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Decision 93255 JUL 7 1981

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application of General Telephone Company of California to modify D.92366 re rate increase in the annual amount of $4,833,033 to offset increased interest costs.	Application 60342 (Filed March 11, 1981)
Application of General Telephone Company of California, a corporation, for authority to increase certain intrastate rates and charges for telephone service to offset increased capital costs.	Application 60343 (Filed March 11, 1981)

A. M. Hart, H. Ralph Snyder, Jr., and Dale W. Johnson, Attorneys at Law, for applicant.
E. Clark Coberly, Attorney at Law, for Upper Hastings Ranch Association, protestant.
George Y. Tyce, by James M. Nelson III, for Los Angeles County Department of Communications; A. John Terrell, Carl A. Dewey, and Alan E. Donnel, for the Regents of the University of California; and Edward J. Perez, Deputy City Attorney, by Ken Walpert, for the City of Los Angeles; interested parties.
Edward W. O'Neill, Attorney at Law, for the Commission staff.

O P I N I O N

General Telephone Company of California (General) seeks authority in Application (A.) 60342 to modify Decision (D.) 92366, on its A.59132 for a general rate increase, to increase its rates $4,833,033 on an annual basis to recover the costs of its $100 million First Mortgage Bonds, 14-1/8%, Series EE, issued on December 1, 1980, and in A.60343 to increase its rates an additional $7,552,954 to offset increased capital costs associated with the contemplated issuance of $250 million of long-term debt and $50 million of preferred stock in 1981, a total increase for both applications of approximately $12,386,000 on an annual basis. This increase is requested to afford General an opportunity to earn the 13.60% return on common equity authorized by D.92366. It is proposed to obtain the additional revenue by increasing the current billing adjustment factor from a negative 2.99% to a positive 0.18%.

A duly noticed hearing on these combined matters was held before Administrative Law Judge (ALJ) N. R. Johnson in Los Angeles on April 22, 1981, and the matter was submitted one week after the receipt of late-filed Exhibit 6 due by April 30, 1981.

Testimony was presented on behalf of General by its treasurer and assistant secretary, C. J. O'Rourke, and by its revenues director, T. E. Quaintance, and on behalf of the Commission staff by one of its financial examiners, Terry R. Mowrey.

In addition, eight public witnesses made statements setting forth their position on the granting of the requested rate relief. Seven of these public witnesses, including E. Clark Coberly, representing the Upper Hastings Ranch Association, who presented a petition containing approximately 220 signatures of General's customers from the area, opposed the granting of any rate increase until the quality of service provided by General is raised to an acceptable level. The eighth public witness advocated granting the full requested increase to assist the utility in earning its authorized rate of return. These two proceedings are generally to offset financial attrition in rate of return since the issuance of D.92366 and the quality of service is therefore not an issue. Public witness statements are more appropriate in A.60340, General's current application for a general rate increase where the quality of service is a major issue. Consequently, we will incorporate the statements of public witnesses and petitions into that record by reference.

Both General and Commission staff witnesses used the D.92366 adopted capital structure, rate base, and net-to-gross multiplier as a basis for computing the additional revenue required to offset the 1980 financing costs associated with the December 1, 1980 issue of Series EE bonds and the higher debt and preferred stock dividend costs General expects to incur in 1981. The capital structure adopted in D.92366 is as follows:

	Capital Ratios	Cost Factors	Weighted Cost
Adopted in D.92366 (12/31/80)			
Long-term debt	48.07%	8.24%	3.96%
Short-term debt	3.39	10.50	0.36
Preferred stock	9.08	7.66	0.70
Common equity	39.46	13.60	5.37
Total	100.00%		10.39%

The $100 million Series EE issue at a coupon rate of 14-1/8% raised the embedded cost of debt to 8.71% as of December 31, 1980. Including the projected 1981 bond issues in the embedded cost of debt computations results in the following figures set forth in General's exhibit and adopted by the staff:

