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Decision 97-04-036 April 9, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of California-Oregon Telephone Co. (U-1006-C) to restructure intrastate rates and charges for telephone services furnished within the State of California.	Application 95-12-073 (Filed December 26, 1995)
Order Instituting Investigation into the rates, charges, service, practices and regulation of California-Oregon Telephone Co. (U-1006-C).	I.96-04-015 (Filed April 10, 1996)

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.

OPINION

Summary

This order requires California-Oregon Telephone Co. (applicant) to reduce its intrastate rates by approximately 3.00% or $77,581 in its 1997 test year, effective January 1, 1997. A 10.00% return on rate base found reasonable for applicant produces an 13.06% return on equity when applied to applicant's test year capital structure of 39.98% debt and 60.02% equity.

Applicant is authorized to withdraw its business, residential, and employee two-party services; eliminate its 8.57% billing surcharge,[1] withdraw its tariff charges for nonpublished listing charges; change its inside wire maintenance and intrabuilding network cable charges from quarter hour increments to hourly rates; standardize semi-public coin box, visit charge and E 9-1-1 services across exchanges; and to bring the Newell and Tulelake business one-party and key line services towards a standardized rate across exchanges. Appendix C to this order summarizes the adopted tariff changes.

Request

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

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1 The 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.

(NRF). Applicant's last general rate case decision was issued in 1982, pursuant to Resolution T-10607.

By its application, applicant sought authority under a traditional general rate proceeding to earn a 11.50% return on its 1997 test year rate base with a 15.59% return on equity, producing an overall increase of approximately $69,000 over forecasted 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 incremental revenue requirement increase to $119,500.

Procedural Background

Notice of the application appeared on the Commission's Daily Calendar of December 28, 1995. A prehearing conference (PHC) was held on March 7, 1996 in San Francisco before 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

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.

schedule and refund procedure agreed to by all parties was approved on May 8, 1996, pursuant to D.96-05-028.

Subsequent to the PHC and prior to the issuance of D.96-05-028, we opened a generic investigation (I.96-04-015) 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 Tulelake on September 24, 1996. Applicant's and ORA's personnel were available to respond to specific customer questions. Although several customers attended the PPH, none chose to speak.

An evidentiary hearing was held before Commissioner Neeper and the ALJ in San Francisco on September 10 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. Public Utility regulatory Analyst III Francis W. Fok, Senior Utilities Engineer W. Harold Rayburn, Public Utilities Regulatory Analyst III Linda J. Woods, Associate Utilities Engineer Jerry H. Shiu, and Public Utility 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 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 2,800 access lines in unincorporated portions of Siskiyou and Modoc Counties and the Cities of Dorris and Tulelake 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.

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 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 report regarding the nine service quality standards found no anomalies. ORA also reviewed applicant's customer complaint files and verified records to the Commission's Consumer Affairs Division for the past three years. No formal complaints have been filed with the Commission during this time period. We find that applicant's service quality is reasonable.

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 8.64% 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 11.48% intrastate return on average 1997 rate base at present rates. The 2.84% difference in return on average rate base between applicant and ORA resulted from the use of different operating revenues, operating expenses, and rate base estimates.

Applicant's $2,495,436 intrastate operating revenue estimate at present rates was $152,362 lower than ORA's $2,647,798 estimate. The difference in estimates occurred in forecasting local, access, toll, and miscellaneous revenues. Applicant's local revenue estimate excluded estimated 1997 revenues for "CLASS" services, including Caller ID, as compared to ORA's estimate which included these services. Another difference in local service revenue resulted from forecasted FCC Universal Service Fund (USF) estimates. Applicant based its estimate on a proposed revision being considered in FCC Docket No.96-45 as compared to ORA's estimate based on currently authorized FCC USF payments. 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 $1,896,460 intrastate operating expense estimate before taxes at present rates was $24,713 higher than ORA's $1,871,747 estimate. This difference in operating expense is attributed to the use of different forecasting methods. Applicant used a three-year average cost per access line times a 3.1% inflation factor for 1996 and 1997 to forecast its operating expenses. ORA used used a 1993 through 1995 three year average of inflation adjusted 1995 constant dollars.

