacent position.

"39. Concentrator-identifiers provide T.A.S. lines between adjacent or non-continguous exchanges. This is electromechanical equipment which serves up to 100 subscriber lines over four to six trunks between a central office and the T.A.S. bureau.

"40. All of the above [i.e., existing] equipment requires a great deal of maintenance to clean and adjust contacts and replace worn jacks, cords and switches. In addition each time a new or additional subscriber line is connected from a local central office to the T.A.S. bureau an installer is required at the central office and at the T.A.S. bureau.

"41. The staff recommends that Pacific be directed to investigate in cooperation with the T.A.S. industry the feasibility of developing or obtaining from private vendors and offering to the T.A.S. industry state-of-the-art equipment incorporating the following suggested features:

A. Automatic call distribution;

B. Typed messages with semi-automatic storage;

C. Semi-automatic message retrieval display;

D. Automatic accounting with message timing on outward calls;

E. Automatic client announcement display after predetermined number of rings;

F. Multiplexing of client lines between central office and T.A.S. bureau to reduce plant requirements and to facilitate client line installation and removal.

"42. A progress report on this undertaking should be filed within six months of the Commission's order."

We endorse the staff suggestions in paragraphs 41 and 42. Pacific should ascertain the availability of modern equipment from both Western Electric and independent manufacturers.

Additionally, we find repair service inadequate. Based upon public witness testimony, much of the problem seems to be that equipment in other areas is more modern in its engineering features and repairmen, including supervisors, are not adequately trained in maintaining this older equipment. We will require that Pacific upgrade its training in repair and maintenance of TAS equipment. Such upgrading shall include the designation of a TAS repair coordinator for each repair station. This person shall be highly trained in TAS maintenance and repair so that he may supervise others in such matters as well as perform the work himself, and so that the more difficult problems may be solved promptly. If not enough such people are available, Pacific shall institute the necessary training program to make them available within six months.

Private Branch Exchange Service (PBX)

Pacific recommends restructuring the NA4-09 PBX system to charge rates for components. The staff concurs with this recommendation (see Exhibit 167 p. 2-5).

Telecor, Inc., an interested party, presented a rate witness who pointed out that NA4-09's are no longer current model PBX's, that there are less than 400 of them, and that "hardware" pricing at this time would force some users to accelerate the displacement of their NA4-09's when they would otherwise be usable for a number of years.

The witness showed that the proposed hardware pricing would cause smaller users to pay more while, depending on circumstances, some large users might actually pay less.

We believe the evidence preponderates that hardware pricing for the NA4-09 PBX is inappropriate. In order that this equipment will bear a fair share of the increase, we will authorize an across-the-board percentage increase of approximately seven percent.

5-MMU Tariffs

In Exhibit 222 and associated testimony, the staff proposes elimination of 5-MMU tariffs and the conversion of those on such tariffs to toll rates.

The background of MMU tariffs and the reasons for their gradual elimination were discussed in our last general rate order, Decision No. 85287 (dated December 30, 1975) in Application No. 55214. The reasons expressed therein apply at this time to the elimination of 5-MMU tariffs, which we will order.

Customer-Provided Equipment Visit Charges

The staff brief recommends that we order Pacific to respond to a customer-trouble report without requiring the customer to verify the trouble source. Pacific represents that this is not their practice and that no such order is necessary. The staff represented in Exhibit 167 that it has received customer complaints that this was, in fact, Pacific's practice. We accept Pacific's representation, but Pacific should circulate a reminder on the proper practice to repair personnel to insure that company policy is carried out.

Certain increases in visit charges for customer provided equipment were supported by cost studies. These non-recurring charges are increased from $10 to $25 or $30. We reject the Scott-Buttner, Inc. recommendation that Pacific be liable for a visit charge if the customer incurs a service call from a private vendor and the trouble is in Pacific's equipment. We agree with Pacific that such a charge would burden other customers with the costs produced by customers using their own equipment.

Other Rate Design Items

The disputes in items not covered in the above discussion are primarily in rate levels, and these differences result, in turn, from different assumptions in how much total rate relief should be awarded. Rates in areas not discussed, such as miscellaneous equipment charges and service connection charges, are set at levels to be consistent with other rates, and to eliminate or reduce losses, in areas in which they occur.

The staff brief raises certain issues relative to rate spread adjustments for directory assistance use. These are properly presented in Case No. 10085 rather than here.

Rate Spread Summary

The table which follows summarizes our adopted rate spread for this proceeding. We are aware that this rate spread does not produce rates that result in returning full cost for certain equipment charges. This is not possible without major reductions in other rates; and we deem that inadvisable, since to adopt a rate spread on that basis would force abrupt and substantial immediate increases upon certain equipment customers. It is more appropriate to increase these equipment rates in stages to lessen impact on those affected ratepayers. We will scrutinize rates for the equipment that we do not price at full cost in Pacific's next rate increase application. Pacific, the staff, and others interested should present cost studies and rate recommendations on these items at that time.

Non-utility companies that compete with Pacific in the terminal equipment market may assert that not pricing all equipment to a level that recovers full cost is in conflict with the Supreme Court's mandate in Northern California Power Agency v Public Utilities Commission, (1971) 5 Cal 3d 370, that we consider anti-competitive ramifications of our decisions. However, that Supreme Court decision points out that we can authorize activity in the course of our regulation that otherwise is not in conformance with antitrust principles, so long as we find an overriding public interest to be served. We find the overriding public interest served by not increasing all terminal equipment charges to a full cost basis in this proceeding is that we avoid needless economic hardship and disruption on the business ratepayers potentially affected. We will in subsequent proceedings undertake to insure this equipment is priced more commensurately with Pacific's costs.

PACIFIC TELEPHONE AND TELEGRAPH COMPANY
Adopted Rate Spread - Application No. 55492

Service	Revenue (Millions)	Remarks
Basic exchange service	$(5.8)	Metro business services reduced; 1MB rate reduced 50 cents per month. Other comparable reductions; See Appendix B.
Key telephone service	5.0	Company and staff proposed restructure adopted. (Exhibits 31 and 167.)
Service connection, move & change		
multi-element	(0.1)	Staff proposed service connection change.
KTS move and change	1.0	Company and staff proposed restructure adopted. (Exhibits 31 and 167.)
NA4-09 PBX	0.3	7 percent across-the-board increase.
Telephone answering service	0.5	Increased to 50 percent of cost. (Exhibits 31 and 167.)
Mobile radio service	0.4	Company Exhibit 172.
Visit charge for customer-provided equipment	0.1	Company and staff proposed. (Exhibits 31 and 167.)
Miscellaneous equipment	4.2	Staff proposed. (Exhibit 167.)
Convert SMMU to toll	13.8	Staff proposed. (Exhibit 167.)
Offset: SG-1; Data Speed 40	1.4	Staff Exhibit 222.
Message toll service	(8.0)	Short-haul toll reduced; staff proposed; See Exhibit 167.
Total	$12.8	

(Negative Figure)

NOTE: Exhibit numbers are for reference only and do not necessarily indicate adopted rates. See Appendix B to this decision for adopted rates.

VIII. SERVICE ISSUES

There were two principal issues regarding service which caused the great bulk of the public testimony during the course of this proceeding.

