

Decision 99-04-027 April 1, 1999

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of Roseville Telephone Company (U 1015 C) to restructure intrastate rates and charges and to implement a new regulatory framework for telephone services furnished within the State of California.

Application 95-05-030  
(Filed May 15, 1995)

Order Instituting Investigation into the rates, charges, service, practices and regulation of Roseville Telephone Company.

Investigation 95-09-001  
(Filed September 7, 1995)

(For appearances see Decision 96-12-074.)

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## O P I N I O N

### 1. Summary

We modify Decision 96-12-074 as provided herein. Roseville Telephone Company shall adjust rates by including as other adjustments in its next new regulatory framework price cap filing the intrastate portions of an increase in total company expenses of \$148,148 (including interest from February 1, 1997), and an increase in rate base of \$1,505,595 (including rate of return from February 1, 1997). This will result in an additional increase of approximately 0.4% in overall revenues. This proceeding is closed.

### 2. Background

Decision (D.) 96-12-074 authorized Roseville (Roseville or applicant) a general rate increase of \$470,492 (0.6%) based on an overall rate of return of 10.0%, ordered limited further inquiry into service quality, authorized a new regulatory framework (NRF) similar to the NRF for Pacific Bell and GTE California Incorporated, and restructured applicant's rates following the rate design principles adopted in the Implementation Rate Design decision (D.94-09-065, 56 CPUC2d 117). On January 23, 1997, Roseville filed an application for rehearing.

Roseville alleged various legal and factual errors. Specifically, Roseville asserted that the decision provided inadequate explanations, or committed calculation errors, with respect to (1) a \$1.8 million annual revenue shortfall due to the adopted rate design, (2) the 4.5% output growth factor for most expenses, (3) the 6% growth factor for customer operations expenses, (4) allowance for funds used during construction (AFUDC), (5) telephone plant in service (TPIS), (6) an expense adjustment for three disallowed employees, and (7) fiber to the curb (FTTC) investment.

D.98-06-028 denied rehearing with respect to the annual shortfall of \$1.8 million. Applicant also included this shortfall in a petition for modification. The petition was granted by D.97-12-045, wherein we allowed recovery of \$1.6 million with interest for the shortage from February 1, 1997 through January 1, 1998, and permanently increased Roseville's rates effective January 1, 1998 by \$1.8 million annually.

D.98-06-028 granted rehearing with respect to five specific matters: (1) the output growth factor of 4.5% for most expenses, (2) the customer operations expense growth factor of 6%, (3) AFUDC, (4) TPIS, and (5) the reduction in expenses for three employees. Rehearing was granted "to allow for clarification of the calculations in question, and to modify and/or supplement the findings of fact and rate orders as shall be determined necessary." (Mimeo., page 2.) In addition, D.98-06-028 corrected a duplicative disallowance for FTTC, ordered the reinstatement of \$156,056 in rate base, and allowed Roseville an opportunity to review the rate calculations for this correction as part of the rehearing procedure.

To accomplish these goals, the Administrative Law Judge (ALJ) prepared a draft decision clarifying the calculations, and modifying the findings of fact and rate orders as necessary. No hearing was necessary for the purpose of clarifying the calculations, and modifying findings of fact and rate orders. Thus, the draft decision was not required to be filed and served on the parties. (Public Utilities (PU) Code § 311(d).) Nonetheless, the public interest required that it be served on the parties for comment. (Rule 77.1 of the Commission's Rules of Practice and Procedure (Rules).) Moreover, service of the draft decision allowed Roseville an opportunity to review the rate calculations correcting treatment of FTTC investment. The draft decision was served for comment on October 27, 1998.

Roseville filed comments on November 16, 1998, and ORA filed reply comments on November 23, 1998. Roseville's comments focused on two items:

calculation of the output growth factor, and treatment of the GTD-5 switch as part of TPIS. The Office of Ratepayer Advocates (ORA) replied that no errors were made in the draft decision, and no corrections are necessary. We reject Roseville's comments on calculation of the output growth factor, but make an adjustment in treatment of the GTD-5 switch, as explained in the appropriate sections below.

### 3. Discussion

#### **3.1 Output Growth Factor of 4.5%**

Roseville contends that the 4.5% output growth factor used for most adopted expenses (cited at mimeo., page 35 of D.96-12-074) is not found in the record.

The decision explains that the growth rate is "based on a composite of growth in access lines and minutes of use as representative of overall output growth." (Mimeo., page 35.) The rate is a simple average of the 1993 through 1996 rates of growth in access lines and minutes of use.<sup>1</sup>

Roseville also states that it is unable to verify the adopted results. The results are calculated by determining allowed and disallowed expenses in relation to the differences in recommended test year levels between Roseville and ORA. The differences are due to output growth, since Roseville does not dispute

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<sup>1</sup> Access lines: 4.7% in 1993-94 from Exhibit 7, Attachment D, page 1 ((94646-90375)/90375); 4.9% in 1994-95 and 5.1% in 1995-96 from Office of Ratepayer Advocates (ORA) Reply Brief, page 6. Minutes of use: 3.9% in Exhibit 15, Attachment C, adopting the 1993-94 rate through test year 1996;  $(1095.9 + 295.886 + 175.478)/(1077.2 + 273.719 + 156.878) = 1.039$ . The composite is:  $((4.7 + 3.9)/2) + ((4.9 + 3.9)/2) + ((5.1 + 3.9)/2)/3 = 4.4$ . The result is 4.4, not 4.5. D.96-12-074 incorrectly cited 4.5%, but the calculations for the decision correctly used 4.4. (See Attachment A).

the escalation factors.<sup>2</sup> The adopted approach reduces the output growth by our adopted total factor productivity. The allowed expense percentage (applied to the difference between recommended levels of expenses) is derived from the ratio of growth net of productivity to total growth, or 55.76%. (See Attachment A.) The disallowance percentage is 44.24% (1 minus 0.5576), and is applied to the difference between the estimates of Roseville and ORA.<sup>3</sup> The adopted results are reached by applying the disallowed expenses to Roseville's requested level of expenses.<sup>4</sup>

As noted in a previous footnote, on review of our calculations, we find that the composite growth is 4.4% (4.3% in 1993-94, 4.4% in 1994-95 and 4.5% in 1995-96), not the 4.5% cited in D.96-12-074. Our calculations were based on 4.4%, however, so no change is required in the adopted results due to this misstatement. We find, however, that our calculations actually used a productivity factor of 1.9% rather than 2.0%. Correcting the productivity factor adjustment increases the disallowance by \$127,756. (See Attachment A.)

