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Decision 97-04-034 April 9, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Calaveras Telephone Company (U-1004-C) to restructure intrastate rates and charges for telephone services furnished within the State of California.	Application 95-12-075 (Filed December 26, 1995)
Order Instituting Investigation into the rates, charges, service, practices and regulations of Calaveras Telephone Company (U-1004-C).	I.96-04-016 (Filed April 10, 1996)

ORIGINAL

Alvin H. Pelavin, E. Garth Black, Mark P. Schreiber, and Sean P. Beatty, Attorneys at Law, for applicant.

Beck & Ackerman, by Jeffrey F. Beck and Juillisa Bronfman, Attorneys at Law, for CP National, Evans Telephone Company, GTE West Coast Incorporated, Kerman Telephone Co., Pinnacles Telephone Company, The Siskiyou Telephone Company, Tuolumne Telephone Company, and the Volcano Telephone Company; and, Barbara Snider, Attorney at Law, for Citizens Telecom-Tuolumne and Citizens Telecom-Golden State, interested parties.

James Rood and Laura Tudisco, Attorneys at Law, and Linda Woods and Hal Rayburn, for the Office of Ratepayer Advocates.

I N D E X

OPINION

Summary

This order requires Calaveras Telephone Company (applicant) to reduce its intrastate rates by approximately 10.85% or $343,366 in its 1997 test year, effective January 1, 1997. A 10.00% return on rate base found reasonable for applicant produces an 12.70% return on equity when applied to applicant's test year capital structure of 29.21% debt and 70.79% equity.

Applicant is authorized to eliminate its 8.57% billing surcharge;[1] withdraw the tariff charges for its business and residential two-party services, tariff charges for its nonpublished listing charges, Semi-Public Coin Box minimum charge, Foreign Exchange Services, Special Billing Services, inside wire tariff rates at quarter hour increments, and intrabuilding network cable rates at quarter hour increments; to reduce its business and residential customers' basic monthly service rates; and, to implement a billing surcredit and other charges as summarized in Appendix C to this order. The effect of this rate reduction on the business basic monthly rate is an $8.20 reduction from $20.20 to $12.00 and on residential service is a $6.85 reduction from $16.85 to $10.00.

Request

This application was filed pursuant to the Implementation Rate Design Decision, Decision (D.) 94-09-065 (56 CPUC2d 117 at 289), which required all small local exchange carriers to submit

1 This billing surcharge was implemented as part of the Commission's Implementation Rate Design Proceeding (IRD) to replace the "common-pooled" intraLATA billing surcharge and to assist each local exchange company in designing company specific rates when it files its next general rate case request.

general rate case filings by December 31, 1995. The order provided applicant with the option of filing for either a traditional general rate case proceeding or an application to adopt New Regulatory Framework (NRF). There is no record on when applicant last filed for a general rate case application.

By its application, applicant sought authority under a traditional general rate proceeding for authority to earn a 11.50% return on its 1997 test year rate base with a 14.86% return on equity. This request would result in an overall increase of approximately $23,000 over forecast intrastate test year revenues at present rates. Subsequently, with the availability of actual 1995 expense data, applicant supplemented its testimony in May 1996, and revised its test year 1997 estimated revenue increase to approximately $101,000

<u>Procedural Background</u>

Notice of the application appeared on the Commission's Daily Calendar of December 28, 1995. Letters of protest were received from three customers complaining of high basic charges for telephone service.

A prehearing conference (PHC) was held on March 7, 1996 in San Francisco before assigned Commissioner Neeper and Administrative Law Judge (ALJ) Galvin to receive appearances, identify procedural concerns, and to schedule evidentiary hearings.

The hearing schedule agreed to by parties at the PHC did not enable a final order on applicant's request to be issued until after the first quarter of applicant's 1997 test year. Accordingly, all parties agreed that applicant's rates and charges should be subject to refund from January 1, 1997, the beginning of the 1997 test year, through the effective date of rates and charges set by an order in this proceeding. A joint motion of applicant and the Office of Ratepayer Advocates (ORA),[2] seeking such authorization was filed on March 14, 1996. The PHC procedural schedule and refund procedure agreed to by all parties was approved on May 8, 1996, pursuant to D.96-05-029.

Subsequent to the PHC and prior to the issuance of D.96-05-029, we opened generic investigation (I.96-04-016) into applicant's rates, charges, service, practices, and regulations and consolidated it with the application. Such an investigation is customary in general rate proceedings to provide a procedural forum and vehicle to fully act on recommendations and other aspects of applicant's operations which may be beyond the confines of the relief requested by applicant in its application.

A duly noticed public participation hearing (PPH) was held before the ALJ in Copperopolis on August 26, 1996. Applicant's and ORA's personnel were available to respond to specific customer questions. Two of applicant's customers attended the PPH, but chose not to provide any statement.

An evidentiary hearing was held before the Commissioner and the ALJ in San Francisco on September 10, 11, and 13, 1996. Certified Public Accountant Roger M. Barker, Service Quality Consultant Kirby L. Smith, Financial and Economic Consultant William E. Avera, and Principal Investment Advisor Consultant Michael C. Hadow testified for applicant. Senior Utilities Engineer W. Harold Rayburn, Associate Utilities Engineer Jerry H. Shiu, Public Utilities Regulatory Analyst III Linda J. Woods, and Public Utilities Regulatory Analyst III Seaneen Wilson testified for the ORA. Citizens Telecom participated actively in the cost of capital phase of the evidentiary hearing. Twenty-one exhibits were

2 By action of the Executive Director, the Commission's Division of Ratepayer Advocates ceased to exist as a staff unit on September 10, 1996. The functions it performed as a participant in this proceeding now resides with the Commission's ORA.

received into evidence during the evidentiary hearing. Opening and reply briefs were received on October 11, 1996, and October 31, 1996, respectively. This proceeding was submitted on October 31, 1996.

Service Area

Applicant operates a small local exchange telephone company serving approximately 3,000 access lines in Calaveras County and areas contiguous thereto, furnishing local, toll, and access telephone services. Applicant's system consists mainly of a local exchange telephone network and facilities for its inter-connection, including underground and aerial cable and lines, central office equipment, land, buildings, and miscellaneous equipment. Applicant's principal place of business is located in Copperopolis.

Service Quality

Commission General Order (GO) 133-B sets forth nine service quality standards which applicant must conform to. These reportable standards are Held Primary Orders, Installation-Line Energizing Commitments, Customer Trouble Reports, Dial Tone Speed, Dial Service, Toll Operator Answering time, Directory Assistance Operator Answering Time, Trouble Report Service Answering time, and Business Office Answering Time. Applicant is exempted from the Dial Tone Speed measurement standard because it is not applicable to applicant's digital central office.

Applicant conforms with the GO by compiling a list of its reportable measurements on a monthly basis. Quarterly reports are submitted to the Commission for measurements not meeting or exceeding GO 133-B standards. Any failure to meet a GO 133-B reporting level is an indication of inadequate service.

ORA's review of applicant's reports regarding the eight applicable service quality standards found no anomalies. ORA also reviewed applicant's customer complaint files and verified records of the Commission's Consumer Affairs Division for the past three years. With the exception of a pending formal Extended Area Service (EAS) complaint case (C.95-06-068), no formal complaints were filed with the Commission during this time period. Additionally, very few informal complaints have been handled by the Commission within the last three years.