The first issue was whether there should be a charge for the use of directory assistance over a certain number of free calls per month. This issue was transferred from this proceeding to Case No. 10085 in our Order Instituting Investigation issued on April 20, 1976. Subsequently, in that proceeding (Decision No. 86082, dated July 7, 1976) we terminated any investigation into directory assistance charges and limited Case No. 10085 to consideration of "systematic abuse of free service by customers using directory assistance for purposes unrelated to the legitimate uses described herein". No further discussion of this issue is necessary here.

The second issue which occupied much of our time earlier in the case was the problem of held orders. This is elaborately discussed in our third interim opinion and order (Decision No. 86593, dated November 2, 1976) and no further review of this issue is necessary here, except to note that Pacific is still under our order from that decision which reduced rate of return by 0.007 percent, until a showing is made that held orders are within normal limits (Pacific is challenging this order). No such showing has yet been made. Our estimates indicate that for the test year in this proceeding, if we continue the small reductions in certain installation charges ordered in Decision No. 86593, this will result in approximately an 0.007 percent rate of return reduction, or very slightly less. We will order such tariff reductions to remain in force.

Use of Directory Assistance Recording

Early in 1976 Pacific began to place into service a recording which is played before the "411" caller is connected to the automatic call director (ACD) which, in turn, connects the caller to the first available directory assistance operator. The recorded message states:

> "If you've checked your directory and are unable to find the number you wish, please stay on the line and a directory assistance operator will answer. Thank you."

This recording is now operative throughout the service area. TURN continues to object to its use. The technical details of the operation of this recording are discussed in our interim order in this proceeding, Decision No. 85487, dated February 18, 1976. The use of the recording causes a minimum delay of 14 seconds, and an average delay of 16 seconds, in addition to any other delay normally encountered while waiting for the directory assistance operator to answer.

We granted Pacific a deviation from General Order No. 133 to allow it to maintain the directory assistance recording where it had already been instituted, and to allow it to begin its use elsewhere upon at least thirty days' written notice to this Commission, pending our further order.

While we have agreed with the consumer parties that we should not approve any plan to charge for directory assistance calls over a certain number per month, growth in the volume of directory assistance calls for the last several years means that we cannot ignore the problem. Directory assistance is a service furnished for the ratepayers. It would be unfair to make the stockholders pay for the expenses associated with it. This being the case, if volume continues to grow and if we are not going to charge for directory assistance, the result will ultimately be to drive basic

residential and business rates up. This would be undesirable. The average delay of approximately 16 seconds to play the recording is a minor inconvenience, but results in a saving, for this test year of approximately $7 million after taxes.[28/]

Emergency situations are not affected by the use of this recording since in an emergency the caller may receive assistance by dialing "operator". Pacific's telephone books carry an instruction on the inside front cover to dial "operator" in an emergency.

We believe that the use of this recording is a step in holding basic monthly rates down, and we will allow the deviation from General Order No. 133, granted in Decision No. 85487, to stand.

Over-the-Counter Payment of Telephone Bills

Two consumer organizations presented evidence concerning the use of banks, savings and loan companies, and various retail establishments as payment agencies for phone bills. The Sunset Parkside Education and Action Committee (SPEAK) presented evidence in our most recent prior Pacific rate increase application (Application No. 55214) and as a result of that evidence we ordered Pacific to make a study of the problem. Communities of the Outer Mission Organization (COMO) also presented evidence concerning payment agencies in the Portola district of San Francisco.

At the time of Application No. 55214, Pacific's policy was apparently not to establish any new public payment agencies. After conferences with the consumer groups, Pacific made a survey of the problem and established guidelines for maintaining public payment agencies in areas where there may be a high percentage of senior citizens and others who need this type of service.

28/ See Exhibit 257, Part V. The before-tax effect, by either the company's or the staff's estimates, is $12.7 million. This saving causes a tax effect which makes the net saving, after taxes, just over $7 million.

We agree with the consumer parties that Pacific should not be the sole and final arbiter of where and when public payment agencies are to be established. On the other hand, it may be self-defeating to order Pacific to establish a public payment agency at a particular location. This Commission has no jurisdiction whatsoever over banks, savings and loan companies, and retail establishments which are likely possibilities for pay agencies. Any order on our part specifically directing Pacific to establish a pay agency at a given location would be unenforceable without the voluntary cooperation of persons not subject to our jurisdiction, and might only make such persons or organizations suspicious of bureaucratic encroachment.

Therefore, at this time, we will simply order Pacific to continue with the program outlined in its Exhibit 47 and associated testimony. We believe that Pacific's standards for determining the location of pay agencies, as outlined in the exhibits and the testimony, are reasonable, although Pacific should also include as a factor the amount of community support for a pay agency. In other words, if a particular neighborhood falls just barely short of the statistical criteria that Pacific has established[29/] then Pacific might consider establishing the agency notwithstanding the fact that full statistical compliance is lacking. The Portola District in San Francisco, is, we believe, one such area. Pacific should attempt to establish an office in this area. Lastly, regarding Pacific's criteria for the average family income of $8,000 or less, we expect that this will be revised from time to time to take into account inflationary considerations.

29/ Median age of the population - 45 years of age or above, concentration of elderly in the area (65 years of age or above) which is twice the state average, and an average family income of $8,000 or less, and lastly, a merchant in the area willing to operate a payment station for a reasonable cost.

Telephone Service for the Deaf

Two owners of companies providing telephone service for the deaf, as well as some of their customers, testified to the effects of SMRT on their particular telephone usage.

Until recently there was no practical way for a deaf person to use a telephone. Now, however, the Bell System provides reconditioned teletypes at as low cost as possible for use with a telephone. These teletypes are connected to an acoustic coupler. With this equipment, a deaf person can dial another deaf person with similar equipment. Additionally, there is an electronic machine resembling a court reporter's transcribing machine, but smaller and lighter, which may be carried in a case and used by a deaf person at any telephone.

The additional problem is presented when a deaf person wishes to call a person who is not deaf, and therefore who will not have the special teletype equipment to receive his message. Two companies in California, one in San Francisco and one in Los Angeles, provide a service which at least is a partial answer to this problem. The deaf person subscribes to this service and is billed on the basis of his usage. He calls and transmits his message on teletype to the service. The service, in turn, uses a regular voice line to call the other party and read the message. Then, when the hearing person responds verbally, the answer is taken down and transmitted to the deaf person on teletype.

This, of course, takes longer than an ordinary voice-to-voice call between two persons who can hear. Since the deaf service is classified as a business, it is subject to the SMRT requirements for business lines. (The deaf person, at his residence, can of course have a residential line, but he still winds up paying in his monthly bill for the charges to use the business lines from the deaf service to complete his calls. Therefore, with the advent of business SMRT, the cost of using the service has increased substantially.)

The deaf services, and their customers who testified, request the Commission to make an exception for these deaf services so that they will not be on SMRT when completing a residential call for a deaf person (there is no request that if a deaf person is calling from a business line, that he be exempted from business SMRT).

The witnesses for the deaf services stated that they did not feel there would be a problem in segregating the telephone lines so that specific lines would be used for the completion of residential calls, and other lines would be used for business calls (either their own or their customers). That is, a deaf service handling calls for a deaf person with a business line would simply place the outgoing call to the nondeaf person over a business line and proper SMRT billing would be achieved.