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<sup>2</sup> See D.96-12-074 at page 35 (mimeo.). At pages 37-8 (mimeo.) we consider and reject other factors that might also account for the differences.

<sup>3</sup> D.96-12-074 explains our adopted approach, which generally describes the ORA methodology adjusted for output growth. The growth net of productivity from the base to the test year is captured by using data over three years. (See Attachment A.) Normalizing for nonrecurring costs is reflected by using ORA's test year recommendations as one element of the calculation.

<sup>4</sup> Total company disallowed expenses here are 44.24% of the difference in expenses due to expense methodologies: plant specific 44.24% of \$2,405,353, or \$1,064,128; plant nonspecific (less depreciation) 44.24% of \$712,550, or \$315,232; and corporate operations 44.24% of \$2,485,401, or \$1,099,541. (See Attachment A, page 1 of 2.) See Exhibit 75, page 2, column P, for the difference in expenses due to expense methodologies.

### **3.1.1 Comments on Draft Decision**

Roseville alleges that the adopted methodology understates output growth. When corrected, Roseville claims total authorized expenses should be increased by \$1,513,452. We are not persuaded.

#### **3.1.1.1 Components of Growth Factor**

Roseville says that the adopted methodology assumes cost increases needed to accommodate growth are caused only by growth in access lines and growth in minutes of use. Roseville is mistaken. The adopted methodology does not assume that these measures are the only causes of growth-related cost increases. Rather, as said in D.96-12-074, the adopted growth rate is "based on a composite of growth in access lines and minutes of use as representative of overall output growth." (Mimeo., page 35.) That is, these measures are representative. They are the only measures with some reasonable quantification in the record. Further, their use is supported by Roseville's testimony on this issue.

Roseville's testimony is that the dominant factors affecting test year expenses are inflation and output growth. (Exhibit 25, page 5, line 6.)<sup>5</sup> When explaining output growth, Roseville's witness specifically cites growth in access lines accompanied by an increased intensity of use.<sup>6</sup> (Exhibit 25,

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<sup>5</sup> The adopted methodology for estimating test year expenses uses both inflation and output growth. (D.96-12-074, mimeo, page 35.) The other factors are not characterized by Roseville's witness as dominant.

<sup>6</sup> Roseville presented an output-based forecast for comparison with ORA's test year forecasts. Roseville's witness, however, only used access lines to represent output, and did not incorporate minutes of use, or any other intensity of use factor. (Exhibit 25, page 11.) Thus, Roseville's output-based method provided no insight into how to include intensity of use.

page 5, lines 1-4.) Our adopted methodology incorporates growth in access lines and intensity of use, where we measure intensity of use by minutes of use.

Roseville's comments also assert that other drivers of output growth must be considered beyond growth in access lines and growth in minutes of use. Roseville identifies technology changes and introduction of new services as examples.<sup>7</sup> Roseville's comments, however, cite no record evidence in support of these two cost drivers.<sup>8</sup> Roseville's comments cite no record evidence stating the specific other factors that it alleges must be considered as cost drivers. Roseville's comments cite no record evidence that quantifies the rate of change of the two identified additional factors, or other factors. Roseville cites no record evidence generally showing how Roseville's output or expenses change with changes in these two additional, or other, factors.<sup>9</sup> Roseville cites no record evidence that directly and specifically applies any quantification of these additional and other variables to the exact change in output or expenses.

Without specifics, we believed before, and continue to believe now, that it is unwise to include these other factors with any specificity in overall output growth, and the resulting effect of output growth on adopted expenses. We reject simply increasing expenses by a "margin" to somehow "account" for these other factors. Moreover, even if we were persuaded to in

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<sup>7</sup> Roseville says of the others: "et cetera." (Comments, page 4.)

<sup>8</sup> Rule 77.3 requires that comments make specific references to the record: "Comments shall focus on factual, legal or technical errors in the proposed decision and in citing such errors shall make specific references to the record."

<sup>9</sup> For example, Roseville does not state whether output generally increases at a rate half the rate of technology changes, equal to the rate of technology changes, exponentially with the rate of technology changes, or at some other rate, and whether expenses generally increase at the same rate, or a different rate.



some way include these other factors, we are not convinced that these other factors always increase output and expenses. Technology changes may or may not increase overall output, but even if they increase output, they may decrease costs (e.g., fiber optic lines in place of copper lines may increase the capacity for output, and increase some categories of costs (e.g., investment in plant), but decrease other costs (e.g., operations and maintenance expenses); see D.96-12-074, mimeo., page 76.).<sup>10</sup> Similarly, introduction of new services may or may not increase overall output, and may decrease costs (e.g., a new service may replace an old, more costly service, with a net overall decrease in costs).

### ***3.1.1.2 Averaging Versus Adding Growth Components***

Roseville asserts that the adopted methodology errs in averaging growth in access lines and growth in minutes of use. Rather, Roseville argues that these measures should be added. Roseville raises several points in support.

Roseville says "access line growth and growth in minutes of use should be added as a minimum because there are additional drivers of output growth that the Commission did not consider." (Comments on the draft decision, page 4.) As stated above, we reject the notion of including a "margin" to account for these other factors. We also reject the specific proposal of adding growth in access lines and growth in minutes of use to somehow capture unquantified and largely unspecified other drivers of output growth. No evidence shows adding these components properly accounts for other factors. In fact, as noted above, some factors may decrease costs.