	Par Value	Net Proceeds	Annual Charges	Effective Cost
Long-term Debt Outstanding 12/31/80	$1,318,028	$1,300,079	$113,210	8.71%
1981 Maturities	(22,800)	(22,846)	(1,061)	
1981 Issues (Estimated):				
Series FF, 15-7/8%	100,000	100,000	15,875	
Series GG, 14-3/4%	50,000	50,000	7,375	
Later issue, 15%	100,000	100,000	15,000	
	$1,545,228	$1,527,233	$150,399	9.85%
1981 Average Basis		$1,413,656	$131,804	9.32%

(Red Figure)

In estimating the cost of preferred stock, General's witness assumed a $24 million issue with a dividend rate of 11-3/4% to be issued April 15, 1981 and a $26 million issue with a dividend rate of 11-3/4% to be issued in October 1981, resulting in a preferred stock cost of 8.55% as of December 31, 1981 and a 1981 average year basis cost of 8.19%. However, because of General's bond down-rating by Standard and Poor's from "A" to "BBB+", General revised its 1981 preferred stock financing from $50 million to $25 million. The staff witness used this later data to project $25 million of preferred stock at a 13% dividend rate resulting in an average year 1981 basis cost of preferred stock of 8.05% which we will adopt as reasonable.

Using the above cost factors in deriving the additional revenue required to afford General an opportunity to earn the 13.60% return on common equity authorized by D.92366 results in the following:

Increase Cost of Long-term Debt		
1980 48.07% x (8.71% - 8.24%) x $2,031,725 a/	=	$ 4,590,256
1981 48.07% x (9.32% - 8.71%) x $2,031,725	=	5,957,566
		10,547,822
Increased Cost of Preferred Stock		
1981 9.08% x (8.05% - 7.66%) x $2,031,725 x 1.88 b/	=	1,352,612
Total Additional Revenue Requirement		11,900,434

a/ Intrastate Rate Base adopted in D.92366.
b/ Net-to-gross multiplier.

According to the record, the revenue base for the initial change to the billing adjustment factor proposed in the application was based on the actual billing for the month of January 1981 and includes revenue from measured local service in the Los Angeles metropolitan area. The resulting revenue base differs from the currently used base which is applied only to monthly recurring revenues and therefore excludes the revenue from measured local service. General's witness testified that he believed a revenue base that includes revenue from measured local service is preferable because it would apply equally to both the customer who pays an access line rate plus a charge per call and to the customer who pays a flat rate. We agree, and the order that follows will so provide.

The $12.386 million of additional revenue requested by General excludes the Extended Area Service (EAS) and uncollectible effects. The increase in billings required to generate the additional required revenue is obtained by applying a multiplier of 1.13895 to obtain a billing requirement of $14.107 million. General's witness Quaintance sponsored an exhibit deriving a billing adjustment factor of 0.28% excluding measured local service revenues and 0.13% including measured local service revenues based on the above $14.107 million additional billing requirement and a revenue base equal to the annualized average revenue received in January, February, and March 1981, rather than the annualized January 1981 revenues used in the application. The Commission staff questioned the applicability of the annualized average of the first three months recorded revenue so the presiding ALJ requested General to file late-filed Exhibit 6 setting forth monthly revenues for the three-year period ending October 1980.

Exhibit 6 shows that the December 1980 recorded revenues are significantly higher than the recorded January, February, and March revenues used by General as a basis for computing the amount of the surcharge. The staff argues, however, that if the historical trends set forth in Exhibit 6 continue, the downward trend in revenues for January, February, and March can be expected to be temporary. Under these circumstances the staff urges the consideration of the December 1980 revenues in determining the appropriate revenue base. The revenues for December 1980 and January, February, and March 1981, including measured local service, are as follows:

December 1980	$40,909,618
January 1981	38,166,414
February 1981	37,463,442
March 1981	37,318,666

The annualized average revenue for January, February, and March used by General as a revenue base is $451,794,088. Including December 1980 in the computations, as urged by the staff, yields an annualized revenue base of $461,574,442. However, a review of Exhibit 6 indicated that on the average, the total of the January, February, and March revenues equal 23.92% of the annual revenues. Applying this factor to the recorded revenues for January, February, and March totaling $112,948,522 yields a revenue base of $472,192,817. We will adopt this amount as a reasonable revenue base for the computation of the billing adjustment factor. The billing adjustment factor required for General to recover the previously discussed net additional revenue of $11,900,434 increased by a factor of

1.13895 to reflect the EAS settlement and uncollectible effects, or $13,553,999, is a negative 0.12% computed as follows:

$$13.554 \div 4.722 + (2.99) = (0.12)$$

We will adopt this billing adjustment factor as reasonable.