During its visit ORA discovered that applicant's informal complaint records were inadequate and that applicant has an unusually high number of monthly disconnects: approximately 450 5-day notices with an average of 85 disconnects per month. ORA recommends that applicant maintain all complaint letters and inquiries in its informal complaint file for a minimum of five years or until its next general rate case proceeding. ORA also recommends that applicant re-evaluate its disconnect procedures.

We find that applicant's service quality is reasonable. However, ORA's recommendations can be a valuable tool in enhancing applicant's service quality and in avoiding future service quality problems. Accordingly, we adopt ORA's recommendations that applicant maintain detailed informal complaint files and that applicant re-assess its disconnect procedures.

Results of Operations

Applicant provides both intrastate and interstate telecommunications services, subject to the regulation of the Commission and the Federal Communications Commission (FCC), respectively. Since applicant's operations serve both jurisdictions, applicant must allocate its operating revenues, expenses, taxes, and investments between interstate and intrastate operations.

The FCC's Part 36 Separations Manual prescribes the basic principles and procedures for the separation of applicant's interstate operations from its total operations. For the purpose of this proceeding, applicant used separations factors from its 1993 cost studies. ORA reviewed these separations factors and found them reasonable for this proceeding. Hence, both applicant and ORA used identical separations factors to arrive at a 1997 test year intrastate results of operations.

Applicant's forecasted 1997 intrastate results of operations produced a 10.28% return at present rates. The ORA forecasted a comparable 1997 intrastate results of operations based on its analysis of applicant's operations. ORA's forecasted results of applicant's operations produced a 14.99% intrastate return on average 1997 rate base at present rates. The 4.71% difference in return on average rate base between applicant and ORA resulted from the use of different operating revenues, expenses, and rate base estimates.

Applicant's $3,308,575 intrastate operating revenue estimate at present rates before taxes was $113,352 lower than ORA's $3,421,927 estimate. The difference in estimates occurred in forecasting local, access, and toll revenues. Differences in local revenue estimates resulted from applicant projecting future EAS and Universal Service Fund (USF) revenues compared to ORA using established procedures to estimate such revenues. Differences between access and toll revenues resulted from the forecast of different expense and rate base estimates, tax rates, and returns from the access and toll pools. Applicant forecasted a 2.32% access pool return and a 4.20% toll pool return compared to ORA's 3.81% and 5.71%, respectively.

Applicant's $2,439,252 intrastate operating expense estimate at present rates was $248,639 higher than ORA's $2,190,613 estimate. The difference in operating expenses is attributed to the use of different forecasting methods. Applicant used a three-year average cost per access line to forecast its operating expenses. ORA used a constant dollar method which converted a three-year recorded average from 1993 through 1995 to an inflation adjusted base.

Applicant's $4,939,525 average intrastate rate base at present rates was $84,247 higher than ORA's $4,855,278 estimate.

This difference in rate base estimates is attributable to ORA excluding taxes and depreciation from its working cash allowance while applicant included both taxes and depreciation as a component of working cash.

At the conclusion of the evidentiary hearing applicant and ORA sponsored a joint exhibit, post hearing Exhibit 320, setting forth in tabular form applicant's and ORA' agreed upon version of the differences between their test year intrastate results of operations, resulting in a 14.23% return on intrastate rate base at present rates. Such an agreement resulted from the parties' individual analyses of each other's evidence presented at the hearings and their desire to limit the number of issues to be adjudicated. No opposition to the late filed exhibit was received.

In sponsoring the joint exhibit, applicant and ORA do not necessarily agree to the methodology used by either party to develop their respective results and do not intend for the joint exhibit to constitute a precedent to be used in any pending or future rate case proceeding before the Commission.

Appendix A to this order sets forth a comparison of applicant's 1997 intrastate results of operations at present rates as testified to by ORA and by applicant, and as subsequently agreed to by ORA and applicant. The agreed upon results of operations between ORA and applicant result in a recommended rate decrease of $424,452 and $221,739 by ORA and applicant, respectively.

<u>Net-to-Gross Multiplier</u>

A net-to-gross multiplier is a tax adjustment constant which, when multiplied by a specific change in applicant's net revenue, provides the necessary change in applicant's gross revenue requirement to reflect changes in net revenue and those expenses and taxes which vary with income.

ORA recommended that a 1.75184 net-to-gross multiplier be used for the 1997 test year. However, its net-to-gross multiplier excluded the state income tax allowance when calculating the federal income tax component of the multiplier.

State income tax expense is deductible from income when calculating federal income tax expense. However, ORA relied on D.89-11-058 (33 CPUC2d 495 at 506), which requires the test year federal income tax amount calculation to utilize the prior year's, not current year's, state income tax expense. This is because the Internal Revenue Service allows for the prior year's state income tax expense to be deducted from income to arrive at the current year federal tax expense.

ORA did not apply this flow-through method of accounting for state income tax on a consistent basis. Unlike its exclusion of state income tax from the federal income tax component of the net-to-gross multiplier, ORA used its state income tax expense as a deduction to calculate its test year federal income tax expense.

ORA, recognizing that its application of state income tax to derive the federal income tax expense component of the net-to-gross multiplier was inconsistent with the methods adopted in D.95-11-024, Citizens Utilities Company of California's (Citizens), and D.96-12-074, Roseville Telephone Company's (Roseville) general rate cases, corrected its method and revised its net-to-gross multiplier from 1.75184 to 1.66433. ORA's method is now consistent with its test year federal income tax estimate and with the method adopted in Citizens' and Roseville's general rate proceedings. Applicant also concurs with the revised net-to-gross multiplier.

As recognized in D.96-12-074, the preparation of a results of operations for one test year is a major undertaking. The preparation of the results of operations for the year prior to the test year is likewise no small task. Recognizing these differences, the consistency with Citizens' and Roseville's recent general rate cases, and the method used in applicant's concurrence with ORA's revised net-to-gross multiplier of 1.66433 should be adopted. We adopt the revised net-to-gross multiplier of 1.66433 as derived in the following mathematical calculation. Gross revenues will require a $1,664 change for every $1,000 change in net revenues.

Gross Revenue Change	1.00000
Less Uncollectibles @ .135%	.00135
	.99865
Less State Income Tax @ 8.84%	.08828
	.91037
Less Federal Income Tax @ 34.00%	.30953
Net Income	.60084
net-to-gross Multiplier (Gross Revenue Change/Net Income)	1.66433

Capital Structure

Applicant proposes a projected capital structure of 29.21% debt and 70.79% equity for its 1997 test year, which does not substantially deviate from its 1996 projected capital structure of 28.79% debt and 71.21% equity. Applicant's witness testified that it is generally accepted that the norms established by comparable firms provide a valid benchmark against which to evaluate the reasonableness of a utility's capital structure. The capital structures maintained by similar companies should reflect their collective efforts to finance themselves so as to minimize capital costs while preserving their financial integrity and ability to attract capital. Hence, applicant compiled a group of ten publicly traded small independent telephone companies to arrive at a reasonable capital structure for applicant.