Applicant's $4,180,449 average intrastate rate base at present rates was $101,762 higher than ORA's $4,078,687 estimate. This difference in rate base estimates is primarily attributable to plant in service and working cash estimates. The plant in service difference resulted from applicant including estimates for construction projects deferred until 1997. The working cash difference resulted from a disagreement on whether amounts attributed to the California Franchise Tax and taxes other than income should be included in the working cash calculation. ORA's position was that Standard Practice U-16 (Working Cash Procedure) dictates that the working cash requirement is equal to the average monthly operating expenses, exclusive of taxes and depreciation, multiplied by a certain number of months.

At the conclusion of the evidentiary hearing, applicant and ORA sponsored a joint exhibit, post-hearing Exhibit 120, setting forth in tabular form applicant's and ORA's agreed upon version of the differences between their test year intrastate results of operations, resulting in a 11.14% 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 $145,440 rate decrease by ORA and a $24,209 rate increase by applicant.

<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.

Applicant calculated a 1.66208 net-to-gross multiplier for its 1997 test year as compared to ORA's 1.75067. The 0.08859 net-to-gross multiplier difference resulted from ORA excluding 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), which requires the test year federal income tax expense 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's federal income tax expense.

ORA did not apply this flow-through method of accounting for state income tax on a consistent basis. Unlike its 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 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 1.75067 to 1.66337. ORA's method is now consistent with its test year federal income tax estimates and with the method adopted in Citizens' and Roseville's general rate proceedings.

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 the method used in Citizens' and Roseville's recent general rate cases, and applicant's concurrence with ORA's revised net-to-gross multiplier of 1.66337 should be adopted. We adopt the revised net-to-gross multiplier of 1.66337 as derived in the following mathematical calculation. Gross revenues will require a $1,663 change for every $1,000 change in net revenues.

Gross Revenue Change	1.00000
Less Uncollectibles @ 0.078%	.00078
	.99922
Less State Income Tax @ 8.84%	.08833
	.91089
Less Federal Income Tax @ 34.00%	.30970
Net Income	0.60119
Net-to-Gross Multiplier	
(Gross Revenue Change/Net Income)	1.66337
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Capital Structure

Applicant proposes a projected capital structure of 39.98% debt and 60.02% equity for its 1997 test year, which does not substantially deviate from its 1996 projected capital structure of 45.77% debt and 54.13% 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 the 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 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 2.5% 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 18 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 applicants 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%.

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 ratio is at the low end of the 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 to be issued during the test year. Since applicant does not plan on issuing any new debt during the test year, it used its 5.40% embedded cost of debt. ORA calculated applicant's embedded cost of debt to be 5.39%. This 0.01% difference between applicant and ORA is not material. We find applicant's 5.40% cost of long-term debt for its 1997 test year is reasonable.

Cost of Capital

Applicant requests a 11.50% overall return on rate base with a resulting 15.57% 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 principal 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 16 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 nonconstant growth DCF analysis. This application of the DCF analysis produced an 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 nonconstant 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 nonconstant 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 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 suggest an even higher cost of equity. Hence, it proposed a 15.59% return on equity as reasonable, and if anything conservative. Using its 15.59% return on equity, applicant requested that it be authorized an 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 consistently of more than 50% of total revenues in 1995. This consisted of 11 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 years 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 is 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 30-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, based upon its subjective 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. These 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 the analysis, and ORA's review of the risks faced by samll telephone companies, ORA recommended a 9.0% return on rate base be adopted for applicant.

<u>Discussion</u>

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 provide the utility with an incentive to manage its capital structure efficiently. We will also apply this principle equally 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 a 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 54.13% actual and 59.98% imputed test year equity ratios are 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 (CHCF) 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 6.35 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 in equity returns and that model results need to be scrutinized.

Both ORA's and applicant's study groups consisted of large telecommunications companies. All 11 companies included in ORA's study group were also included in applicant's group of 15 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 to date. On the other side, cable companies and other wireless service providers, such as personal communications services 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 carriers may opt to compete with applicant if applicant does not obtain a local competition exemption from the Federal Communications Commission. Hence, the potential competition from cable companies, 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 from 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 59.98% equity ratio results in a 15.59% return on equity, approximately 153 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 11.42% equity return within the small telephone companies' equity range, however, it does not adequately compensate shareholders for the additional risk associated with the low end of the equity ratio range. We also decline to adopt ORA's recommended return on equity for this latter reason. Applicant's equity ratio requires an equity return within the 13.00% to 14.00% 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 13.08% 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 11.97% 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%	5.40%	1.62%
Equity	70.00	11.97	8.38
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 13.06% equity return, within the upper side of the reasonable range of common equity for small telephone companies. This is because applicant has leveraged its equity in a direction which imposes more risk to the shareholders, justifying the higher end of the equity range. Applicant has the flexibility to increase or decrease its equity return through management of its debt cost and equity ratio. The following tabulation reflects applicant's capital structure with the adopted 10.00% return on rate base.