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<sup>10</sup> Expenses are the subject here, and may decrease with technology changes. All other things held equal, cost-effective technology changes result in cost decreases.

Roseville further contends that growth in access lines and growth in minutes of use are independent drivers of output growth and, as such, must be added. Roseville cites no record support that these drivers are independent, and presents no compelling argument to cause us to change our adopted methodology.

Roseville presents a hypothetical example in further support of its proposition that growth in access lines and minutes of use should be added.<sup>11</sup> The example purports to show that growth in access lines and growth in minutes of use per line produces growth in total minutes of use greater than the growth in total minutes of use calculated by averaging the growth in access lines and the growth in minutes of use per line. To demonstrate its point, Roseville's example multiplies lines times minutes of use per line to derive total minutes of use. Our adopted methodology, however, is already based on total minutes of use, not minutes of use per line. While Roseville's example may be interesting, and appears to be mathematically correct, it is irrelevant in relation to our adopted methodology, and does not persuade us to make any changes.

Roseville cites the specific testimony of its witness in further support of its proposal that the output measures must be added, not averaged. According to Roseville, the testimony:

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<sup>11</sup> The example starts with 100 access lines and 1,000 minutes of use per access line in year 1, for 100,000 total minutes of use. Year 2 assumes a 5% increase in access lines and a 5% increase in minutes of use per line, resulting in 105 access lines and 1050 minutes of use per line, for 110,250 total minutes of use. Roseville asserts that the methodology in the draft decision averages the 5% increase in access lines with the 5% increase in minutes of use to find an increase in total output of 5%, or 105,000 total minutes of use. Roseville argues that the full impact of the growth in access lines and minutes of use is 110,250 total minutes of use.

"...explained that increases in minutes of use should be reflected in the calculation of total output in addition to access line growth. Specifically, Dr. Mitchell observed, '[a]lthough the total number of access lines provides an indicator of the growth in Roseville's output, it is nevertheless only a partial measure of that growth.' (Mitchell (for Roseville), rebuttal testimony, Ex. 25 (BMM-2), at p. 13, ll. 12-13.) The effect of growth in access lines should be added to, rather than averaged with, the effect of growth in minutes of use to derive total output." (Comments on the draft decision, page 5, emphasis in original.)

This testimony does not support Roseville's claim. First, the cited testimony only states that the total number of access lines provides a partial measure of output growth. It does not provide any specific guidance on the exact method for combining several measures (i.e., whether they should be combined by addition, subtraction, multiplication, division, simple averaging, weighted averaging).

Second, the cited testimony is taken out of context.<sup>12</sup> The cited testimony is in response to a question on the "differences between

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<sup>12</sup> The entire question and answer is:

Q: Are there important differences between types of subscriber lines in the growth in access lines?

A: In Roseville's markets the number of business lines has been growing at a faster rate than residential lines. Since 1989, business lines have grown at an annual rate of 7.4%, compared to the annual growth of residential lines of 4.8%. This basic difference affects both the revenues and the costs Roseville will experience in 1996, as shown in Exhibit 6. [Exhibit 6 is a table showing the growth in access lines from 1989 through projected results in 1996; it does not show revenues and costs.]

Although the total number of access lines provides an indicator of the growth in Roseville's output, it is nevertheless only a partial measure of that growth. As a result of the more rapid growth in business lines, with their generally greater variety of services and rates of calling, Roseville's costs have been growing more rapidly than the total number of lines." (Exhibit 25, page 13, lines 4 - 16.)

types of subscriber lines in the growth of access lines." (Exhibit 25, page 13.) The answer discusses differences in the rates of growth of business and residential access lines, and the generally greater business line variety of services and rates of calling. Access lines, varieties of services and rates of calling are not minutes of use. The testimony does not specifically address minutes of use, nor how minutes of use should be treated in a composite measure of overall growth.

Finally, the testimony states that "Roseville's costs have been growing more rapidly than the total number of lines." (Exhibit 25, page 13.) The answer addresses business and residential line growth. There is no statement that growth in access lines and growth in minutes of use should be added.

Quite remarkably, Roseville's comments turn the testimony of its own witness into a new theory. The testimony asserts that: "Although the total number of access lines provides an indicator of the growth in Roseville's output, it is nevertheless only a partial measure of that growth." (Exhibit 25, page 13.) Roseville characterizes this as "increases in minutes of use should be reflected in the calculation of total output in addition to access line growth." (Comments on the draft decision, page 5, emphasis in original.) In the context of the testimony, "in addition to" reasonably means "something more than." Roseville, however, takes its own characterization of "in addition to" to mean the two measures should be strictly, mathematically, added. This is neither proposed in, nor supported by, any testimony cited by Roseville.

Rather, we decided then, and affirm now, that overall output growth should be measured by averaging the growth in access lines and growth in minutes of use. Just as we found ORA's averaging method over 1992 to 1994 to be a reasonable base for expenses (D.96-12-074, mimeo., page 35), averaging growth in access lines and growth in minutes of use provides a

reasonable base for average overall output growth. The goal is to calculate average total output growth. An average is not calculated by addition.

For example, assume Roseville identified 12 component measures of output growth,<sup>13</sup> each component measure grows at the 5% in Roseville's hypothetical example, and apply Roseville's novel recommendation (first made in its comments) to add component measures. The result would be a remarkable 60% overall growth in output. This would be an unreasonable method of calculating average overall growth. Rather, an average of overall output growth is derived by averaging, not adding, components.

#### ***3.1.1.3 Growth in Minutes of Use***

Roseville further argues that the 3.9% factor used for growth in minutes of use is too low. According to Roseville, data on growth in minutes of use was available from 1998 through 1994, and shows considerable fluctuation over the years. Roseville charges that use of 3.9% is arbitrary and capricious in that it picks one of the lowest growth rates. Roseville says the Commission should average more than one year's growth in minutes of use to arrive at the minutes of use growth factor for the test period.

To the contrary, the 3.9% factor is based on the latest available data (growth from 1993 to 1994). Using the lowest year (1989-1990), or an average of non-consecutive lowest years, might be arbitrary and capricious.