This is an unnecessary refinement. In a busy answering-service type office, too many mistakes would be made in the use of particular outgoing lines, and complaints would result. But the main point to remember is that a deaf person with a business is already going to be calling the deaf service from a business phone, which itself will be on business SMRT. There is no reason to subject such a person to "double SMRT" (once for the outgoing call from his place of business to the deaf service, and once from the deaf service to the other party), especially since he already has to pay for extra equipment just to use the telephone at all.

We believe the request for relief from SMRT by those deaf services has merit. Accordingly, the rates authorized herein provide that a business furnishing service to the deaf may subscribe to untimed business message lines equal to the number of teletypes used by the business to send messages to deaf persons.

We recognize that this does not solve all telephone problems for the deaf, and that this Commission, the State Department of Rehabilitation, and various telephone companies are still exploring this entire area. Nevertheless, this is a significant step in the right direction. Moreover, there are not enough deaf persons who need this service to cause any significant adverse revenue impact as the result of eliminating SMRT under the above conditions.

We will order Pacific to file, within thirty days from the effective date hereof, a tariff which will exempt from SMRT the telephone lines of a deaf service which are used to complete calls for deaf subscribers. The tariff should define "deaf service" based on this record and require that the lines of such services used for other purposes be segregated.

Extended Area Service - Sonoma County

At the hearing in Santa Rosa, several public witnesses from Petaluma and certain other locations in Sonoma County pointed out that their telephone bills were high because there is no way they can have a telephone rate which will include Santa Rosa, the county seat. They suggest that the situation could be rectified by establishing extended service. Most of these witnesses stated that they wished a flat-extended area service charge which would apply to all telephones.

At least parts of Sonoma County are in a state of flux from rural to suburban. While it may be wise to study the situation at this time, we believe any study should be to establish whether the demand exists for Optional Calling Measured Service (OCMS), which is an optional rather than compulsory extended service.

The difficulty with a compulsory system is that persons who make minimum use of their phones, such as low income families or senior citizens on fixed incomes, are forced to pay more for their monthly service. OCMS, on the other hand, offers people with differing needs a choice. We think it is better to offer various options, especially in a county like Sonoma which has both rural and suburban areas, and even some small areas which may be regarded as urban.

We do not have the technical information necessary for us to make a decision on whether this is the time to install an OCMS system (compare the evidence and discussion in Decision No. 81767, dated August 21, 1973, Application No. 53076, et al. concerning extended service in various areas in Fresno County). We will order that Pacific submit a study on OCMS for Sonoma County within six months of the effective date of this order. The study should include the necessary information on demand for this type of service over various routes from and to various locations.

Service Outages in Rural Areas

Customers living in rural areas testified to service interruptions generally associated with stormy or wet conditions. The two most serious problems brought to our attention were in Bodega Bay and the Calabasas area. The particular problems which were brought before us have received attention, and we need not make further orders regarding them at this time.

However, this brings up the problem of whether any further steps should be taken generally by Pacific in weatherproofing its system. The ALJ ordered the company to present its wet-weather program. In response to his request, company witness Roche outlined the company's progressive maintenance and cable replacement program in Exhibit 134. He testified that most of the wet-weather problems

are caused by moisture entering cables, and that Pacific is now using newer types of cables which have polyethylene insulated conductors more resistant to moisture than the older installation. The company is also using air pressure within most pulp and paper insulated cables to keep moisture from entering. In buried cable, the company is now using cable filled with petroleum jelly.

The company is also adopting new connection change methods to reduce splice entries into cables, and computerized scanning of pressured cable which scans certain monitoring points each 24 hours (or in certain cases on a more frequent schedule) to spot the trouble areas.

The witness pointed out that this would not eliminate all difficulties since some problems continue to be undetectable until a first heavy rain, and also cables are sometimes damaged by bullets or small animals.

We believe the company is proceeding correctly to upgrade its rural cable. The one thing that may possibly be lacking is the systematic removal of the older cable. The company witness testified that "in some areas" the company is progressively replacing old cable which is causing problems. The witness was not aware of any company-wide summary by wire centers or any similar breakdown which would identify geographically the worst trouble spots.

We believe that Pacific should submit, in its next rate increase application, a more comprehensive survey of this problem. Such survey should specifically include whether a company-wide progressive maintenance program is in progress that includes the removal of identifiable old cable which is likely to give difficulty, and whether the company has identified particular areas which need priority treatment. If a company-wide progressive maintenance project to eliminate the troublesome cables and older installations would cause an increase in estimated expenses or plant installation, this should be detailed.

Abandoned Telephone Installations

Mr. Ted Mimura testified at our public hearing in Modesto that because of Pacific's extension into the former territory of the Farmers Exchange No. 1 Telephone Company many old unsightly poles and wire, of no further use, have been left in the Sultana area. Mr. Mimura introduced pictures showing typical examples (Exhibit 5).

The Farmers Exchange No. 1 Telephone Company was constructed many years ago as a mutual company when the area was too far from the nearest public utility telephone company to obtain service. There are other such farmer telephone companies. Pacific estimates that in northern California there are still in excess of 400 farmer lines, comprising about 2,400 route miles. A broad engineering survey by the company convinces Pacific that it would cost about $12,000 to $15,000 per route mile for removal and disposal of this type of plant. This would mean a total of $3.5 million. Pacific's position is that if any of these facilities are usable, it would negotiate a sale as it expands its regular telephone service into these areas. However, apparently in many instances the plant is so old, or even inoperative, that it is worthless.

We do not believe that the job of removal of obsolete or unusable farmer exchange telephone lines should be paid for by Pacific's ratepayers. It is even questionable whether we have the jurisdiction to order Pacific to expend funds in this manner. We recognize the problem of unsightliness as described by witness Mimura, but we are of the opinion that Mr. Mimura and others similarly situated will have to look to other sources of funds to remedy the problem.

Other Individual Service Problems

Other individual service problems were presented during the extensive hearings in this proceeding. We required Pacific to furnish us with an exhibit detailing Pacific's responses to the various problems. These are contained in Exhibits 15 and 137. The company's review of the various problems in that exhibit appears to be satisfactory.

Two of the most serious problems in these exhibits are (1) service outages and held orders in the San Luis Obispo County area, and (2) general service problems at Camp Roberts, a U.S. Army installation in San Luis Obispo County. Pacific will be ordered to file a supplementary report on these matters six months after the effective date of this order.

C. Wayne Coombs, Jr., of San Jose, who has organized a citizens band radio club designed to help motorists in emergency situations requested to be supplied with all of the Pacific telephone books. While we realize he can obtain most of such books indirectly from his orgmization's members, we consider the request as unreasonable since, if granted, it will lead to more such demands and the process will become burdensome. We believe that such requests would be obviated by Pacific giving more priority to public library distribution.

Service Recommendations by the Staff

The staff has made several service recommendations beginning at Section 2.12 of Exhibit 167. These recommendations are adopted subject to the following exceptions and comments.

Special bills. Part of this staff recommendation is that persons who travel should have available a procedure whereby they can make advance payments "at any time" to the company to avoid disconnects. We assume the staff does not mean that anyone could simply send in money at any time. This could produce confusion. We interpret the staff suggestion as meaning a party with this particular problem should have a system available whereby he can work out a special arrangement with his service representative.