Our consideration of these applications without a showing of financial emergency and our adoption of the above-discussed billing adjustment factor is in no way to be construed as guaranteeing General a specific rate of return. Rather, A.60342 seeks to rectify an error on our part in D.92366, because that decision did not fully provide for General's 1980 debt costs. Rates authorized in general rate proceedings before this Commission are designed to give a utility an opportunity to earn a reasonable rate of return for the adopted test period and for the period immediately following the issuance of the decision. Normally the adopted capital costs remain relatively stable for reasonable periods of time. In this instance, however, a bond issue of $100 million one month after the effective date of the decision raised the embedded cost of debt for the test year 1980 from 8.24% to 8.71%. The substantially increased amount of financing projected for the year 1981, combined with the increased year 1981 debt costs will effectively deny General any opportunity to earn its authorized return on equity during the year 1981. For these reasons we have entertained and granted the applications for rate relief in addition to that granted in the general rate proceeding. With specific allowances for attrition now being made in our general rate case decisions we do not expect our action here to serve as prudent for future applications outside the test year.

Findings of Fact

1. General's embedded cost of long-term debt as of December 31, 1980 is 8.71%.

2. The embedded cost of long-term debt on an average 1981 basis, including the projected cost of contemplated 1981 bond issues, is 9.32%.

3. The 1981 average year basis cost of preferred stock computed by including a $25 million preferred stock issue at 13% is 8.05%.

4. Using the cost factors set forth in Findings 1, 2, and 3, a net revenue requirement of $11,900,434 is necessary to afford General an opportunity to earn the return on equity authorized by D.92366, supra.

5. The additional billing revenue required to generate the above $11,900,434 after allowing for EAS settlement and uncollectible effect is $13,544,000.

Conclusions of Law

1. General should be authorized an increase in annual billing revenues of $13,544,000 to offset the increase in the 1980 and 1981 cost of long-term debt and the 1981 cost of preferred stock to afford it an opportunity to earn the 13.60% return on common equity authorized by D.92366.

2. This additional revenue of $13,544,000 should be obtained by increasing the current billing adjustment factor of a negative 2.99% excluding measured local service revenues to a negative 0.12% including measured local service revenues.

3. General should be granted additional billing revenues of $13,544,000 on an annual basis to afford it an opportunity to earn the 13.60% return on equity authorized by D.92366, supra.

4. The additional billing revenue of $13,544,000 set forth in Finding 5 should be obtained by increasing the current billing adjustment factor of a negative 2.99% excluding measured local service revenues to a negative 0.12% including measured local service revenues.

5. Because the additional revenue requirements are based on 1980 and 1981 cost factors, the effective date of the order should be the date of signature.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, General Telephone Company of California is authorized to file the revised rate schedule set forth in Appendix A, reflecting the adopted billing adjustment factor and concurrently withdraw and cancel its presently effective Billing Adjustment schedule. Such filings shall comply with General Order 96-A.

2. The effective date of the revised schedules authorized by Ordering Paragraph 1 shall be 5 days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date thereof.

This order is effective today.

Dated JUL 7 1981, at San Francisco, California.

President

Commissioners

Commissioner Richard D. Gravelle, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

The billing adjustment factor shown in Schedule Cal. P.U.C. No. A-38 of General Telephone Company of California is revised as set forth in this appendix.

	Monthly Percentage Rate
Authorized Billing Adjustment Factor	(0.12)*

Special Conditions

1. The monthly percentage rate applies to all monthly recurring and MRS (Measured Rate Service exchange unit) charges for service or equipment provided under Schedules Cal. P.U.C. No. A-1 through A-40.

*(   ) indicates reduction