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<sup>13</sup> While Roseville's comments do not state or cite to each of these measures (relying only on "et cetera"), it is possible that Roseville's rebuttal witness generally described 12 measures: growth in business access lines, growth in residential access lines, growth in minutes of use, technology changes, introduction of new services, market characteristics, expansion plans, deployment of technology, deployment of systems, timing of expenditures due to software upgrades, adoption of new management information systems, and extension of new technologies deeper into the network. (Exhibit 25, pages 5 and 13; Comments, page 4.)

We do not do this. Rather, we use the same years for growth in minutes of use that we used for growth in access lines, and reasonably base our estimate of growth in minutes of use on the latest available data.

#### **3.1.1.4 Conclusion**

By adding growth components, and increasing the minutes of use component, Roseville recommends the Commission correct the 4.4% annual output growth factor (2.4% net of productivity) in the draft decision to adopt an annual output growth factor of at least 12.8% (10.8% net of productivity), and thereby increase adopted expenses by \$1,513,452. We find no evidence to corroborate the reasonableness of this rate of growth when applied to expenses, and Roseville points to none. In fact, we continue to believe, as we stated in D.96-12-074, that the reasonableness of the adopted growth rate less the productivity factor (i.e., 2.4%) is supported by it being close to the 2.6% real annual increase Roseville experienced from 1988 through 1994. (D.96-12-074, mimeo., page 37.) Annual growth in the range of 12.8% (10.8% net of productivity) is outside the range of reasonableness in relation to Roseville's experience.

Rather than point out factual, legal, or technical errors (as required by Rule 77.3), Roseville's comments essentially reargue previous arguments, present a new theory of adding growth components, and argue the reasonableness of another basis for measuring growth in minutes of use. These are all outside the authorized scope of comments. For this reason, as well as all the reasons stated above, we reject Roseville's comments on the draft decision, and reject Roseville's recommendation to increase adopted expenses by \$1,513,452.

### 3.1.2 Misleading Comments

Roseville's comments go beyond vigorous advocacy. For example, as explained above, Roseville turns the testimony of its own witness into a new theory for adding rather than averaging growth components. This new theory is neither proposed in, nor supported by, any testimony cited by Roseville.

Rule 1 of the Commission's Rules of Practice and Procedures states:

"Any person who signs a pleading or brief, enters an appearance at a hearing, or transacts business with the Commission, by such act, represents that he or she is authorized to do so and agrees to comply with the laws of this State; to maintain the respect due to the Commission, members of the Commission and its Administrative Law Judges; and never mislead the Commission or its staff by any artifice or false statement of fact or law."

The turning of the testimony into a new theory by clever application of the words "in addition to" is an artifice.<sup>14</sup> Moreover, the cited testimony does not say what Roseville's comments claim, and no cited evidence supports Roseville's novel new theory first made in its comments.<sup>15</sup> Roseville's characterization of its new theory as coming from the record is false. Thus, Roseville's comments mislead the Commission by an artifice and false statement.

By its comments on the output growth factor, Roseville sought an increase in rates of \$1,513,452. A penalty of up to \$1,513,452 might be reasonable for Roseville's violation of Rule 1. We decline, however, to adopt a

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<sup>14</sup> An artifice is "(1) skill or ingenuity (2) a clever expedient (3) trickery or craft (4) a sly or artful trick." (Webster's New World Dictionary, Third College Edition, 1988, page 78.)

<sup>15</sup> Rule 77.3 requires that comments make specific references to the record.

penalty. Roseville's comments fail to achieve Roseville's goal, and ratepayers are not harmed. Nonetheless, we put Roseville on notice that we will look closely at any potential or actual future Rule 1 violation, and we will be less likely to decline adoption of a penalty even if no harm to ratepayers has resulted.

### **3.2 Customer Operations Expense Growth Factor of 6.0%**

Roseville contends the 6% growth factor net of productivity for customer operations at page 37 of D.96-12-074 is not found in the record. Roseville says the decision does not make explicit the cost drivers used for customer operations that were not used for other expense categories.

The decision explains:

"We take into consideration the cost drivers identified by Roseville, which include the number of call completions, the quantity of directory assistance calls, product management, marketing and access line growth." (Mimeo., page 37.)

This contrasts with the cost drivers (access lines and minutes of use) used for growth of other expenses as explained at page 35. We continued, further explaining the difference with the factors used for other expenses:

"Roseville testifies that 25% of customer service costs are driven by an increasing array of complex products and services, especially those offered to business customers. Business lines are growing at a faster rate than residential lines. Therefore, we apply a larger composite growth net of the productivity factor, for a combined 6.0%." (Mimeo., page 37.)

The 6.0% output growth is derived by considering several factors. For example, work load indicators cited by ORA are 2.5% annual growth from



1992 to 1994 for bills processed and mailed,<sup>16</sup> and 4.4% for average in-service access lines. (Exhibit 101, page 8-6.) Business line growth was 7.35% in 1995 and 6.31% in 1996. (Exhibit 25, page 20.) Roseville sought an overall increase in customer operations expenses from its 1995 budget of 11.7% (14.6% final request).<sup>17</sup> This increase includes both escalation (3.1%<sup>18</sup>) and output growth. The output growth (i.e., net of inflation) is 8.6% (11.5% final request). Overall adopted total factor productivity is 2%. The adopted 6% expense growth factor net of productivity (8% before reduction of 2% for productivity) reflects the range of output growth factors (from 2.5% to 11.5%).

As further consideration, the 6% composite growth net of productivity for customer operations expenses is 3.5 percentage points more than the 2.5% adopted for other expenses (i.e., 6.0% compared to 2.5%).<sup>19</sup> The additional 3.5% reflects the other work load factors.

Roseville says it is unable to verify the adopted results. The results are developed as follows. Roseville requested test year 1996 customer operations

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<sup>16</sup> ORA points out that data on processed bills tend to show a lower annual growth rate than access lines due to multi-line business customers usually having their services billed under a single invoice. This effect is taken into account in weighing the various factors.