Automatic system for coin phones. The staff's suggestion in this section (that Pacific study the feasibility of eliminating operator handling on some toll calls from coin phones) is commendable, but a six-month time to report on this seems too brief,

considering the extent of the engineering involved. We will allow one year for the study to be submitted. We also believe that this should be a joint study which will include General Telephone Company, Continental Telephone Company, and any of the smaller companies who wish to participate.

Optional checkless payment of bills. This study should also have a one-year time limit.

Phone store. This concept has already been implemented by Pacific.

Study of conversion of flat rate to measured rate service. In Decision No. 87584 dated July 12, 1977 we have already ordered Pacific to study and report on this subject.

Sales Techniques

Testimony of a service representative indicated that at least some service representatives, when dealing with a customer on an initial service order or an order modifying service, furnish a total cost but do not in all cases (unless requested) give the customer a breakdown of the cost of optional equipment. For example, a service representative might suggest touch-tone (push-button rather than dial) telephones without indicating that there is a separate extra charge.

TURN believes this practice is undesirable. Pacific argues that enumeration of tariff items to all customers would generate additional contact time and therefore additional expense.

It would certainly complicate matters if for a business customer with many telephones and pieces of equipment, the service representative had to enumerate the cost of each item. We believe we can rely on the common sense of the business customer to protect

his own interests in this regard (in any event, there is no testimony or evidence indicating business customer problems on this subject).

The residential customer is another matter. Not all such persons may be aware that, for example, there is an extra monthly charge for touch-tone. An especially undesirable situation can result if a service representative volunteers, "Do you wish touch-tone service?" since some subscribers may assume, unless told, that it is a no-cost option.

There is nothing wrong, as such, with Pacific trying to "sell" options to residential subscribers, but we believe that an item breakdown should be given to the subscriber at the time the installation order is taken. We will order that such a procedure be followed.

Extension of Measured Rate Residential Service

TURN argues that the evidence shows electronic equipment is available in many central offices which could be used for measured rate residential service (30MU lifeline or 60MU service), but that the company has no plans to do so. We are urged to order the company to institute measured residential service in such areas.

Pacific states that TURN's assumptions are incorrect. ESS (electronic switching) cannot, according to Pacific, automatically take care of measured service; additional machine capacity, which is not uniformly available, must be installed.

We do not have a definite enough record on this matter to order Pacific to proceed as suggested. TURN may renew its request in Pacific's next rate increase application. We point out that in order to decide whether to make such an order, we need not only "hardware" evidence but cost estimates regarding installation of plant. Even if we decide to make such an order we must do so at a time when it will not cause premature replacement of existing useful plant, which adds unduly to the rate base and forces rates up.

Findings

Monitoring

1. Pacific's monitoring practices do not violate federal or state statutes.

2. When supervisory or administrative monitoring is performed without giving notice to the customer by one of the methods prescribed in our previous orders, and under conditions where the customer can be heard by the monitor, providing customers with adequate information that such monitoring may take place is essential to protect the privacy rights of customers under the Fourth Amendment to the U.S. Constitution and Article I of the Constitution of the State of California.

3. Telephone company employees receive adequate information concerning monitoring through company training programs.

4. Supervisory and administrative monitoring are not per se repugnant to constitutional privacy guarantees.

5. Supervisory monitoring occurs on one percent or less of all operator-assisted, business office, and repair calls, and administrative monitoring occurs on approximately 0.031 percent of operator-assisted calls.

6. A customer-to-employee call is not of the same personal nature as a customer-to-customer call; therefore, it is not necessary to apply the same strictures as exist for customer-to-customer calls to calls between customers and employees.

7. Providing customers with adequate information concerning monitoring practices during customer-to-employee calls can be achieved by inserting a reasonably conspicuous notice in each telephone directory (as more fully set out in the Order) which describes the extent and purposes of such monitoring.

8. Requiring a beep tone or other type of automatic tone warning each time a customer-to-employee call is monitored is not required to meet constitutional requirements, and would be undesirable because the value of remote supervisory monitoring would be destroyed, or at least seriously impaired, leading in turn, to a reduction in service quality.

9. In certain of Pacific's local offices, managers or supervisory personnel have adopted and enforced unauthorized de facto traffic instructions which have the effect of lowering service standards in the interest of increasing the volume of calls to be answered. The use of such de facto instructions should cease forthwith, and the company should be ordered to augment training of supervisors and appropriate managerial personnel to assure compliance with company traffic instructions and any appropriate orders or rules of this Commission. Such augmented training should include:

a. Instructions or material to insure all supervisory and appropriate managerial personnel understand and correctly interpret offical instructions relating to emergency calls;

b. Instructions or material to insure that all supervisory and appropriate managerial personnel correctly apply official instructions relating to waiting time on operator-assisted calls;

c. A specific admonition that managerial and supervisory personnel shall not attempt to improve the quantitative performance of traffic personnel by the de facto adoption and enforcement of unauthorized traffic instructions.

10. Company traffic instructions concerning waiting time on operator-assisted calls should be clarified (see discussion, mimeo. pp. 36-37).

11. It is undesirable, at this time, for us to enter orders directly regulating staffing ratios, the number of calls operators are expected to answer, the methods of supervision or monitoring, or methods of grading the performance of personnel.

12. Reactions to remote monitoring vary from operator to operator, and the evidence does not establish that, as a general rule, such monitoring interferes with the ability of operators to perform their tasks.

13. Remote monitoring is a valuable tool in correcting unacceptable operator performance and, on occasion, eliminating unfit operators. None of the methods suggested as alternatives to remote monitoring would be as effective in maintaining quality of service. Pacific must hire traffic department employees in large numbers, and even the best employee screening procedures cannot weed out all those who do not have the skills or temperament to make good operators.

14. There may be occasional instances of overly aggressive supervision, which, when it occurs, is best dealt with via collective bargaining or company - union grievance procedures.

15. There have been instances of violations by Pacific of our orders prohibiting the making of written notations of monitored conversations (see discussion, mimeo. pp. 41-43). Pacific should be ordered to adopt a checklist form for a supervisor's use during supervisory monitoring.

16. Future monitoring questions should be the subject of separate complaints or petitions to reopen Case No. 7915.

17. Any other telephone corporation respondent herein which also employs supervisory or administrative monitoring without giving notice to the customer by one of the methods prescribed in our previous orders, should provide information of this practice on the same basis as is required for Pacific.

Operating Expenses

18. The annualization of wages set forth by Pacific (Column "M" in Pacific's proposed results of operations) is not appropriate since trending of wage increases is included in other accounts.

19. Amounts included in Column L of Pacific's proposed results of operations are not properly includable in the adopted results.

20. It is unreasonable to interpret the "Western Electric Adjustment" to guarantee Western Electric a minimum assumed rate of return. The upward adjustment for Western Electric proposed by Pacific is inappropriate.

21. The staff's updated (Exhibit 257) estimate of the expense reduction attributable to the directory assistance recording is reasonable.