The average capital structure of the ten comparable small independent companies consisted of approximately 21% debt and 79% equity. Applicant acknowledged that its comparable companies were not perfectly comparable to applicant and concluded that a reasonable capital structure for a small telephone company is between 60% and 80% equity. Such an equity range provides applicant the opportunity to preserve its borrowing capacity so that it will have ready and continuous access to adequate capital to meet its service requirements to customers.

Similarly, ORA compiled a group of publicly traded companies to test the reasonableness of applicant's capital structure. ORA's comparable group of companies produced a 51% average equity ratio for 1995. As a reality check, ORA calculated the 1994 and 1995 average common equity for California's eighteen small independent telephone companies. This secondary analysis showed an average common equity ratio of 70.3% for 1994 and 75.9% for 1995. Given that applicant's proposed capital structure was within a reasonable range of California small telephone companies average common equity ratio, ORA agreed to the proposed capital structure.

Although applicant's comparable group of companies is more comparable to applicant than ORA's, which included Pacific Telesis and Bell Atlantic, applicant's comparable group is not truly comparable. For example, applicant included Roseville Telephone Company in its comparable analysis which, when compared to applicant in terms of total rate base, shows that applicant's adopted rate base is less than 2.6% of Roseville's total rate base (D.96-12-074).

For a comparative analysis to produce meaningful results, it is essential that the companies in the comparable group be truly comparable to applicant. However, this is not practical in this case because of applicant's small size compared to other small publicly traded companies. Nevertheless, it is necessary to establish a reasonable range of equity ratios for applicant. Upon our analyses of the 1994 and 1995 average common equity for California's eighteen small independent telephone companies and evaluation of a higher equity ratio trend for smaller companies, as demonstrated by comparing the results of ORA's large comparable companies to applicant's mid-size comparable companies analyses, we concur with applicant's assessment that a reasonable range of common equity for small telephone companies, such as applicant, should be between 60% and 80% equity.

In setting returns for large and mid-size telephone companies, we have traditionally imputed a capital structure where we believe a utility's actual equity ratio is too high or too low. This is because a utility's capital ratio affects its equity return; the more equity in the capital structure, the lower the return. This is logical because the more equity in a capital structure, the lower the risk to shareholders. If the utility wishes to increase its equity return, it may do so by issuing lower-cost long-term debt.

Consistent with our treatment of cost of capital for large and mid-size telecommunications companies and as an incentive for applicant to manage its capital structure we decline to adopt a specific capital structure. However, we do find that applicant's proposed common equity is within the reasonable range of common equity for small telephone companies.

Cost of Debt

The cost of long term debt consists of interest and issuance expenses of all long term bonds and notes issued by applicant, both currently outstanding and projected for the test period. Since applicant does not plan on issuing any new debt during the test year, it used its 3.44% embedded cost of debt. ORA calculated applicant's embedded cost of debt to be 3.43%. This 0.01% difference between applicant and ORA is not material. We find applicant's 3.44% cost of long-term debt for the test year to be reasonable.

Cost of Capital

Applicant requests a 11.50% overall return on rate base with a resulting 14.83% return on equity. This rate base return is 2.50% higher than ORA's recommended 9.00%, which produces a resulting 10.31% equity return. Both applicant and ORA supported their equity returns with Discounted Cash Flow (DCF), Capital Asset Pricing Model (CAPM), and risk premium (RPM) analyses. Each of these analyses was used to estimate the investor's required return for equity investments.

The DCF analysis employs the concept of presenting the price of common stocks equal to the present value of the cash flows investors expect to receive from owning the common stocks. The discount rate at which investors discount future cash flows to present value is equal to the cost of capital. The CAPM analysis employs the concept that there is a positive and linear relationship between risk and return. CAPM assumes that an investor's expected return on equity is proportional to what the investor expects to receive on a risk-free security plus a risk premium related to the inherent risk of the investment. The RPM analyses recognizes differences in the risk and return requirements for investors holding common stocks as compared to bonds. The RPM analyses are based on the principle that common stock investments are riskier than long-term debt instruments.

Applicant's Position

Since applicant's stock is not publicly traded, there is no share price data to directly calculate applicant's equity return under the DCF method. Therefore, applicant applied the DCF method to two groups of large telecommunications companies. The first group consisted of eight independent telecommunications companies and the second group consisted of seven regional holding companies (RHCs), previously part of AT&T.

Applicant's estimate under sixteen separate constant growth variations of the DCF analysis resulted in an equity cost range from 8.01% to 18.29% and from 1.58% to 14.04% for the independent group and RHCs, respectively. Based on applicant's judgment of risk these telecommunications companies face, it rejected all equity cost below 10.00% and above 14.00% as being implausible values. This left five estimates ranging from 10.73% to 13.56% for the independents and four ranging from 11.01% to 13.73% for the RHCs.

To reflect the increasingly competitive nature of the telecommunications industry, applicant conducted a non-constant growth DCF analysis. This application of the DCF analysis produced a equity cost range from 10.60% to 40.08% and from 6.40% to 14.10% for the independent group and RHCs, respectively. The average equity cost was 18.80% and 11.80% for the independent group and the RHCs, respectively.

Applicant employed a third variation of the DCF analysis by using its non-constant results to impute future prices based on projected internal growth. This DCF method produced an equity cost range from 8.80% to 15.70% and from 10.10% to 15.60% for the independent group and the RHCs, respectively. The average equity cost was 13.30% and 12.80% for the independent group and RHCs, respectively.

Applicant summarizes these results to suggest that a reasonable equity cost range under the constant method is 11.50% to 12.50% and under the non-constant and imputed future price variation is 12.00% to 13.00%. Taken together, applicant concludes that its DCF analyses indicates a reasonable DCF equity cost range for large telecommunications firms to be between 11.75% and 12.75%.

For its CAPM analysis, applicant reviewed the comparable returns realized on long-term treasury bonds and the stocks in the S&P's 500 from 1926 to 1994. The risk premium difference in the return on the stock portfolio and the bonds over this time period was between 5.4 and 7.0 percentage points, depending on whether the average equity risk premium is calculated under the geometric or arithmetic mean. The mid point of these two numbers was multiplied by the published beta for each of the two groups producing a 5.77% and 4.53% risk premium. These results were then added to the November 1995 long-term government bond rate of 6.26%, resulting in a 12.03% and 10.79% equity cost for the independent companies and RHCs, respectively.

Applicant's RPM analysis estimated the risk premium by applying the historical realized rate of return approach directly to the telephone companies as well as on allowed rates of common equity returns. Over a ten-year time period from 1985 to 1995, the realized rates of return for telephone companies exceeded those on utility bonds by an average of 4.59% and 5.43%, depending on whether a geometric or arithmetic mean is used. The 5.01% mid-point of these equity risk premiums for single A bond rated independent companies was added to the November 1995 single A public utility bonds 7.43 average yield resulting in a 12.44% equity cost for the Independents. The same method was used to calculate a 12.23% RHC equity cost, except that double A data was used in place of single A to reflect the RHCs double A bond ratings.

Applicant adjusted its RPM to reflect an inverse relationship between interest rates and equity risk. This is because when interest rates are high, equity risk narrows, and when interest rates are relatively low, equity risks are greater. A regression equation between interest rates and equity risk was used to reflect this inverse relationship, resulting in a 12.19% and 11.98% equity cost for its independent and RHC study group, respectively.