<sup>17</sup> 1996 budget of \$14,262,000 over 1995 budget of \$12,773,000 (total company), or 11.7%. (Exhibit 4, Attachment 4, page 1 of 1, line 10.) Roseville's final test year request (rounded to thousands) is \$14,635,000 (Exhibit 75, page 1, column A), compared to its 1995 budget of \$12,773,000 (Exhibit 4, Attachment 4, page 1 of 1, line 10), or a 14.6% increase.

<sup>18</sup> Roseville does not dispute ORA's price escalation factors. ORA uses forecast inflation of 3.1%. (Exhibit 101, page 8-7.)

<sup>19</sup> That is, the output growth factor of 4.5% for other expenses (corrected to 4.4%—see footnote 1), less 2.0% total factor productivity, for a net increase of 2.5%.

expenses of \$14,635,094. (Exhibit 75, page 1, column A, total company.) ORA recommended \$11,838,306 (i.e., an adjustment of \$2,796,788 for expense methodologies (Exhibit 75, page 2, column P)).<sup>20</sup> The decision escalates ORA's recommendation by 6.0% for work load factors net of productivity resulting in \$12,548,604.<sup>21</sup>

### **3.3 Allowance For Funds Used During Construction (AFUDC)**

Roseville contends the AFUDC adjustment discussed at page 77 is not found anywhere in the decision. Roseville says it is a figure that was derived or computed in some fashion by the Commission, but it is impossible to verify the calculation, or verify that it was derived from evidence in the record.

We adopted the parties' joint proposal to use Roseville's methodology for calculating the AFUDC adjustment in depreciation expense and plant in service, modified, as the parties agreed, to account for the Commission's other adopted results. (Exhibit 75, Joint Position Statement, paragraph 7, page 2 of 3.) Roseville's AFUDC adjustment is an increase of \$1,816,251 in plant in service, and an increase of \$268,512 in depreciation expense. (Exhibit 75, Joint Position Statement, paragraph 7, page 2 of 3.) The decision increases AFUDC for plant in service by \$1,727,518 (0.72% of TPIS) and \$263,926 in depreciation expense (0.11% of TPIS). This is done by adjusting Roseville's estimate by \$88,733<sup>22</sup> for TPIS and \$4,586 for depreciation expense:

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<sup>20</sup> \$14,635,094 (Exhibit 75, page 1, column A) less \$2,796,788 (Exhibit 75, page 2, column P) equals \$11,838,306.

<sup>21</sup> \$11,838,306 times 1.06 equals \$12,548,604.

<sup>22</sup> This is \$668 more than the adjustment taken in TPIS (see Section 3.4 below) due to rounding.

<u>LINE NO.</u>	<u>ITEM</u>	<u>ROSEVILLE</u>	<u>D.96-12-074</u>	<u>DIFFERENCE</u>
1	TPIS	\$250,564,856	\$239,933,041	
2	TPIS Adjustment for AFUDC	1,816,251	1,727,518	\$88,733
3	Percent of TPIS	0.72%	0.72%	
4	Depreciation Expense Adjustment	268,512	263,926	4,586
5	Percent of TPIS	0.11%	0.11%	

In Section 3.4 below, we increase TPIS by \$1,494,832 (from \$239,933,041 to \$241,427,873). Applying the percentages described above, the TPIS adjustment for AFUDC should be reduced by \$10,763, and the depreciation expense adjustment should be reduced by \$1,645.

LINE NO.	ITEM	AMOUNT
1	TPIS	\$241,427,873
2	Percent for TPIS for AFUDC	0.72%
3	TPIS Adjustment for AFUDC	1,738,281
4	Roseville recommended	1,816,251
5	Difference	77,970
6	D.96-12-074 adjustment	88,733
7	Correction to TPIS Adjustment	10,763
8	Percent of TPIS for Depreciation Expense	0.11%
9	Depreciation Expense	265,571
10	Roseville recommended	268,512
11	Difference	2,941
12	D.96-12-074 adjustment	4,586
13	Correction to Depreciation Expense Adjustment	1,645

### **3.4 Telephone Plant In Service**

Roseville contends that it is impossible to determine the test year TPIS. Roseville says the discussion at mimeo., page 80 (Section 5.5.11) obscures the issue by claiming Roseville failed to include an adjustment for, among other things, working cash and depreciation. Roseville says working cash and depreciation are not part of TPIS. Further, Roseville says the decision is contradictory on the GTD-5 switch, seemingly including the switch at mimeo., page 72 and Finding of Fact 41, but at mimeo., page 80 suggesting the GTD-5 switch is excluded from TPIS.

Roseville is correct that we misspoke when we attributed some of the TPIS adjustment to working cash and depreciation reserve. These items are

not part of TPIS. Section 5.5.11 was added to the proposed decision (PD) of the ALJ to address Roseville's comments on the PD. It was added at the end of the section on rate base (Section 5.5) with an incorrect reference to other items in Section 5.5. Correcting the text to delete references to working cash and depreciation reserve, however, the explanation remains correct, citing to adjustments for the expense methodology, salaries and wages, museum, FTTC, and AFUDC.