22. In future proceedings, the presentation of advertising issues should be simplified.

23. Based upon the fact that the Disneyland and Museum of Science and Industry exhibits are primarily institutional, and are constantly changed and thus need continual reexamination, and because of other factors mentioned in the discussion (mimeo. p. 60) we will disallow the expense.

24. The "essay ads" and Bell System Television are institutional and should not be charged to the ratepayer.

25. Although the "AT&T exhibits" are intended to stimulate equipment sales, there was no showing that the sums spent on the exhibits contributed to net revenue: therefore, such amounts should be disallowed.

26. Funds charged to advertising which are unidentifiable should be disallowed.

27. A categorical disallowance in future applications for promotional advertising is inappropriate.

28. Adoption of a trend for promotional advertising expense is not appropriate.

29. It is reasonable to allow 50 percent of the "plan ahead" campaign on the basis that one of its goals was to reduce installation expenses.

30. For this test year the cost of Design Line advertising should be disallowed.

31. Regarding the "supplemental residence market campaign", the design line portion of it should be disallowed, and the part of the campaign attributable to the "plan ahead" campaign should receive the same treatment as the "plan ahead" campaign (see Finding 29).

32. The minor media portion of the business marketing campaign is reasonably includable in operating expenses.

33. One half of Pacific's expenses for its long distance toll stimulation campaign is properly includable in operating expenses.

34. Pacific's yellow page advertising for the test year is reasonable, but Pacific should update its survey on how much benefit is attributable to this type of campaign.

35. The supplemental accounting information regarding advertising (discussion, mimeo. pp. 68-69) is reasonable and should be provided.

36. We should adopt the staff's proposed $7 million adjustment to commercial expense since Pacific's expenditure of this sum to improve business office accessibility does not cure any actual service deficiency and is therefore unreasonable.

37. The staff's basic estimate for traffic expense is reasonable, adjusted downward by $13 million for use of the directory assistance recording.

38. We should continue to adopt our traditional 6.04 percent and 7.25 percent factor adjustments to Pacific's license contract expense. Additionally, it is reasonable to adopt additional adjustments connected with certain specific areas (as more fully set out in the discussion section under this heading): Bell System "divestiture suit", AT&T Marketing Department, Bell Telephone Laboratories PBX development, Basking Ridge, New Jersey, building, and the purchase of land in New York City. It is also reasonable to adopt the effective tax rate of 5.12 percent in computing Pacific's allocated share of expenses for AT&T's General Department.

39. Pacific's estimate for executive salaries is reasonable and should be accepted for this proceeding, less $30,000 for certain salary increases to 23 high-level executives.

40. The "stockholder visit program" is not a proper expense to be borne by the ratepayer.

41. The staff's adjustment for undetailed legal expenses should be adopted. Pacific, the staff, and representatives of the appropriate law firms should confer prior to the next general rate increase application and attempt to arrive at agreement regarding what detail should be made available regarding these expenses.

42. The staff's $6,000 disallowance for legal expenses associated with legislative advocacy is appropriate.

43. The staff's estimates for general office salaries and expenses, legislative advocacy, and the staff's $270,000 disallowance for dues and donations are proper.

44. The staff's treatment of expenses associated with charitable work performed by executives on loan is proper.

45. A 50 percent disallowance of amounts spent on local community affairs activities of customer operations managers is appropriate.

46. Because of the rapid and disproportionate growth of BIS expenses, we find it reasonable to disallow $2.5 million of Pacific's total estimated BIS expenses for the test year.

47. BIS expenses have been increasing rapidly. It is not appropriate to use a trend to estimate future BIS expenditures. Pacific should submit a complete breakdown of BIS expenditures and claimed cost savings as part of its direct showing in future rate applications (see discussion, mimeo. p. 90).

48. The staff's proposed disallowances for the Bell System Savings Plan and meal and entertainment expense are inappropriate. We should disallow test period expenses of $336,000 connected with payments to employees as a result of settlement of EEOC litigation.

49. The Finance Division's recommendation regarding changes to certain clearing accounts (Exhibit 174) should be adopted.

Revenues

50. The company test year revenue estimate is reasonable and should be adopted.

51. The aforementioned company revenue estimate should be adjusted to reflect the revenue loss from modifications to SMRT in our fifth interim order herein (Decision No. 87584 dated July 12, 1977).

52. At the present time, no downward adjustment in our adopted revenue estimate should be made to reflect our treatment of yellow page advertising revenues in Application No. 55214.

53. The staff's proposal of an upward revenue adjustment for discounts to management employees is unreasonable and should not be adopted; however, the subject of employee discounts should be investigated in Pacific's next rate proceeding, and Pacific should be ordered to file a tariff declaratory of current discount policies.

Rate Base (Including Working Cash Allowance)

54. Pacific should be ordered, prospectively, to stop capitalizing interest and taxes on land upon which plant is being constructed and to hold such land in Account 100.3 (for future use) until the construction is completed, at which time it should be transferred directly into Account 100.1 (telephone plant in service). A retroactive application of this method is unreasonable.

55. The deduction from rate base for termination of subscription television should remain in effect for two years after the expiration of the test period in this proceeding.

56. The staff's West Valley Coaxial cable plant adjustment to rate base is reasonable.

57. The staff's proposed accounting and rate base treatment of telephone plant which is the subject of inventory loss is reasonable.

58. An 8½ percent rate for AFDC is reasonable.

59. The staff's recommendations concerning new accounting treatment for canceled projects are unreasonable.

60. The company's proposed new depreciation rates (Exhibit 187) are reasonable and should be adopted as of January 1, 1976.

61. The staff's methods of computing weighted plant additions and plant retirements are reasonable.

62. The staff's recalculation of Pacific's estimate of working cash allowance is reasonable.

Taxes and Related Issues

63. Rates herein should be calculated on a full normalization basis, subject to refund, pending the disposition of ratemaking treatment for federal income taxes in another proceeding.

64. The staff development of CCFT, both for the estimation of the tax, and for the computation of the net-to-gross multiplier, is reasonable.

65. Staff witness Amaroli's treatment of the accrued vacation pay adjustment is reasonable.

66. The staff's treatment of the accrued vacation pay adjustment is reasonable.

67. The staff's .950 percent rate for uncollectibles is reasonable.

68. A 48 percent rate for Pacific's federal income tax is reasonable.

Other Estimates and Adjustments

69. A net-to-gross multiplier of 1.966 is reasonable.

70. For this decision, and pending further hearings and study, the Ozark separations formula for allocating plant between intrastate and interstate operations should continue in use.

71. Based upon the above findings and the adopted results of operations, the additional revenue necessary to produce a rate of return of 8.85 percent on rate base is as follows:

Rate of return authorized in D.83162	8.85%
Rate of return adjustment in D.86593	0.007%
Adjusted authorized rate of return	8.843%
Rate of return at present rates	8.72%
Increase in rate of return required	0.123%
Adopted rate base	$5,304,821,000
Net revenue increase	$ 6,525,000
Net-to-gross multiplier	1.966
Gross revenue increase	$ 12,800,000
Settlement provision	($1,900,000)
(The total settlement provision includes an approximate $1,700,000 reduction for General Telephone Company, an approximate $100,000 reduction for Continental Telephone Company, and the effect on other companies combined is an approximate $100,000 reduction.)	
Gross billing increase required	$ 10,900,000

( ) = negative figure

Rate Design

72. For the total rate relief found reasonable, basic residential rates should remain unchanged.

73. Basic metropolitan business rates should be reduced by 50 cents per month (with similar minor reductions in other business line charges) to partially compensate for the impact of SMRT; basic rural business rates should remain unchanged, and foreign exchange rates should not be changed.