	Ratio	Cost	Weighted Cost
Long-term Debt	39.98%	5.40%	2.16%
Equity	60.02	13.06	7.84
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 $2,636,387 in revenues, $1,882,674 in expenses, $299,109 in taxes, $454,604 in net operating revenue, and $4,079,633 in average rate base. This produces a 11.14% rate of return on rate base at present rates.

A gross revenue requirement decrease of $77,581 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 proposes to withdraw its two-party business and residential service; increase its returned check charges, inside wire maintenance plan, nonpublished service; restructure its various labor charges for customer premise visits; and to increase its bill and keep surcharge.

Applicant did not contemplate a revenue requirement reduction and, therefore, presented no evidence on how such a decrease should be implemented. However, it did testify that the first priority in rate design should be to standardize rates for monthly service across its four exchanges. Regardless of the revenue requirement adopted, applicant does not believe that its existing access line rates should be reduced below the $16.85 monthly rate. This would allow it to access the CHCF in the future, if needed.

ORA concurred with applicant's proposal to withdraw two-party service. It also proposed eliminating applicant's existing surcharge, standardize rates across exchanges where disparate rates currently exist, and to decrease business and residential flat rate exchange service on a proportionate basis.

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 $3,702 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 on the ALJ's proposed decision.

Of concern to us is the financial impact on the customers currently paying for two-party service that will be upgraded to one-party service. Based on present tariff rates the 12 two-party business service customers in the Dorris and Macdoel exchanges will experience a $3.30 monthly increase in basic rates from $22.45 to $25.75 and the two-party business customers in the Newell and Macdoel exchanges will experience a $8.05 monthly increase in basic rates from $23.45 to $31.50. The 61 residential customers on two-party service in the Dorris and Macdoel exchanges will experience a $1.30 monthly increase in basic rates from $15.50 to $16.65 and the 86 customers in the Newell and Tulelake exchanges a $3.30 monthly increase from $13.50 to $16.85. Currently, there are no employees under the two-party service rate.

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. Of the customers being impacted, the Newell and Tulelake two-party business customers are most impacted. However, we will reduce their financial burden for upgraded one-party service through the use of unapplied revenue reductions to bring their one-party line rate down toward the lower Dorris and Macdoel monthly rate. Hence, we concur with this proposal.

Although applicant recommends that the standarized $16.85 basic residential monthly rate for its four exchanges remain at that level, ORA recommends it be reduced by $2.40 to $14.45. Applicant wants the residential basic rate to remain unchanged 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 in the near future.

Given the magnitude of the rate reduction being authorized, our desire to eliminate the current surcharge, withdraw nonpublished tariff rates, and standardize rates across applicant's four exchanges, there are insufficient funds to change the residential monthly basic rate. Hence, applicant's residential basic rates should not be changed. At the same time we observe that applicant's continued ability to access the CHCF mitigates the risk of investors.

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 and nonpublished service rates, and to standardize monthly rates across applicant's four exchanges. Specifically, we adopt ORA's proposal for semi public coin box, inside wire maintenance service, visit charges, intra-building cable service, and E 9-1-1 service. The remaining revenue reduction amount should be used to bring the Newell and Tulelake business one-party and key line services down towards the Dorris and Macdoel exchanges $25.75 monthly service rate.

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 Section 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 15.59% return on equity producing an overall increase of approximately $119,500 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.96-05-028 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.96-04-015) into applicant's rates, charges, service, practices, and regulations was consolidated with this application.

5. A duly noticed PPH was held before the ALJ in Tulelake on September 24, 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, and 13, 1996.

8. Applicant's service quality is reasonable.

9. Applicant's forecasted 1997 intrastate results of operations produced an 8.64% return at present rates as compared to ORA's forecasted results of applicant's operations which produced 11.48%.

10. Applicant and ORA sponsored a joint 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 11.14% return on intrastate rate base at present rates.

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

12. 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.

13. The agreed upon results of operations at present rates between ORA and applicant results in a recommended rate decrease of $145,440 by ORA and a $24,209 rate increase by applicant.

14. The 0.8859 net-to-gross multiplier difference between applicant's 1.66208 and ORA's 1.75067 resulted from ORA excluding the state income tax allowance when calculating the federal income tax component of the calculation.