Applicant concludes from its DCF, CAPM, and RPM analyses that a reasonable equity cost for large telecommunications firms is 12.00%, based on an overall range of 11.50% to 12.50%. Applicant then applied a 360 basis point premium to the 12.00% equity cost to arrive at a 15.60% equity cost for small telephone companies, such as applicant. This 30% premium was derived from the mid-point of financial data for publicly traded companies and implied that small firms' equity costs exceed large firms by 200 to 520 basis points. It was used to reflect applicant's greater risk due to its small size and lack of liquidity.

Applicant, ignoring size differences, believes a 50% premium for the non-marketability of the common stock in a privately-held telephone company implies a cost of equity on the order of at least 17%. Applicant concludes that the reflection of both the small size and illiquidity of its stock together suggests an even higher cost of equity. Hence, it proposed a 14.86% return on equity as reasonable, and if anything, conservative. Using its 14.86% return on equity, applicant believes that it should be authorized a 11.50% return on rate base.

<u>ORA's Position</u>

ORA's comparable group of companies for use in its DCF analysis consisted of large telecommunications companies which, among other items, had combined local, toll, and access revenues consisting of more than 50% of total revenues in 1995. This consisted of eleven large telecommunications companies, all of which were included in applicant's comparable companies. The only differences between ORA's and applicant's companies is that applicant used four additional companies and split the companies into two groups between independents and RHCs.

ORA employed a three and five-year growth projection in its DCF analysis to reflect its view that the telephone industry is changing at a pace faster than in previous decades. To arrive at its dividend growth rate, ORA relied on both historical and forecasted rates for the comparable companies. The historical and forecasted earnings growth ranged from 5.08% to 10.95%, while its sustainable growth rate for the comparable companies averaged 5.85% for the past three year and 5.03% for the past five years, respectively. Using subjective judgment, ORA concluded that the comparable companies will experience a 5.50% to 6.00% long-term dividend growth rate. When this dividend growth range applied to the current three-month average dividend yield of ORA's comparable companies, it supports an equity return range of 9.86% to 10.38%.

When applied to the average six-month dividend yield it supports an equity return range of 9.76% to 10.28%.

For its CAPM analysis, ORA used the comparable companies average beta risk factor, forecasted interest rates, and historical intermediate and long-term market risk premiums for the time period from 1926 to 1994. ORA's analysis supports a 12.31% and 12.56% equity return based on the five-year treasuries, and thirty year treasuries, respectively.

ORA's RPM analysis shows the existence of a 1.78% average risk premium when its comparable companies are compared to 30-year treasury bond yields and .90% when compared to double A utility bonds. The adding of these average risk premiums to ORA's forecasted 6.82% interest rate and 7.74% double A utility bonds results in a 8.60% and 8.64% equity return, respectively.

Based on its DCF, CAPM, and RPM, ORA believes that investors currently require common equity returns within a range of 8.60% to 12.56% for small telephone companies, such as applicant. This range consists of the lowest and highest equity return as derived from its various analyses.

ORA declined to recommend a specific equity return. This is consistent with recent mid-size telephone companies' rate case proceedings in which the Commission opted not to adopt a specific equity return as an incentive for the utilities to manage their capital structures. However, upon its analysis of several factors including applicant's low financial risk, ORA concluded that a 10.30% equity return is a reasonable return to consider in arriving at a rate base return for small telephone companies, such as applicant. The factors weighed by ORA included applicant's past five years performance of actual rates of return and of financial ratios, continuance of cost recovery mechanisms, generation of internal capital, competition, potential delay in competition for small telephone companies, continued rate-base regulation, lower current and forecasted interest rates than when applicant was last authorized a return on equity and rate base.

ORA applied this 10.30% equity return to the average 75% equity and 25% debt capital structure, derived from its analysis of California small telephone companies, to develop a range of returns on rate base for the five small telephone companies (California-Oregon, Calaveras, Ducor, Sierra, and Foresthill) that filed a general rate proceeding in December, 1995. This analysis resulted in a range of return on rate base from 8.58% to 9.32%, which averaged 8.99%. Based on this analysis, and ORA's review of the risks faced by small telephone companies, ORA recommended a 9.00% return on rate base be adopted for applicant.

Discussion

We have consistently found in recent years that the DCF, CAPM, and RPM models used by the parties in general rate proceedings offer guidance to our determination of appropriate rates of return. However, because these models are necessarily dependent on subjective inputs, there are variations in their results and they do not provide absolute answers to questions regarding appropriate capital costs. We reaffirmed this view in D.89-10-031 (33 CPUC2d 43 (1989)), which established rates of return for GTE California, Inc. and Pacific Bell, noting that we continue to view these models with considerable skepticism. Consistent with our past application of financial models in determining capital costs, we will consider the models put forth by the parties, but use our judgment in determining a reasonable range of capital costs for applicant.

By D.89-10-031, we also stated our view that adopting a return on rate base without reference to an adopted capital structure provides the utility with an incentive to manage its capital structure efficiently. We will also apply this principle to applicant. This will provide applicant with the flexibility to increase or decrease its equity return through management of its debt cost and capital structure while maintaining a reasonable return on rate base. Therefore, we decline to adopt a specific equity return and will focus instead on an appropriate return on rate base.

The adopted return on rate base, consistent with the Federal Power Commission v. Hope Natural Gas Company 320 U.S. 591 (1944), must provide applicant's investors an opportunity to earn an equity return equivalent to returns on alternative investments in other firms with comparable risk. Hence, we scrutinized applicant's and ORA's financial and risk analyses to derive a benchmark range of reasonable equity returns for applicant, as a small telephone company, which will provide applicant's investors an equity return commensurable with alternative investments.

Our scrutiny of the financial models in this proceeding shows that applicant's 71.21% actual and 70.79% estimated test year equity ratios are much higher than applicant's and ORA's comparable companies' 51% average equity ratio. This indicates that applicant's financial risk is lower than that of comparable companies in applicant's and ORA's financial analyses due to less leveraged capital.

Applicant's risk is also mitigated when compared to the study-group companies because of applicant's choice to continue with traditional rate-base regulation instead of opting for the new incentive rate regulation, as well as continued participation in revenue recovery pools, such as the California High Cost Fund and various settlement pools.

We observe that applicant's risk is further mitigated through its plan to not raise any significant amount of capital during the test year. We note that applicant's 28.82 times average pretax interest coverage for the past five years exceeds Standard & Poor's 4.5 times pretax interest coverage benchmark for a double A debt rating.

We also observe that ORA's DCF and RPM analyses are based on a combination of historical and forecasted growth rates to mitigate the inability of forecasted growth rates to track with actual growth rates. This contrasts with applicant's reliance on only forecasted rates. ORA used all of its economic data results from its study group to arrive at an equity range in its DCF analysis. Applicant, however, excluded two-thirds of its own economic data results from its constant growth DCF analyses as being illogical since it produced results with equity returns below 10.00% and above 14.00%. In addition, ORA's CAPM analyses is based on the arithmetic mean of stock market data as compared to applicant's use of arithmetic and geometric mean. Such differences support the theory that subjectivity is used in the financial models to identify alternative investments to equity returns and that model results need to be scrutinized.