74. The staff's proposed short distance toll rate reductions are reasonable and should be adopted.

75. Pending further study of Centrex rates in Case No. 10191, Centrex rates should remain unchanged.

76. For this level of total rate relief, the rates for voice grade local private line loops should remain unchanged.

77. A 3.3 percent raise in KTS rates is appropriate for total rate relief at this level.

78. Mobile telephone rates should be revised as discussed herein. Pacific should be ordered to convert mobile service to IMTS, as further set out in the order.

79. Much of the equipment used for TAS is obsolete.

80. Repair and maintenance of TAS equipment is inadequate.

81. Because of the condition of TAS equipment and inadequacy of repair and maintenance for TAS, and also because of the amount of total relief awarded, an appropriate TAS rate increase in the 19 percent range is appropriate.

82. Pacific should be ordered to update TAS equipment and improve repair and maintenance for TAS.

83. Pacific's proposed restructuring of NA4-09 PBX rates is inappropriate. It is reasonable to raise present NA4-09 rates approximately seven percent.

84. 5-MMU tariffs should be canceled.

85. The staff's recommendation concerning Pacific's response to trouble reports on customer-provided terminal equipment should not be adopted, but Pacific should circulate a reminder on proper practice to repair personnel.

85.a. Certain visit charges for customer provided equipment should be increased.

85.b. Rates and charges for certain miscellaneous equipment and service connection move and changes should be increased.

86. We find that a reasonable rate spread for this proceeding, and for the total rate relief awarded, (with rates subject to refund because of certain outstanding issues as discussed in the opinion section of this decision) is as set forth in the table in the rate design portion of the discussion section of this decision (mimeo. p. 133). Such rate spread gives adequate weight to anticompetitive factors (see discussion, mimeo. p. 132).

Service Issues

87. Tariff reductions instituted in our third interim order herein (Decision No. 86593 dated November 2, 1976) should remain in force pending our further order.

88. Use of the directory assistance recording should continue.

89. Pacific should continue with the program for establishing locations for over-the-counter payment of telephone bills outlined in Exhibit 47 and associated testimony, and should attempt to establish one such location in San Francisco's Portola district. Pacific's "average family income" criteria for establishing such payment locations should be periodically revised to take inflationary factors into account.

90. The request for relief from SMRT on the part of organizations furnishing telephone service for the deaf is reasonable. Such services should be allowed to subscribe to untimed business message rate lines equal to the number of active teletype machines used in each business location to send messages to the deaf, as provided in Appendix B.

91. Pacific should submit to us a study on possible installation of OCMS in Sonoma County.

92. In its next rate increase application, Pacific shall submit a survey of its progressive maintenance program to replace old rural cable, in accordance with our discusion herein (mimeo. p. 141-142).

93. It is not reasonable to order old rural telephone plant, not the property of Pacific and not installed by Pacific, to be removed at Pacific's expense.

94. Pacific should be ordered to file a supplementary report on service outages in San Luis Obispo County and general service problems at Camp Roberts within six months of the effective date of this order.

95. The service recommendations of the staff in Exhibit 167 should be adopted subject to our comments in the discussion section on this subject (mimeo. p. 144-145).

96. Pacific should furnish a residential customer with an itemized breakdown of the cost of optional equipment ordered by the customer at the time the order is taken.

97. Tariff reductions to Schedule 28-T ordered by our previous decisions herein shall remain in effect until our further order.

Conclusions

1. The application should be granted to the extent set forth in the order and in all other respects denied.

2. The effective date of this order should be the date on which it is signed because:

a. There is an immediate need for modifying monitoring practices as set forth herein;

b. This case has included more than the usual number of complex issues and has therefore been before us for a greater amount of time than is usual for this type of proceeding; therefore, there is need for immediate rate relief (subject to refund).

O R D E R

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company (Pacific), and all other telephone corporations which are respondents hereto and which employ supervisory or administrative monitoring without giving notice thereof at the time of such monitoring by one of the methods provided by our previous orders on this subject, shall print, in each directory on the same page on which the index begins, a boxed notice printed in at least ten points boldface type, to read as follows:

NOTICE CONCERNING MONITORING

> For training and quality control purposes, a sampling of telephone calls (one percent or less of operator-assisted or directory assistance calls) between telephone company employees and customers are monitored, without notice to the customer or the employee, by supervisory or management personnel. No recording of the call is made. CALLS BETWEEN CUSTOMERS ARE NOT MONITORED FOR THIS PURPOSE, or for any purpose without the use of an automatic tone warning, except when required by law enforcement and national defense agencies, pursuant to law and under legal safeguards. If you have any questions concerning monitoring, please contact your service representative.

Pacific, and other respondents employing supervisory or administrative monitoring shall, prior to April 1, 1978, and at reasonable intervals thereafter, include with its bills a notice briefly describing such monitoring and its purposes.

2. The use of unauthorized de facto traffic instructions shall cease forthwith. Pacific shall augment training of supervisors and appropriate managerial personnel to assure compliance with company traffic instructions and any appropriate orders or rules of this Commission. Such training shall include:

a. Instructions or material to insure all supervisory and appropriate managerial personnel understand and correctly interpret official instructions relating to emergency calls;

b. Instructions or material to insure that all supervisory and appropriate managerial personnel correctly apply official instructions relating to waiting time on operator-assisted calls;

c. A specific admonition that managerial and supervisory personnel shall not attempt to improve the quantitative performance of traffic personnel by the de facto adoption and enforcement of unauthorized traffic instructions.

3. Company traffic instructions concerning waiting time on operator-assisted calls shall be clarified.

4. Within six months of the effective date of this order, Pacific shall adopt a checklist form for a supervisor's use during supervisory monitoring.

5. Pacific is authorized to file with this Commission, not less than five days after the effective date of this order and in conformity with 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 schedules shall be five days after the date of filing. The revised tariff schedules shall apply only to service rendered on or after the effective date of these tariffs.

6. The rates established by this order shall be subject to refund for the reasons set forth in this opinion, with interest at seven percent a year from the date of collection. Pacific shall maintain such books and records as are necessary to determine the difference between the rates established and any other rates which may be established by further order.

7. In Pacific's next rate increase application, it shall provide the Commission with the accounting information for advertising described herein (mimeo. pp. 68-69), and shall furnish the Commission with reasonably current information on the value of yellow page advertising.

8. Pacific, the staff, and appropriate representatives of law firms shall, prior to the next Pacific rate increase application, consult on the detail of legal expense which should be made available for our purposes in a rate proceeding.

9. In future rate applications, Pacific shall submit, as part of its direct showing, a complete breakdown of Business Information System expenditures and claimed cost savings.

10. Clearing accounts shall be treated as recommended in Exhibit 174.

11. Pacific shall file a revised Tariff Schedule 42-T, which will set forth in proper tariff form the employee discount practices described in Exhibit 112 in Application No. 55214, and incorporating any changes since that exhibit was prepared.