Roseville's comments on the PD failed to reflect the GTD-5 switch adjustment. We included the GTD-5 switch, but adopted Roseville's proposal to amortize the remaining portion of the GTD-5 switch over 2 years. (D.96-12-074, mimeo., p. 72.) The switch was planned for retirement in mid-1996. The disputed amount of \$2,397,721 (Exhibit 75, page 2, line 23, column R) was Roseville's proposed amount in rate base for the last year of its remaining life. It is this amount that we amortized over 2 years. We elected to do this by reducing the rate base amount by half of the disputed amount, or \$1,198,861. This is nearly the full amount of \$1,258,586 which Roseville contends was unexplained. (Roseville's Comments on the PD, dated December 2, 1996, page 3.) Other items are the employee adjustment, sale of Tahoe facility adjustment, and a different number for the AFUDC adjustment. Our calculation of TPIS is:

Roseville's Proposed TPIS	\$250,564,855
Less:	
Salary/Wages Adjustment	\$34,432
Employees Adjustment	4,688
Sale of Tahoe Adjustment	23,200
Methodology Adjustment	8,542,770
Museum Adjustment	219,611
AFUDC Adjustment	88,065
FTTC Adjustment	520,187
GTD-5 Adjustment	<u>1,198,861</u>
Total	\$10,631,814
TPIS in D.96-12-074	\$239,933,041

### 3.4.1 Comments on Draft Decision

Roseville asserts we incorrectly calculated treatment of the GTD-5 switch in our adoption of Roseville's proposal to amortize the remaining portion of the GTD-5 switch over two years. Roseville says correct treatment requires increasing TPIS for the GTD-5 switch by \$3,596,582.<sup>23</sup> We disagree in part, and agree in part, with Roseville's comments, and make necessary changes.

We disagree with Roseville's comment when Roseville says we decided that the GTD-5 switch should stay in service for ratemaking purposes until the end of 1997. That is, Roseville contends our decision means the full amount of the GTD-5 switch (\$4,795,442) should be reflected on both January 1 and December 31 of test year 1996, just as the full amount of all other plant is included that is in service both at the beginning and end of the test year.

<sup>23</sup> That is, Roseville would add \$3,596,582 to the \$1,198,861 already in TPIS, for a total of \$4,795,442.

To the contrary, we decided that the switch "should be included in rates as is any asset to the extent used and useful." (D.96-12-074, page 72.) There was neither any evidence that the switch would be used and useful through the entire test year, nor for two years. All the evidence was that the switch would be retired in mid-1996. Roseville did not propose, and we did not adopt, any suggestion that the switch would be used and useful during the entirety of the test year. We, therefore, disagree with Roseville that the entire cost of the switch (\$4,795,442) should be reflected in the test year in order to be consistent with what Roseville believes to be the decision's policy to amortize the remaining GTD-5 cost in the 1996 test year over two years.

We based our ratemaking treatment of the GTD-5 switch on the proposal made by Roseville in its reply brief:

"At a minimum, the Commission should permit a two year amortization of the \$2,397,721 remaining investment in rate base and its associated depreciation expense. This would permit Roseville to recover its investment over a short period of time without unduly burdening future customers and Roseville's ability to compete." (Reply Brief, page 88.)

We believe it would unduly burden ratepayers to now adopt Roseville's proposal to increase TPIS by \$3,596,582 to, in Roseville's view, properly amortize the remaining investment over two years. We are troubled that Roseville's comment proposes a treatment that would be worse for ratepayers than we understood from Roseville's reply brief. Thus, we decline to adopt Roseville's comment.

At the same time, however, we agree with Roseville that we misapplied the two year amortization by reducing the remaining value of the switch by half. Therefore, we correct our GTD-5 adjustment to include the amount of the GTD-5 switch originally recommended by Roseville, consistent

with its retirement in mid-1996. That is, we increase TPIS by \$1,198,861, to bring the GTD-5 switch to \$2,397,721 in the test year. For consistent ratemaking treatment of all aspects of the switch, we also reverse our two year amortization as expressed in depreciation expenses and reserves. This has the effect of adopting Roseville's original rate case proposal without modification from its reply brief.

Thus, we eliminate the GTD-5 adjustment (i.e., thereby increasing TPIS by \$1,198,861). We also reduce depreciation reserve by the amount of the adjustment we had applied for a two year amortization (\$137,030), and we increase depreciation expenses by the amount we had applied for a two year amortization (\$137,030).

### 3.4.2 Adjusted TPIS

In Section 3.5 below, we reinstate 61.55% of disallowed expenses for three employees. We, therefore, similarly increase TPIS by 61.55% of the \$4,688 that had been disallowed as part of the employee adjustment, for a net increase of \$2,885. Also, in Section 3.6 below, we reinstate \$156,056 of FTTC, and apply that increase here. Therefore, final TPIS (which we used in Section 3.3 above) is:

D.96-12-074	\$239,933,041
Change to employee adjustment	2,885
Change to FTTC adjustment	156,056
Reversal of GTD-5 adjustment	1,198,861
Reversal of depreciation reserve	137,030
Final TPIS	\$241,427,873
Increase in TPIS	\$1,494,832



### **3.5 Expense Adjustment for Three Employees**

Roseville asserts that neither of the decision's explanations for excluding recovery for three employees is supported by the record. Roseville contends that the decision commits factual error in its assertion that adopted employee growth is 22 from 1995 to 1996 as a result of applying the 4.5% expense growth factor. Rather, Roseville says employee growth is 12, since the expense growth is not 4.5% but 2.5% after applying the 2% productivity adjustment. Moreover, Roseville asserts the three-employee adjustment is an error because the decision had already reduced employee expenses based on its forecasting methodology, reducing employees and expenses by nearly \$4.5 million, according to Roseville. To illustrate, Roseville says ORA's development used Roseville's 1995 and 1996 additions as a starting point, and therefore had some evidence to support an analysis. The decision does not explicitly utilize either ORA's projection of test year employees or Roseville's projection, according to Roseville. Roseville says the decision uses its own method that does not take into account Roseville's employee additions for the test year. Roseville concludes that removal of three employees duplicates a disallowance already made through the forecasting methodology.

On review of our calculations, we find the disallowance duplicates the adjustment in part, and make the following changes. We delete the second paragraph in Section 5.2.3.3 of D.96-12-074. We adjust expenses for two employees excluded from corporate operations, and one from customer operations, as explained below.

Regarding corporate operations expenses, the adopted methodology applied a disallowance to the difference between the recommendations of ORA and Roseville. (See Section 3.1 above.) ORA's recommendation did not include the two employees, while they were included in Roseville's recommendation. To

apply the methodology consistently, the employees should have first been included or excluded from both estimates. That is, the employees could have been included in both recommendations (i.e., added to ORA's recommendation), the methodology applied, and the adjustment made, or the employees could have been excluded from both recommendations (i.e., subtracted from Roseville's recommendation), the methodology applied, and no further adjustment made. As applied in D.96-12-074, part of the expenses for the two employees were reduced twice.