Both ORA's and applicant's study groups consisted of large telecommunications companies. All eleven companies included in ORA's study group were also included in applicant's group of fifteen companies. Although applicant increased its calculated alternative investments equity returns by 30% to reflect the difference in size and liquidity between the study group of large companies and applicant's small size, ORA did not make any such adjustment. We do not necessarily concur with applicant's 30% risk premium to compensate applicant for its small size as compared to the large companies in the study group. However, we do concur that applicant's risk is impacted by its small size in relation to the large size of the companies in the study group.

Local competition also must be considered and weighed carefully. Such competition may come from a multitude of telecommunications providers such as wireless carriers, cable service providers and competitive local carriers. Cellular carriers, being in existence since the late 1980's, should be considered a mitigated risk since there is no evidence that applicant has been adversely impacted by these carriers from the start of their operations. On the other side, cable companies and other wireless service providers such as personal communications carriers are new to the local exchange arena. Although there was no evidence presented to demonstrate that these entities have impacted applicant's operations, they have the potential to impact applicant's operations. In addition, competitive local exchange carriers may opt to compete with applicant if applicant does not obtain a local competition exemption from the FCC. Hence, the potential competition from cable carriers, wireless service providers, and competitive local carriers increases small telephone companies risk, which, in this case, is somewhat mitigated by applicant's sparsely populated rural terrain and reliable service.

Finally, we observe that interest rates are again on the rise. The 7.37% cost of 30-year treasury bonds in 1994 decreased to 6.88% in 1995, but began turning around in 1996 at 6.89% and was projected to increase to 7.02% for the test year. Accordingly, our determination of a reasonable range of equity returns for alternative investments will reflect this increased-interest-rate trend.

Although ORA concluded that investors would require a 8.60% to 12.56% equity return range to invest in alternative investments, it chose to recommend the 10.30% mid-point of its equity range. Similarly, applicant selected the mid point of its equity range. We find that the selection of a specific equity rate provides less flexibility for applicant to manage its equity return than we would like. Hence, we opt for a range of reasonableness.

Upon consideration, evaluation, and weighting of applicant's and ORA's financial and risk analyses with the above mentioned observations of mitigated and increased risks, we find that a reasonable equity range for small telephone companies, such as applicant, should be 10.10% to 14.06%. This range is derived by applying a 150 basis point increased risk factor to the low and high ends of ORA's recommended 8.60% to 12.56% equity range. It is also approximately 150 basis points above the upper range of applicant's 11.50% to 12.50% equity range prior to its addition of a risk premium for small telephone companies.

With the above ranges of equity ratios and return on equity for small telephone companies, applicant's adopted return on rate base should be set to provide it with an equity return that falls within the small telephone companies' equity ratio range. In other words, an equity ratio at the bottom of the 60% to 80% small-telephone-companies' equity-ratio range should compensate a utility at the upper end of the 10.10% to 14.06% small telephone companies' equity return range. Conversely, an equity ratio at the top of the small telephone companies equity ratio range should be compensated at the low end of the small telephone companies equity return range. This is because equity ratios at the lower end of the range require a higher equity return to compensate shareholders for increased risk.

Applicant's requested 11.50% return on rate base applied to its 70.79% equity ratio results in a 14.83% return on equity, approximately 86 basis points above the top range of the equity return range for small telephone companies with 60% equity. We decline to adopt applicant's proposed return on equity for this reason.

ORA's 9.00% recommended return on rate base provides shareholders with a 11.32% equity return within the range for small telephone companies; however, it does not adequately compensate shareholders for the additional risk associated with the mid-range equity ratio. We also decline to adopt ORA's recommended rate of return on equity for this latter reason. Applicant's equity ratio requires a equity return within the 12.00% to 13.00% range based on the reasonable ranges of equity ratios and return on equity. We find that a 10.00% return on rate base resulting in a 12.70% return on equity will adequately compensate shareholders for their risk and is fair and reasonable to ratepayers and shareholders.

This return on rate base applied to the mid point of the 60% to 80% common equity range found reasonable for small telephone companies results in a 12.81% equity return, as shown in the following tabulation, and is well within the equity return range found reasonable for small telephone utilities in this proceeding.

	Ratio	Cost	Weighted Cost
Long Term Debt	30.00%	3.44%	1.03%
Equity	70.00	12.81	8.97
Total	100.00%		10.00%

The application of this 10.00% authorized return on rate base to applicant's proposed capital structure found reasonable in this proceeding results in a 12.70% equity return, well within the reasonable range of common equity for small telephone companies. Applicant has the flexibility to increase or decrease its equity return through management of its debt cost and equity ratios. The following tabulation reflects applicant's capital structure with the adopted 10.00% return on rate base.

	Ratio	Cost	Weighted Cost
Long Term Debt	29.21%	3.44%	1.01%
Equity	70.79	12.70	8.99
Total	100.00%		10.00%

Summary of Earnings

The Commission is not obligated to accept applicant's and ORA's agreed-upon separated results of operations at present rates. However, upon evaluation of the evidentiary record in this proceeding and consideration of the specific explanations for disagreements between ORA and applicant, we conclude that the adopted intrastate results of operations absent such an agreement would be nominally different. For example, applicant and ORA provided persuasive testimony why each other's revenue estimates for access and pool rates of return should not be adopted. By the joint exhibit, applicant and ORA have agreed upon a 3.32% and 5.20% rate of return for access and toll revenue, respectively. The agreed upon returns are the approximate returns we would adopt if not for the agreement. It is for this reason that we adopt applicant's and ORA's joint intrastate results of operations for the 1997 test year at present rates.

Our adopted 1997 intrastate results of operations at present rates is $3,502,652 in revenues, $2,328,129 in expenses, $481,020 in taxes, $693,503 in net operating revenue, and $4,871,935 in average rate base. This produces a 14.23% rate of return on rate base at present rates.

A gross revenue requirement decrease of $343,366 is required to produce the 10.00% adopted test year rate of return found reasonable for applicant. Appendix B to this order sets forth applicant's adopted results of operations at present and proposed rates.

Rate Design

After the total revenue requirement is determined in a rate proceeding, there still remains the need to distribute that revenue requirement among the various components of applicant's rate structure.

Applicant proposed to withdraw its two-party business and residential services and other services for which there are no customers. It also proposed minor changes in other rates to make them comparable to those of other local exchange companies, and to increase its bill and keep surcharge.

Applicant did not contemplate a revenue requirement reduction and therefore, presented no evidence on how a revenue reduction should be implemented. However, upon review of ORA's rate design proposal, applicant concurs with ORA that a billing surcredit should be used for the revenue reduction. Applicant does not concur with ORA's proposal to reduce the existing residential access line below the $16.85 per month level because it would need to return its residential basic monthly rates to this level prior to accessing the California High Cost Fund (CHCF) in the future, if needed. In addition, applicant has a complaint (C.95-06-068) pending regarding a group of customers in its Jenny Lind exchange seeking free local calling into San Andreas. Applicant estimates it will cost approximately $100,000 to provide the requested service if the complaint is granted.