12. Interest and taxes on land shall be treated for accounting purposes as set forth in Finding 54.

13. Pacific is authorized to continue use of its directory assistance recording.

14. Pacific shall continue its program for establishing locations for over-the-counter payment of telephone bills, as set forth in Finding 89. Pacific shall attempt to establish such a location in the Portola district of San Francisco. Pacific's "average family income" criteria for establishing such payment agencies shall be periodically revised to take inflationary factors into account.

15. Within six months of the effective date of this order, Pacific shall submit to this Commission a study on the installation of Optional Calling Measured Service for Sonoma County. The study shall include the necessary information on demand for this type of service over various routes from and to various locations.

16. Pacific shall submit, in its next rate increase application, a comprehensive survey of its progressive maintenance program to eliminate old rural cable, in accordance with the discussion on this subject (mimeo. pp. 141-142).

17. Within six months of the effective date of this order, Pacific shall file a supplementary report on service outages in San Luis Obispo County and the service problems at Camp Roberts.

18. The staff's service recommendations in Exhibit 167 are adopted, subject to our comments in the discussion section on this subject (mimeo. pp. 144-145).

19. Within twenty-four months of the effective date of this order, Pacific shall replace its existing manually operated mobile systems with IMTS. Service to existing mobile stations not equipped for IMTS shall be terminated thirty-six months after the effective date of this order. Within sixty days of such effective date, Pacific shall notify its mobile service customers of such conversion.

20. Pacific shall furnish residential customers with itemized breakdowns of the cost of optional equipment ordered by such customers at the time the order is taken.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 13th day of DECEMBER, 1977.

Robert Batinovich
President

Vernon L. Sturgeon
Richard D. Gravelle
Clair T. Dedrick
Commissioners

I concur in part and dissent in part
Vernon L. Sturgeon
Commissioner

Commissioner William Symons, Jr.

Present but not participating.

APPENDIX A

LIST OF APPEARANCES

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

Respondents and Interested Parties: A. M. Hart and H. Ralph Snyder, Jr., Attorneys at Law, for General Telephone Company; Richard S. Kopf, Attorney at Law, for Southern Pacific Communications Co.; R. C. Brown, for California Independent Telephone Association; Lessing E. Gold, Attorney at Law, for Western Burglar and Fire Alarm Association; Ann Murphy, Attorney at Law, and Sylvia Siegel, for Toward Utility Rate Normalization; David M. Wilson, Attorney at Law, for Allied Telephone Companies Association; Martin J. Rosen, Attorney at Law, for Telecor, Inc.; Boris H. Lakusta and David J. Marchant, Attorneys at Law, for California Hotel and Motel Association; Paul Alexander, Attorney at Law, for Citizens Utilities Company; Ronald L. Bauer, Attorney at Law, for Telephone Answering Service Committee; Charlotte G. Hamaker, for Santa Clara Valley Coalition; William L. Knecht, Attorney at Law, for California Farm Bureau Federation; Allen B. Wagner, Attorney at Law, for the Regents of the University of California; Gordon E. Davis and William H. Booth, Attorneys at Law, for California Retailers Association and California Manufacturers Association; Burt Wilson and Herman Mulman, for Campaign Against Utility Service Exploitation; David L. Wilner, for Consumers Lobby Against Monopolies; Joel Effron, for Scott-Buttner Communications, Inc.; Alice Fornia, for San Francisco Chapter, National Federation of the Blind; Joseph Garcia, Attorney at Law, for State Department of Consumer Affairs; Arthur S. Hecht, for Sunset-Parkside Education and Action Committee; Alexander Larkin, for Communities of the Outer Mission Organization; Leonard L. Snaider, Attorney at Law, and Manuel Kroman, for the City of Los Angeles; Robert Laughead, for the City and County of San Francisco; John W. Witt and William S. Shaffran, Attorneys at Law, for the City of San Diego; Dina G. Beaumont, for Communications Workers of America, District Eleven; James B. Booe, for Communications Workers of America, District Nine; and John L. Mathews, Attorney at Law, for General Services Administration.

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

Rates - The Pacific Telephone and Telegraph Company

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

SCHEDULE CAL. P.U.C. NO. 4-T - INDIVIDUAL AND PARTY LINE SERVICE and SCHEDULE CAL. P.U.C. NO. 13-T - PBX TRUNK LINE SERVICE

Metropolitan Extended Area Exchanges (Los Angeles, Orange County, Sacramento, San Diego, San Francisco-East Bay):

Business Service	Message Rate per Month
Individual Line	$7.00 (80)
PBX Trunk	3.50
Semi-public Coin	7.00

Foreign Exchange Service--No change in rates.

Service for the Deaf

Business organizations which transmit messages for the deaf may subscribe to untimed business message rate individual lines and/or PBX trunks up to the number of active teletype machines at each business location equipped for sending messages to the deaf. Such businesses must furnish evidence of serving the deaf in order to qualify for untimed service.

SCHEDULE CAL. P.U.C. NO. 6-T - MESSAGE UNIT SERVICE

Schedule shall be so modified as to convert 5 message unit routes to message toll routes. Schedule Cal. P.U.C. No. 53-T shall be appropriately modified to accommodate this change.

SCHEDULE CAL. P.U.C. NO. 12-T - PRIVATE BRANCH EXCHANGE SERVICE

Schedule shall be modified to include a 7% surcharge in addition to the existing 15% surcharge on rates and charges for NAL-09 PBX service.

SCHEDULE CAL. P.U.C. NO. 22-T - KEY EQUIPMENT SERVICE

Schedule shall be modified as proposed in Exhibit No. 167, Appendix A, except rates and charges shall be as follows:

Item	Installation Charge	Monthly Rate
Stations:		
Non-button	$ 18.00	$ 1.25
COM PAK I	20.00	1.75
COM PAK II	27.00	3.00
COM PAK III	45.00	6.50
COM PAK IV	55.00	7.25
COM PAK V	80.00	8.75
COM PAK VI	330.00	45.00
COM PAK VII	400.00	55.00
COM PAK VIII	500.00	65.00

SCHEDULE CAL. P.U.C. NO. 22-T - KEY EQUIPMENT SERVICE (Cont.)

Item	Installation Charge	Monthly Rate
Line Feature:		
Line equipment	$12.00	$2.60
Intercommunications Arrangements:		
Single talking path manual	10.00	1.55
Single talking path dial selective		
First 9 station codes	50.00	6.45
Each add'l station code	18.00	1.35

SCHEDULE CAL. P.U.C. Nos. 22-T, 32-T and 83-T - KEY, SUPPLEMENTAL AND SPECIAL ASSEMBLIES OF EQUIPMENT

Schedules shall be modified as proposed in Exhibit No. 167, Appendix E.

SCHEDULE CAL. P.U.C. NO. 28-T - SERVICE CONNECTIONS AND MOVE AND CHANGE CHARGES

Schedule shall be modified as proposed in Exhibit No. 167, pages 2-2 through 2-4, except charges for the following items shall be as set forth below:

	Change Location Charge
COM PAK II	$26.00
COM PAK III	40.00
COM PAK IV	50.00

SCHEDULE CAL. P.U.C. NO. 36-T, RULE No. 6 - ESTABLISHMENT AND REESTABLISHMENT OF CREDIT

Schedule shall be modified to include provision that all customers be informed of allowed credit limit and changes in credit limit be communicated in writing as proposed in Exhibit No. 167, page 2-12, paragraph 52.