We make the correction by reducing the difference between the recommendations of ORA and Roseville by \$153,723.<sup>24</sup> Of this difference, we had disallowed 44.24%. We, therefore, reinstate 44.24% of the \$153,723, or \$68,007.

For customer operations expenses, the adopted methodology escalated ORA's estimate by 6.0%. (See Section 3.1 above.) ORA's estimate already excluded the one employee also excluded in D.96-12-074. Therefore, we reinstate \$69,222.<sup>25</sup>

Thus, we had previously disallowed \$222,945 including benefits (D.96-12-074, mimeo., page 44) for the three employees. We now reinstate \$137,229, or 61.55% of the amount previously disallowed.

### **3.6 Fiber to the Curb**

Roseville asserts that the decision disallows Roseville's FTTC investment twice. First, the decision reduces Roseville's budgeted plant in

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<sup>24</sup> That is, we add back to ORA's recommendation \$153,723, reducing the difference between the recommendations by \$153,723. The excluded expenses for the two employees were \$125,030 (Exhibit 101, page 9-8), increased by 22.949% for benefits (Exhibit 74, page 2 of 2, benefits column), for a total of \$153,723.

<sup>25</sup> The excluded expenses were \$56,301 (Exhibit 101, page 8-7), increased by 22.949% for benefits (Exhibit 74, page 2 of 2, benefits column), or a total of \$69,222.

service by 30%, including FTTC, according to Roseville. Second, Roseville says the decision reduces FTTC costs that exceed the cost of copper.

Roseville is correct. We delete the first full paragraph in D.96-12-074 at mimeo., page 77. As provided in D.98-06-028, this item is corrected by reinstating \$156,056, subject to Roseville having the opportunity to review the rate calculations as part of the rehearing.

The adopted rate base estimating methodology excluded 30%, or \$8,542,770, including FTTC. The disallowed FTTC investment above the cost of copper was \$520,187, of which 30% (\$156,056) was already excluded by the rate base methodology. Therefore, we reinstate \$156,056, as we show in Section 3.4 above.

### **3.7 Rate Adjustment**

As a result of these changes, we reinstate on a total company basis \$148,148 in expenses, and \$1,505,595 in rate base, derived as follows:

LINE NO	SECTION	ITEM	EXPENSE	RATE BASE
1	3.1	Output Growth Factor	<\$127,756>	
2	3.3	AFUDC		\$10,763
3	3.3	Depreciation Expense	1,645	
4	3.4	GTD-5 Switch		1,198,861
5	3.4	Depreciation Reserve		137,030
6	3.4	Depreciation Expense	137,030	
7	3.4	Employee Adjustment		2,885
8	3.4	FTTC Adjustment		156,056
9	3.5	Employee Adjustment	137,229	
10	Total		148,148	1,505,595

Roseville is authorized to include the intrastate portion of these total amounts as other adjustments in its next NRF price cap filing. Roseville should be allowed to include interest on the expense adjustment from February 1, 1997 (the effective date of the new rates ordered in D.96-12-074) through the date the rates are changed by the price cap adjustment to provide Roseville an equivalent amount as if authorized February 1, 1997. Interest should be applied at the three-month commercial paper rate. (See, for example, D.97-12-045.) Roseville should also be allowed to include rate of return over the same period for the rate base adjustment, at the rate of return authorized in D.96-12-074. Roseville should provide supporting workpapers with its price cap filing which show Roseville's calculations, including the conversion to intrastate amounts, calculation of interest and rate of return amounts, and the effect on rates.

#### **Findings of Fact**

1. The output growth factor of 4.4% (inadvertently cited as 4.5% in D.96-12-074) is a simple average of the 1993 through 1996 rates of growth in access lines and minutes of use.
2. Adopted operating expenses (other than customer operations expenses, depreciation, and amortization) are calculated by determining allowed and disallowed expenses in relation to the difference in test year recommendations of ORA and Roseville. The difference in estimates is due to output growth, since Roseville does not dispute escalation factors. The allowed expense percentage is the ratio of the compounded output growth net of productivity to the compounded output growth, and the disallowed expense percentage is one minus the allowed expense percentage.
3. The disallowance percentage for operating expenses (other than customer operations, depreciation, and amortization) is applied to the difference in

estimates between ORA and Roseville, and is subtracted from Roseville's requested level of expenses.

4. The adopted results in D.96-12-074 incorrectly apply a total factor productivity factor of 1.9% rather than 2.0% in adopted expenses (other than customer operations, depreciation, and amortization), necessitating an increased expense disallowance of \$127,756.

5. The 6.0% growth factor net of productivity for customer operations expenses takes into consideration the cost drivers identified by Roseville (number of call completions, quantity of directory assistance calls, product management, marketing, and access line growth); the increasing array of complex products and services offered customers, especially business customers; growth in residential and business access lines, with faster growth in business lines relative to residential lines; work load indicators cited by ORA (annual growth in bills processed and mailed, annual growth in average in-service access lines); Roseville's requested percentage increase in customer operations expenses from its 1995 budget, recognizing both escalation and output growth; the adopted total factor productivity of 2.0%; and the relationship of the adopted growth net of productivity in customer operations relative to that adopted for escalating other expenses recognizing the additional work load factors for customer operations expenses.

6. Adopted customer operations expenses are 6.0% greater than the level recommended by ORA, reflecting work load factors net of productivity.

7. The AFUDC adjustment methodology adopts the agreement of the parties, which includes modifying the results for consistency with the Commission's other adopted results. (Exhibit 75, Joint Position Statement, paragraph 7, page 2 of 3.)

8. TPIS is calculated by adopting Roseville's recommendation for the GTD-5 switch from its initial showing, and making adjustments consistent with other adjustments for salary/wages, employees, sale of Tahoe, expense methodology, museum, AFUDC, and FTTC.