ORA concurred with applicant's proposal to withdraw two-party service and other services for which there are no customers. It also proposed to eliminate applicant's existing 8.57% surcharge, and to apply any remaining revenue requirement decrease to reduce applicant's business and residential flat rate exchange service charges with any remaining balance being put into a surcredit.

Subsequent to the closing of the evidentiary hearing, Senate Bill 1035 (Chapter 675) was enacted, effective January 1, 1997. This measure, among other matters, amends Public Utilities (PU) Code § 2893 to prohibit telephone corporations, including applicant, from charging any of its customers for having an unlisted or unpublished telephone number. Such telephone services shall continue to be free until local telephone service becomes competitive. The Commission is required to implement this change on a revenue neutral basis, and not eliminate any such charges prior to the effective date upon which offsetting rates are implemented by the Commission.

Neither applicant nor ORA had an opportunity to comment on the impact PU Code § 2893 on applicant's rate design. However, this application does address applicant's rate design and, absent the reopening of this proceeding or the opening of a generic proceeding to implement Senate Bill 1035, it is unknown when applicant's next rate review will occur. Accordingly, the assigned ALJ recommended in his proposed decision that the tariff charges for unlisted and unpublished telephones be withdrawn by this order and that applicant maintain revenue neutrality for the $1,949 test year revenue generated by such services through a reduction in the overall revenue decrease being required by this order. All parties were provided an opportunity to comment on this proposal in their respective comments to the ALJ's proposed order.

Of concern to us in applicant's proposal, and ORA's concurrence to upgrade customers from two-party service to one party service, is the financial impact on the customers currently paying for two-party service. Based on present tariff rates, the six two-party business service customers and 128 residential two-party customers would experience a $3.35 monthly increase in basic rates from $16.85 to $20.20 for business service and from $13.50 to $16.85 for residential customers.

The proposal to upgrade service from two-party to one-party service is consistent with the customers' basic service rights as set forth in the Universal Service Order (D.96-10-066) and implements the goal to have single party local service available to all California customers. None of the affected customers appeared or spoke at the public participation hearing. Hence, we concur with the proposal to upgrade two-party service to one-party service. However, the financial impact to such customers will not materialize due to the adopted rate structure which results in one-party service monthly rates being lower than the monthly rate for two-party service.

Although applicant recommends that its $16.85 monthly rate for residential basic service remain at that level, ORA recommends it be reduced by $6.85 to $10.00 a month. Applicant wants this rate to remain constant so that it may readily access the CHCF as an external funding source should it need future revenue recovery. Any reduction in this rate will require applicant to return to the current $16.85 rate prior to accessing CHCF funds.

We observed in the Universal Service Order (D.96-10-066) that, except for the one-time recovery of 1995 "IRD" impacts, draws from the CHCF-A have not been significant and that the small independent telephone companies, including applicant, do not anticipate that draws from the CHCF-A under the current rules will be significant. Applicant explains that the telecommunications industry changes taking place at the state and federal level may require applicant to access the CHCF-A in the near future.

Applicant's concerns may develop into reality. However, it has not convinced us that it will need to access the CHCF in the near future. Given the magnitude of the rate reduction being authorized, it is reasonable to, along with other ORA proposals, reduce the basic service charge.

Applicant recommends that the surcredit mechanism set forth in the ALJ's proposed decision be used to a greater degree so that it may avoid radical rate changes that may occur because of the FCC's consideration of interstate universal service funding changes, Pacific Bell's Application 97-03-004 for authority to reduce toll rates, and the Jenny Lind EAS complaint case.

ORA disagrees with applicant's recommendation because ORA and applicant considered the interstate universal service funding issue before submitting a Joint Exhibit, Exhibit 320, containing agreed upon revenue for interstate universal service funding. In addition, the EAS route sought by the Jenny Lind Exchange subscribers is pending in a proceeding not consolidated with this rate application. ORA opposes keeping this general rate proceeding open pending a decision on whether the EAS route should be established and, if so, what the cost of implementing that route should be.

Applicant's rate change concern, to the extent not reflected in the Joint Exhibit, is not a reality at this time.

Future impacts of rates, if any, should be addressed in the respective proceeding impacting rates. Hence, the surcredit should not be used as a vehicle to provide for future rate impacts that are both unknown and uncertain.

With the exception of those areas of differences already addressed, applicant's and ORA's rate design proposals do not materially differ. We rely on ORA's rate design proposal to spread the revenue reduction. The revenue reduction should be used to eliminate applicant's billing surcharge; withdraw two party, nonpublished service rates, foreign exchange service, special billing number service, voice mail services for which there are no customers; and other changes proposed by ORA. Specifically, we adopt ORA's proposal to reduce business and residential flat rate monthly service, semi public coin box service rates, restructure of inside wire maintenance service for non-recurring service and intra-building network cable services from quarter hour increments to an hourly rate, with the implementation of a billing surcredit for the remaining unspread revenue reduction. A summary of the rate changes we will adopt is included in Appendix C to this order.

Section 311 Comments

The ALJ's proposed decision on this matter was filed with the Docket Office and mailed to all parties of record on March 7, 1997, pursuant to § 311 of the PU Code. Comments and reply comments to the ALJ's proposed order were timely received from applicant and ORA.

Rule 77.3 of the Commission's Rules of Practice and Procedure specifically requires Section 311 comments to focus on factual, legal, or technical errors in the Proposed Decision and in citing such errors requires the party to make specific references to the record. Comments which merely reargue positions taken in briefs accord no weight and are not to be filed. New factual information, untested by cross-examination, must not be included in comments and must not be relied on as the basis for assertions made in post publication comments. Rule 77.4 requires comments proposing specific changes to the Proposed Decision to include supporting findings of fact and conclusions of law.

We have carefully reviewed the comments filed by the parties to this proceeding that complied with Rule 77.3 and to the extent that such comments required discussion or changes to the Proposed Decision, the discussion or changes have been incorporated into the body of this order. Comments which have not complied with Rule 77.3 were not considered.

Findings of Fact

1. Applicant sought authority under a traditional general rate proceeding to earn a 11.50% return on its 1997 test year rate base with a 14.86% return on equity producing an overall increase of approximately $101,000, over forecasted separated intrastate test year revenues at present rates.

2. Notice of the application appeared on the Commission's Daily Calendar of December 28, 1995.

3. D.96-05-029 approved the parties' agreement that applicant's rates and charges should be subject to refund from January 1, 1997, the beginning of the 1997 test year, through the effective date of the rates and charges set by an order in this proceeding.

4. A generic investigation (I.96-04-016) into applicant's rates, charges, service, practices, and regulations was consolidated with this application.

5. A duly noticed public participation hearing (PPH) was held before the ALJ in Copperopolis on August 26, 1996.

6. No customer spoke in opposition to the application at the PPH.

7. An evidentiary hearing was held in San Francisco on September 10, 11, and 13, 1996.

8. ORA found applicant's informal complaint records to be inadequate and that applicant has an unusually high number of monthly disconnects.

9. Applicant's service quality is reasonable.

10. Applicant's forecasted 1997 intrastate results of operations produced a 10.28% return at present rates as compared to ORA's forecasted results of applicant's operations which produced 14.99%.

11. Applicant and ORA sponsored a jointly exhibit setting forth applicant's and ORA's agreed upon version of the differences between their test year intrastate results of operations, resulting in a 14.23% return on intrastate rate base at present rates.