SCHEDULE CAL. P.U.C. NO. 36-T, Rule No. 11 - DISCONTINUANCE AND RESTORATION OF SERVICE

Schedule shall be modified as proposed in Exhibit No. 167, page 2-12, paragraph 53.

SCHEDULE CAL. P.U.C. NO. 36-T, Rule No. 12 - OPTIONAL RATES AND INFORMATION TO BE PROVIDED THE PUBLIC

Schedule shall be modified as proposed in Exhibit No. 167, page 2-12, paragraph 50. Modification shall be applicable only to residential customers.

SCHEDULE CAL. P.U.C. No. 41-T - MOBILE TELEPHONE SERVICE

	Rates and Charges		
	Pre-IMTS Rates	IMTS Interim Rates*	IMTS Final Rates**
Each Basic Service			
Non Recurring Charge	$35.00	$35.00	$35.00
Each Service per Month 6 -35 MHz	15.00	15.00	15.00
-150 MHz	18.00	18.00	18.00
-450 MHz	12.00	12.00	12.00
Radio Link Charge			
Per Minute or Fraction - Air time			
Home Area Mobiles - Dialed			
On Peak# - 1st Min.	-	.25	.25
- Next 4 min. per min.	-	.40	.40
- Over 5 min, per min.	-	.80	.80
Off Peak## - 1st Min.	-	.20	.20
- Next 4 min, per min.	-	.20	.20
- Over 5 min, per min.	-	.40	.40
Foreign Area Mobiles (Roamers) Dialed			
All Hours - 1st 5 min, per min.	-	.40	.40
- Over 5 min, per min.	-	.80	.80
Operator Handled Calls			
On Peak# - 1st Min.	.25	.40	.90
- Next 4 min. per min.	.40	.40	.40
- Over 5 min, per min.	.80	.80	.80
Off Peak## - 1st Min.	.20	.40	.90
- Next 4 min, per min.	.20	.20	.20
- Over 5 min, per min.	.40	.40	.40

* Rates apply upon conversion to IMTS.
** Rates apply three years after notice to customers.
\# Peak rates apply 8 AM to 8 PM daily except Saturdays, Sundays, and Holidays.
Off-peak rates apply 8 PM to 8 AM daily plus all day Saturdays, Sundays and Holidays.
6 The message allowance in the monthly rate is discontinued.

SCHEDULE CAL. P.U.C. No. 53-T - MESSAGE TOLL SERVICE

Rate Mileage	Initial Period						Each Additional Minute		
	Station					Person	All Classes of Service		
	Dial			Coin	Operator				
	1 Min. Day	1 Min. Evening	1 Min. Night	3 Min. - All Days - All Hours			Day	Evening	Night
0 - 8	$0.10	$0.08.	$0.06	$0.20	$0.62	$1.22	$0.06	$0.04	$0.03
9 - 12	.10	.08	.06	.20	.62	1.22	.06	.04	.03
13 - 16	.13	.11	.09	.25	.69	1.29	.08	.07	.05
17 - 20	.16	.14	.12	.35	.76	1.36	.10	.09	.08
21 - 25	.19	.16	.15	.40	.83	1.43	.12	.11	.10
26 - 30	.22	.18	.17	.45	.88	1.48	.13	.12	.11
31 - 40	.25	.21	.19	.50	.93	1.53	.14	.13	.12
41 - 50	.28	.23	.19	.65	.98	1.58	.15	.14	.12
51 - 70	.31	.25	.19	.80	1.05	1.65	.17	.15	.12
71 - 90	.34	.27	.19	.95	1.12	1.72	.19	.16	.12
91 - 110	.37	.29	.19	1.05	1.19	1.79	.21	.17	.12
111 - 130	.40	.31	.19	1.10	1.24	1.84	.22	.18	.12
[illegible] - 150	.43	.32	.20	1.15	1.31	1.91	.24	.19	.13
151 - 170	.45	.32	.20	1.20	1.37	1.97	.26	.19	.13
171 - 195	.47	.32	.20	1.25	1.43	2.03	.28	.19	.13
196 - 220	.49	.33	.20	1.30	1.49	2.09	.30	.20	.13
221 - 245	.51	.33	.20	1.35	1.55	2.15	.32	.20	.13
246 - 270	.53	.33	.20	1.40	1.61	2.21	.34	.20	.13
271 - 300	.55	.34	.21	1.45	1.65	2.25	.35	.21	.14
301 - 330	.57	.34	.21	1.50	1.71	2.31	.37	.21	.14
331 - 360	.59	.34	.21	1.55	1.77	2.37	.39	.21	.14
361 - 430	.61	.35	.21	1.60	1.83	2.43	.41	.24	.14
431 - 510	.64	.35	.21	1.65	1.90	2.50	.43	.24	.14
511 - 590	.66	.35	.21	1.70	1.96	2.56	.45	.24	.14
Over 590	.67	.35	.21	1.75	2.01	2.61	.47	.24	.14

SCHEDULE CAL. P.U.C. No. 100-T - TELEPHONE ANSWERING SERVICE

Schedule shall be modified as proposed in Exhibit No. 167, Appendix D, as amended by Exhibit No. 223, except monthly rates shall be as set forth below:

Item	USOC	Monthly Rate
CORD-OPERATED EQUIPMENT		
Type A Equipment		
Each non-multiple position	SSA,SSD	$47.00
Jack equip.-5 add'l. trunks	9MA	3.60
Each add'l. cord pair	SS3	2.45
Jack equip.-terminating lines		
direct wire termination	SSM	13.25
from identifier unit	9AN	3.75
strip - 10 jacks	SSN	1.65
strip - 20 jacks	SS9	3.25
Add'l. appearances equip.	PZ7	3.75
Type B Equipment		
Each non-multiple position		
80 lines or less	PJH	60.00
81 to 120 lines	PJT	70.00
Key shelf extension	9AQ	-
Pilot lamp	69T	-
Position splitting arrangement	SS7	-
Secretarial line jacks	PZ7XX	.75
Type A and Type B Equipment		
Position grouping	9AU	-
Assistance jacks	FYY	.90
Attendant circuit extended to key set		
first extension	FLN	2.50
each add'l. extension	FLO	1.75
Lamp test equipment	SNB	1.35
Interposition trunk, each	PZP	1.65
Add'l. appearances equip.		
station line jacks	PZJ	1.35
trunk, tie, private line jacks	PZJ	1.35
Battery Power Plant	-	20.00
CONCENTRATOR-IDENTIFIER EQUIPMENT		
Systems installed before 8/17/64	ST5	82.50
Systems installed on or after 8/17/64	SNU	110.00
Concentrator unit-independent exch.	FCO	150.00
Identifier unit-independent exch.	FCP	110.00
OCCASIONAL SERVICE EQUIP.	A9Q	15.00

SCHEDULE CAL. P.U.C. No. 135-T - CONNECTIONS OF CUSTOMER-PROVIDED EQUIPMENT AND SYSTEMS

Schedule shall be modified as proposed in Exhibit No. 31, page 110.