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

16. 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.

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

18. ORA revised its net-to-gross multiplier from 1.75067 to 1.66337 to bring its net-to-gross method into conformance with its test year federal income tax estimate for this proceeding, consistent with the method adopted in Citizens' and Roseville's general rate proceedings.

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

20. Applicant proposes a projected capital structure of 39.98% debt and 10.02% equity for its test year.

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

22. ORA concurs with applicant's capital structure.

23. Applicant used its 5.40% embedded cost of debt as compared to ORA's calculated 5.39%.

24. Applicant seeks a 11.50% return on rate base with a 15.56% equity return, as compared to ORA's recommended 9.00% return on rate base and 10.31% equity return.

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

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

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

28. 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%.

29. 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.

30. ORA's comparable group of companies for use in its DCF analysis consisted of 11 large telecommunications companies were also included in applicant's comparable group of companies.

31. 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.

32. 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.

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

34. 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.

35. Applicant's 54.13% actual and 60.02% test year equity ratios are higher than that of applicant's and ORA's comparable companies' 51% average equity ratio.

36. 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.

37. 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.

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

40. Applicant's 6.35 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.

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

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

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

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

48. ORA's rate design eliminates the existing 8.57% surcharge and decreases business and residential access line service rates on a proportionate basis.

50. Senate Bill 1035 prohibit 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.

51. 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.

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

Conclusions of Law

1. A 1.66337 net-to-gross multiplier should be used for the 1997 test year, resulting in a $1,663 change in gross revenue for every $1,000 change in net revenue.

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

3. Applicant's test year capital structure of 39.98% debt and 60.02% equity is reasonable and should be used for the 1997 test year.

4. Applicant's 5.40% cost of debt is reasonable and should be used for the 1997 test year.

5. 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.

6. A specific equity return should not be adopted.

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

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

9. A 10.00% return on rate base, which results in a 13.06% equity return, is reasonable and should be adopted for applicant because it appropriately recognizes risk and provides investors with a fair equity return.

10. Applicant's and ORA's joint intrastate results of operations at present rates should be adopted, which results in a 11.14% rate base return.

11. A $77,581 gross revenue requirement decrease is reasonable and should be adopted for the test year.

12. Applicant's Tariff Schedule applicable to unlisted and unpublished tariff rates should be withdrawn with the related lost revenue requirement offset against the revenue requirement decrease being required by this order.

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

14. 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 herein, are for the future unjust and unreasonable.

15. The revenue requirement reduction being authorized by this order should be applied retroactively to January 1, 1997, pursuant to D.96-05-028, 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.

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

O R D E R

IT IS ORDERED that:

1. California-Oregon Telephone Co. (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 withdraw its business, residential, and employee two-party services, eliminate its 8.57% billing surcharge,

and withdraw tariff charges for nonpublished listing charges; change its inside wire maintenance and intrabuilding network cable charges from quarter hour increments to hourly rates; standardize semi-public coin box, visit charge and E 9-1-1 services across exchanges; and bring its Newell and Tulelake business one-party and key line services towards a standardized rate across exchanges.

4. 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.

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

6. Application 95-12-073 and Investigation 96-04-015 are closed.

This order is effective today.

Dated April 9, 1997, at San Francisco, California.

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

APPENDIX A
California-Oregon Telephone Co.
INTRASTATE RESULTS OF OPERATIONS
TEST YEAR 1997 AT PRESENT RATES

	ORA's ESTIMATE	APPLICANT'S ESTIMATE	JOINT ESTIMATE
OPERATING REVENUES			
Local Network Revenues	$ 1,399,292	$ 1,284,885	$ 1,399,292
Network Access Service	623,909	603,405	617,936
Long Distance Network	598,044	580,593	592,606
Miscellaneous	29,931	29,931	29,931
LESS Uncollectibles	3,378	3,378	3,378
GROSS OPERATING REVENUE	2,647,798	2,495,436	2,636,387
OPERATING EXPENSES			
Plant Specific	417,824	428,998	423,363
Plant Non-Specific	92,777	93,910	93,378
Depreciation & Amort.	753,007	756,100	753,007
Customer Operations	128,625	130,255	129,780
Corporate Operations	479,514	487,197	483,146
TOTAL OPERATING EXPENSE	1,871,747	1,896,460	1,882,674
OPERATING TAXES			
Federal Income Tax	195,833	139,536	189,005
State Income Tax	55,820	42,081	53,907
Taxes Other than Income	56,197	56,197	56,197
TOTAL OPERATING TAXES	307,850	237,814	299,109
NET OPERATING REVENUE	$ 468,201	$ 361,162	$ 454,604
RATE BASE			
Plant in Service	$ 8,108,354	$ 8,144,429	$ 8,108,354
Plant Construction	165,410	166,146	165,410
Materials & Supplies	39,416	39,592	39,416
Working Cash	137,911	170,043	138,857
LESS Depreciation Res.	4,017,774	3,987,656	4,017,774
LESS Deferred Tax	352,105	352,105	352,105
LESS Customer Deposits	2,525	0	2,525
TOTAL AVERAGE RATE BASE	$ 4,078,687	$ 4,180,449	$ 4,079,633
RATE OF RETURN	11.48%	8.64%	11.14%