12. No opposition to the jointly filed exhibit was received.

13. In sponsoring the joint exhibit, applicant and ORA do not necessarily agree to the methodology used by either party to develop their respective results and do not intend for the joint exhibit to constitute a precedent to be used in any other rate case or proceeding pending or which may be filed in the future before the Commission.

14. The agreed upon results of operations at present rates between ORA and applicant results in a recommended rate decrease of $424,452 and $221,739 by ORA and applicant, respectively.

15. ORA's original 1.74997 net-to-gross multiplier excluded the state income tax allowance from the federal income tax component of the calculation.

16. State income tax expense is deductible from income when calculating federal income tax expense.

17. D.89-11-058 requires the test year federal income tax expense calculation to utilize the prior year's, not current year's state income tax expense.

18. ORA used its intrastate test year state income tax expense as a deduction to calculate its test year federal income tax expense.

19. ORA revised its net-to-gross multiplier from 1.75184 to 1.66433 to bring its net-to-gross method into conformance with its test year federal income tax estimate for this proceeding and with the method adopted in Citizens' and Roseville's general rate proceeding.

20. Applicant concurs with ORA's revised net-to-gross multiplier.

21. Applicant proposes a projected capital structure of 29.21% debt and 70.79% equity for its test year.

22. Applicant concludes that a reasonable capital structure for a small telephone company is between 60% and 80% equity.

23. ORA concurs with applicant's capital structure.

24. Applicant used its 3.44% embedded cost of debt as compared to ORA's calculated 3.43%.

25. Applicant seeks a 11.50% return on rate base with a 14.83% equity return as compared to ORA's recommended 9.00% return on rate base and 10.31% equity return.

26. Applicant and ORA supported their equity returns with DCF, CAPM, and RPM analyses.

27. Applicant applied its DCF analyses to two groups of large telecommunications companies consisting of eight independent telephone companies and seven RHCs.

28. Applicant's constant growth DCF analysis rejected all equity costs below 10.00% and above 14.00% as being implausible values.

29. Applicant concludes from its DCF, CAPM, and RPM analyses that a reasonable equity cost for large telecommunications firms is 12.00%, based on an overall range of 11.50% to 12.50%.

30. Applicant applied a 360 basis point premium to the 12.00% equity cost to arrive at a 15.60% equity cost for small telephone companies, such as applicant.

31. ORA's comparable group of companies for use in its DCF analysis consisted of eleven large telecommunications companies were also included in applicant's comparable group of companies.

32. ORA believes that its DCF, CAPM, and RPM analyses substantiates that investors currently require a 10.30% common equity return, the mid point of its 8.60% to 12.56% common equity range for small telephone companies, such as applicant.

33. ORA concluded that a 10.30% equity return is a reasonable return to consider in arriving at a rate base return for small telephone companies.

34. The DCF, CAPM, and RPM models are dependent on subjective inputs.

35. The adoption of a return on rate base without reference to an adopted capital structure provides the utility with an incentive to manage its capital structure efficiently.

36. Applicant's 71.21% actual and 70.79% estimated test year equity ratios are much higher than that of applicant's and ORA's comparable companies' 51% average equity ratio.

37. Applicant's financial risk is lower than that of the comparable companies in applicant's and ORA's financial analyses due to less leveraged capital.

38. Applicant's risk is mitigated when compared to the study-group companies because of applicant's choice to continue with traditional rate-base regulation and continued participation in revenue recovery pools instead of opting for the new incentive rate regulation.

39. Applicant's risk is mitigated through its plan to not raise any significant amount of capital during the test year.

40. Applicant's 28.82 times average pretax interest coverage for the past five years exceeds Standard & Poor's 4.5 times pretax interest coverage benchmark for a double A debt rating.

41. Local competition comes from a multitude of telecommunications providers such as wireless carriers, cable companies, and competitive local exchange carriers

42. Applicant proposes to withdraw its two-party business and residential service and upgrade such customers to one-party service.

43. No customer appeared at the PPH to oppose the withdrawal of two-party service.

44. Applicant concur with ORA that a billing surcredit should be used to implement the revenue reduction.

45. Applicant does not concur with ORA's proposal to reduce the existing residential access-line below the $16.85 per month level.

46. Applicant has a complaint pending before the Commission regarding a group of customers in its Jenny Lind exchange seeking to include local calling into the San Andreas exchange.

47. ORA's rate design proposal eliminates the existing 8.57% surcharge, decreases business and residential access line service rates on a proportionate basis, and implements a billing surcredit for the remaining unapplied revenue requirement decrease.

48. Senate Bill 1035 prohibits telephone corporations from charging any of its customers for having an unlisted or unpublished telephone number and requires the Commission to implement this change on a revenue-neutral basis.

49. The ALJ recommended withdrawal of applicant's unlisted and unpublished tariff rates and to offset projected revenue losses from the revenue requirement decrease required by this order.

50. All parties had an opportunity to comment on the ALJ's proposal to withdraw unlisted and unpublished tariff rates.

Conclusions of Law

1. Applicant should maintain a detailed informal complaint file and should review its disconnect procedures.

2. A 1.66433 net-to-gross multiplier should be used for the 1997 test year, resulting in a $1,664 change in gross revenue for every $1,000 change in net revenue.

3. A reasonable range of common equity for small telephone companies, such as applicant, should be between 60% and 80%.

4. Applicant's test year capital structure of 29.21% debt and 70.79% equity is reasonable and should be used for the 1997 test year.

5. Applicant's 3.44% embedded cost of debt is reasonable and should be used for the 1997 test year.

6. Applicant should have the flexibility to increase or decrease its equity return through the management of its debt cost and equity return while maintaining a reasonable rate base return.

7. A specific equity return should not be adopted.

8. A reasonable range of equity returns should be adopted so that applicant may have flexibility to manage its equity return.

9. A reasonable range of equity returns for small telephone companies should be between 10.10% and 14.06%.

10. A 10.00% return on rate base, which results in a 12.70% equity return, is reasonable and should be adopted for applicant because it appropriately recognizes risk and provides investors with a fair equity return.

11. Applicant's and ORA's joint intrastate results of operations at present rates should be adopted, which results in a 14.23% rate base return.

12. A $343,366 gross revenue requirement decrease is reasonable and should be adopted for the test year.

13. Applicant should withdraw its tariff charges applicable to unlisted and unpublished tariff services with the related lost revenue requirement offset against the revenue requirement decrease being required by this order.

14. ORA's rate design proposal should be adopted as set forth in Appendix C.

15. The surcredit being authorized by this order should be used to benefit all of applicant's customers and not be restricted or reserved for the outcome of the pending Jenny Lind exchange complaint case.

16. The decrease in rates and charges authorized in Appendix B and Appendix C are just and reasonable, and the present rates, insofar as they differ from those prescribed, are for the future unjust and unreasonable.

17. The revenue requirement reduction being authorized by this order should be applied retroactively to January 1, 1997, pursuant to D.96-05-029, and should flow back to ratepayers through a monthly surcredit not later than nine months after the effective date of the revised tariffs being required by Ordering Paragraph 1 of this order.