9. The output growth factor methodology for expenses other than customer operations applies a disallowance of 44.24% to the difference between ORA's recommendation (which excluded two specific employees) and Roseville's recommendation (which included the two employees) and, when the expenses for these employees are again eliminated, results in a portion of the expenses for these two employees being disallowed twice in D.96-12-074.

10. The adopted customer operations expense methodology escalated ORA's recommendation, which already excluded one employee, the expenses for whom were incorrectly excluded a second time in D.96-12-074.

11. Thirty percent of the \$520,187 disallowance for FTTC was already disallowed as part of the rate base estimating methodology in D.96-12-074.

12. Total company adjustments discussed herein must be converted to intrastate amounts in the forthcoming price cap filing in order to provide intrastate results consistent with adopted intrastate results in D.96-12-074, with application of interest on expenses and rate of return on rate base to provide Roseville equivalent amounts as if authorized February 1, 1997.

### **Conclusions of Law**

1. On a total company basis, additional expenses of \$148,148, and additional rate base of \$1,505,595, should be allowed.

2. Roseville should be authorized to include the intrastate portion of these total company changes as other adjustments in its next NRF price cap filing, with interest on the expense adjustment and rate of return on the rate base adjustment.

3. This decision should be effective today to allow Roseville to seek recovery of the amounts authorized herein as soon as possible.

## **O R D E R**

### **IT IS ORDERED that:**

1. Roseville Telephone Company shall include as other adjustments in its next new regulatory framework price cap filing the intrastate portion of total company increased authorized expenses in the amount of \$148,148, and increased authorized rate base of \$1,505,595. Roseville may include interest on the total company expense increase of \$148,148 from February 1, 1997 through the date the price cap adjustment becomes effective, and rate of return on the total company rate base adjustment of \$1,505,595 for the same period. Interest shall be calculated at the three-month commercial paper rate, and rate of return at the rate authorized in Decision 96-12-074. Roseville shall include workpapers with its price cap filing showing its calculations, including the conversion to intrastate amounts, the calculation of interest and rate of return amounts, and the effect on rates.

2. Application 95-05-030 and Investigation 95-09-001 remain open for consideration of Roseville Telephone Company's appeal of an Assigned Commissioner's Ruling regarding the verification/nonregulated operations audit.

This order is effective today.

Dated April 1, 1999, at San Francisco, California.

RICHARD A. BILAS  
President  
HENRY M. DUQUE  
JOSIAH L. NEEPER  
Commissioners



# ATTACHMENT A

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## EXPENSE DISALLOWANCE CALCULATION (TFP 1.9%)

<u>Year</u>	<u>Access Line Growth</u>	<u>MOU Growth</u>	<u>Avg.</u>	<u>Total Factor Productivity</u>	<u>Net</u>
93-94	4.7	3.9	4.3	1.9	2.4
94-95	4.9	3.9	4.4	1.9	2.5
95-96	5.1	3.9	4.5	1.9	2.6

Avg = access line growth plus MOU growth divided by 2

Net = avg minus productivity

Compounded Avg:  $1.043 \times 1.044 \times 1.045 = 1.13789$

Compounded Net:  $1.024 \times 1.025 \times 1.026 = 1.07689$

Allow percentage:  $.07689 / .13789 = 0.5576$

Disallow percentage:  $1 - 0.5576 = 0.4424$

<u>Item</u>	<u>Difference between RTC and ORA</u>	<u>Disallow (0.4424)</u>
Plant Specific	\$2,405,353	1,064,128
Plant Non-Specific (without depreciation)	712,550	315,232
Corporate Operations	2,485,401	1,099,541
TOTAL	5,603,304	2,478,901

## ATTACHMENT A

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EXPENSE DISALLOWANCE CALCULATION  
(TFP 2.0%)

<u>Year</u>	<u>Access Line Growth</u>	<u>MOU Growth</u>	<u>Avg.</u>	<u>Total Factor Productivity</u>	<u>Net</u>
93-94	4.7	3.9	4.3	2.0	2.3
94-95	4.9	3.9	4.4	2.0	2.4
95-96	5.1	3.9	4.5	2.0	2.5

Avg = access line growth plus MOU growth divided by 2

Net = avg minus productivity

Compounded Avg:  $1.043 \times 1.044 \times 1.045 = 1.13789$ Compounded Net:  $1.023 \times 1.024 \times 1.025 = 1.07374$ Allow percentage:  $1.07374 / 1.13789 = 0.5348$ Disallow percentage:  $1 - 0.5348 = 0.4652$ 

<u>Item</u>	<u>Difference between RTC and ORA</u>	<u>Disallow (0.4424)</u>
Plant Specific	\$2,405,353	1,118,970
Plant Non-Specific (without depreciation)	712,550	331,478
Corporate Operations	2,485,401	1,156,209
TOTAL	5,603,304	2,606,657

## Difference in disallowances

TFP 1.9% \$2,478,901

TFP 2.0% 2,606,657

Difference 127,756

(END OF ATTACHMENT A)

Decision 99-04-038

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of Roseville Telephone Company (U 1015 C) to restructure intrastate rates and charges and to implement a new regulatory framework for telephone services furnished within the State of California.

Application 95-05-030  
(Filed May 15, 1995)

Order Instituting Investigation into the rates, charges, service, practices and regulation of Roseville Telephone Company.

Investigation 95-09-001  
(Filed September 7, 1995)

**ORDER CORRECTING ERROR**

The Commission has been informed of an error in Decision (D.) 99-04-027. Therefore, pursuant to Resolution A-4661,

**IT IS ORDERED** that D.99-04-027 is corrected as follows:

The last sentence in the Summary (Chapter 1, mimeo., page 2) is changed from "This proceeding is closed" to "This proceeding remains open for consideration of the verification/nonregulated operations audit."

This order is effective today.

Dated April 15, 1999, at San Francisco, California.

/s/ WESLEY M. FRANKLIN

WESLEY M. FRANKLIN  
Executive Director