(END OF APPENDIX A)

APPENDIX B
California-Oregon Telephone Co.
INTRASTATE RESULTS OF OPERATIONS
TEST YEAR 1997 AT PRESENT & ADOPTED RATES

	PRESENT RATES	ADOPTED RATES
OPERATING REVENUES		
Local Network Revenues	$ 1,399,292	$ 1,321,711
Network Access Service	617,936	617,936
Distance Network	592,606	592,606
Miscellaneous	29,931	29,931
LESS Uncollectibles	3,378	3,317
GROSS OPERATING REVENUE	2,636,387	2,558,867
OPERATING EXPENSES		
Plant Specific	423,363	423,363
Plant Non-Specific	93,378	93,378
Depreciation & Amort.	753,007	753,007
Customer Operations	129,780	129,780
Corporate Operations	483,146	483,146
TOTAL OPERATING EXPENSE	1,882,674	1,882,674
OPERATING TAXES		
Federal Income Tax	189,005	164,979
State Income Tax	53,907	47,054
Taxes Other than Income	56,197	56,197
TOTAL OPERATING TAXES	299,109	268,230
NET OPERATING REVENUE	$ 454,604	$ 407,963
RATE BASE		
Plant in Service	$ 8,108,354	$ 8,108,354
Plant Construction	165,410	165,410
Materials & Supplies	39,416	39,416
Working Cash	138,857	138,857
LESS Depreciation Res.	4,017,774	4,017,774
LESS Deferred Tax	352,105	352,105
LESS Customer Deposits	2,525	2,525
TOTAL AVERAGE RATE BASE	$ 4,079,633	$ 4,079,633
RATE OF RETURN	11.14%	10.00%

(END OF APPENDIX B)

APPENDIX C
Page 1
California-Oregon Telephone Co.
Test Year 1997 Adopted Tariff Changes

TARIFF NO.	ITEM	MONTHLY RATE CHANGE FROM	TO
A- 1	Business Service		
	Dorris & Macdoel		
	Two Party Service	$22.45	$ 0
	Newell & Tulelake		
	One Party Service	31.50	30.55
	Two Party Service	23.25	0
	Each Key Line	34.95	30.55
	Residential Service		
	Dorris & Macdoel		
	Two Party Service	15.55	0
	Newell & Tulelake		
	Two Party Service	13.50	0
A-10	Billing Surcharge	8.57%	0
A-12	Semi-Public Coin Box		
	Newell & Tulelake		
	Individual Line	34.95	26.40
A-23	Inside Wire Maintenance		
	Normal Working Hours	0	40.00
	After Working Hours	0	60.00
A-33	NonPublished Listing	.50	0
A-34	Visit Charge		
	Dorris & Macdoel		
	Normal Charge	39.65	40.00
	Overtime Charge	59.45	60.00
	Newell & Tulelake		
	Normal Charge	25.00	40.00
	Overtime Charge	37.50	60.00
A-38	Intrabuilding Cable		
	Normal Charge	0	40.00
	Overtime Charge	0	60.00
A-39	E-911 Service		
	Dorris & Macdoel		
	End Office Trunk	19.75	17.30
	PSAP Trunk	25.10	21.20

SERVICE WITHDRAWAL

A- 1 Business & Residential Two Party Services.
A-10 Billing Surcharge.
A-16 Employee Two Party Line Services.
A-23 Inside Wire Maintenance Service on 15 minute increments.
A-33 Nonpublished Listing.
A-38 Intrabuilding Network Cable Service on 15 minute increments.

(END OF APPENDIX C)