18. The application should be granted to the extent provided for in the following order.

O R D E R

IT IS ORDERED that:

1. Calaveras Telephone Company (applicant) shall file revised tariffs consistent with this order, the revenue requirement and revenue reduction in Appendix B, and the rates and charges in Appendix C. This filing shall comply with General Order (GO) 96-A. The revised tariffs shall become effective when authorized by the Commission's Telecommunications Division, but not less than five days after filing, and shall apply only to services rendered on and after their effective date.

2. Applicant shall establish a temporary surcredit balancing account to accumulate the revenue reduction required by this order from the effective date of the approved tariffs set forth in Ordering Paragraph 1 retroactive to January 1, 1997. Applicant shall file a tariff, consistent with GO 96-A, to refund the

temporary surcredit balancing account over a time period not to exceed nine months from the effective date of this order. This temporary surcredit shall be applicable to the same billing base that applicant used for its 8.57% surcharge rate.

3. Applicant shall maintain a detailed informal complaint file and review its disconnect procedures to resolve the Office of Ratepayer Advocates concerns addressed in this order.

4. Applicant shall withdraw its business and residential two party services; eliminate its 8.57% billing surcharge; withdraw its tariff charges for nonpublished listing charges, Semi-Public Coin Box minimum charge, Foreign Exchange Services, Special Billing Services, inside wire tariff and intrabuilding network cable rates at quarter hour increments; reduce its business and residential customers basic monthly service rates; and, implement a billing surcredit and other charges as summarized in Appendix C to this order.

5. Applicant shall notify its customers of the new rates, terms, and conditions adopted herein within 30 days after the date of this order, or, if performed by a bill insert, shall be completed within 60 days of the effective date of this order. Prior to such notification, applicant shall submit a draft of its customer notice to the Commission's Public Advisor for review and approval.

6. The application is granted to the extent set forth above.

7. Application 95-12-075 and Investigation 96-04-016 are closed.

This order is effective today.

Dated April 9, 1997, Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners

APPENDIX A

CALAVERAS TELEPHONE COMPANY
INTRASTATE RESULTS OF OPERATIONS
TEST YEAR 1997 AT PRESENT RATES

	ORA's Estimate	Applicant's Estimate	Joint Estimate
Operating Revenues			
Local Network Revenues	$1,519,410	$1,319,005	$1,531,960
Network Access Service	705,493	740,163	732,450
Long Distance Network	1,184,177	1,236,560	1,225,395
Miscellaneous	17,472	17,472	17,472
LESS Uncollectibles	4,625	4,625	4,625
Gross Operating Revenue	3,421,927	3,308,575	3,502,652
Operating Expenses			
Plant Specific	355,732	407,696	391,538
Plant Non-Specific	81,529	89,013	85,312
Depreciation & Amort.	573,914	573,914	573,914
Customer Operations	186,475	259,668	211,846
Corporate Operations	992,963	1,108,961	1,065,519
Total Operating Expense	2,190,613	2,439,252	2,328,129
Operating Taxes			
Federal Income Tax	349,814	236,159	332,161
State Income Tax	99,772	71,220	94,737
Taxes Other Than Income	54,122	54,122	54,122
Total Operating Taxes	503,708	361,501	481,020
Net Operating Revenue	727,606	507,822	693,503
Rate Base			
Plant in Service	$8,872,443	$8,872,443	8,872,443
Plant Construction	67,431	67,431	67,431
Materials & Supplies	46,730	46,730	46,730
Working Cash	193,155	275,359	209,812
LESS Depreciation Res.	4,101,984	4,101,984	4,101,984
LESS Deferred Tax	220,454	220,454	220,454
LESS Customer Deposits	2,043	0	2,043
Total Average Rate Base	4,855,278	4,939,525	4,871,935
Rate of Return	14.99%	10.28%	14.23%

(END OF APPENDIX A)

APPENDIX B

CALAVERAS TELEPHONE COMPANY
INTRASTATE RESULTS OF OPERATIONS
TEST YEAR 1997 AT PRESENT & ADOPTED RATES

	Present Rates	Adopted Rates
Operating Revenues		
Local Network Revenues	$1,531,960	$ 1,188,594
Network Access Service	732,450	732,450
Long Distance Network	1,225,395	1,225,395
Miscellaneous	17,472	17,472
LESS Uncollectibles	4,625	4,161
Gross Operating Revenue	3,502,652	3,159,750
Operating Expenses		
Plant Specific	391,538	391,538
Plant Non-Specific	85,312	85,312
Depreciation & Amort.	573,914	573,914
Customer Operations	211,846	211,846
Corporate Operations	1,065,519	1,065,519
Total Operating Expense	2,328,129	2,328,129
Operating Taxes		
Federal Income Tax	332,161	225,881
State Income Tax	94,737	64,424
Taxes Other Than Income	54,122	54,122
Total Operating Taxes	481,020	344,427
Net Operating Revenue	$ 693,503	$ 487,194
Rate Base		
Plant in Service	$8,872,443	$8,872,443
Plant Construction	67,431	67,431
Materials & Supplies	46,730	46,730
Working Cash	209,812	209,812
LESS Depreciation Res.	4,101,984	4,101,984
LESS Deferred Tax	220,454	220,454
LESS Customer Deposits	2,043	2,043
Total Average Rate Base	$4,871,935	$4,871,935
Rate of Return	14.23%	10.00%

(END OF APPENDIX B)

APPENDIX C
CALAVERAS TELEPHONE COMPANY
TEST YEAR 1997 ADOPTED TARIFF CHANGES

Tariff		Monthly Rate Change	
No.	Item	From	To
A- 1	Business Service		
	Individual Lines	$20.20	$12.00
	Two Party Line Service	16.85	0
	Key Line Service	20.20	12.00
	Central Office Trunk	30.30	18.00
	Residential Service		
	Individual Lines	16.85	10.00
	Two Party Line Service	13.50	0
A- 5	Semi-Public Coin Box		
	Individual Line	5.05	30.00
	Minimum Charge	6.00	0
A-10	Foreign Exchange Service		
	Each Quarter Mile	1.00	0
	Each Residential Line	11.50	0
A-13	Directory Listing		
	NonPublished Service	.15	0
A-25	Billing Surcharge	8.57%	0
	Billing Surcredit	0	1/
A-26	Inside Wire Maintenance		
	Hourly Normal Rate	0	40.00
	Hourly Overtime Rate	0	50.00
A-27	Voice Mail	4.20	4.00
	Local Call Placed	1.20	0
A-32	Intra-building Network Cable		
	Hourly Normal Rate	0	40.00
	Hourly Overtime Rate	0	50.00

SERVICE WITHDRAW

A- 1 All Two Party Business and Residential Services.
A- 5 Semi Public Coin Box Minimum Charge.
A-10 Foreign Exchange Service.
A-11 Special Billing Number Services.
A-13 NonPublished Services.
A-25 Billing Surcharge.
A-26 Inside Wire Maintenance Quarterly Hour Charges.
A-27 Voice Mail Service With No Customers and Local Call Placement.
A-32 Intra-building Network Cable Quarterly Hour Charges.

1/ Actual surcredit to be calculated by applicant and to be included in its tariff filing which implements rates authorized by this order. Workpapers supporting the surcredit calculation shall be included with applicant's tariff filing.

(END OF APPENDIX C)