

DOCKET NO. 78

RE: THE APPLICATION OF SOUTHWESTERN
BELL TELEPHONE COMPANY FOR A RATE
INCREASE

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PUBLIC UTILITY COMMISSION
OF TEXAS

FINAL ORDER

The application of Southwestern Bell Telephone Company, hereinafter referred to as Southwestern Bell, for a rate increase was filed with the Public Utility Commission of Texas, hereinafter referred to as the Commission, on September 1, 1976, requesting a rate increase in the sum of \$298.3 million and the first pre-trial hearing on the matter was held on September 21, 1976, as reflected by the interim order, thereon, at which time the following parties were allowed to intervene as classes of rate payers for the limited purpose of protesting proposed telephone rates for their class:

1. The General Services Administration representing all of the Federal Agencies.
2. The Attorney General of the State of Texas and the Texas Municipal League representing all of the State Agencies and Cities of Texas.
3. Association of Community Organizations for Reform Now representing low income rate payers.
4. The Texas Alarm and Signal Association, the Texas Retail Federation and the Communications Workers of America, representing large and specialized rate payers, and the employees supporting such services.
5. Rate Band Cities Numbers 1 to 5 representing the cities in their band.
6. Rate Band Cities Number 6 representing the cities in their band.
7. Rate Band Cities Number 7 representing the cities in their band.
8. Rate Band Cities Number 8 representing the cities in their band.
9. Rate Band Cities Number 9 representing the cities in their band.
10. Rate Band Cities Number 10 representing the cities in their band.
11. The complaint by the Fisk Telephone Company against Southwestern Bell was consolidated with Docket No. 78, however, due to the inability of Fisk to participate in the proceedings, said cause was severed before the end of the hearing and placed back in its original position for hearing under Docket No. 156.
12. All telephone companies having settlement contracts with Southwestern Bell for long distance or toll service, as follows: Alto Telephone Company, Big Bend Telephone Company, Inc., Central Texas Telephone Co-op., Inc.,

Coleman Co. Telephone Co-op., Inc., Colorado Valley Telephone Co-op., Inc., Conroe Telephone Company, Continental Telephone Company of Texas, Eastex Telephone Co-op., Inc., Fort Bend Telephone Company, Guadalupe Valley Telephone Co-op., Inc., Gulf States-United Telephone Company, Hill Country Telephone Co-op., Inc., Industry Telephone Company, Inc., Lufkin Telephone Exchange, Inc., Muenster Telephone Corporation of Texas, Nocona Telephone Company, Palo Pinto Telephone Company, Peoples Telephone Company, Inc., Poka-Lambro Rural Telephone Co-op., Inc., Rocksprings & Nueces Canyon Telephone Company, Santa Rosa Telephone Coop., Inc., South Plains Telephone Co-op., Inc., Sugar Land Telephone Company, Taylor Telephone Co-op., Inc., Texas-Midland Telephone Company, Trinity Valley Telephone Company, Inc., Valley Telephone Co-op., Inc., XIT Rural Telephone Co-op., Inc., AC Telephone Company, Avery Telephone Company, Blossom Telephone Company, Bluffdale Telephone Company, Brazoria Telephone Company, Brazos Telephone Co-op., Byers and Petrolia Telephone Company, Cameron Telephone Company, Campbell Telephone Co-op., Inc., Cap Rock Telephone Company, Inc., Clifton Telephone Company, Coahoma Telephone Company, Colmesneil Telephone Company, Comanche County Telephone Company, Inc., Community Telephone Company, Cumby Telephone Co-op., Inc., Electra Telephone Company, Etex Telephone Co-op., Inc., Five Area Telephone Co-op., Inc., Frio Canyon Telephone Company, Ganado Telephone Company, Inc., Garrison Telephone Company, Inc., Garwood Telephone Company, Inc., Gary Telephone Company, Home Telephone Company, Hooks Telephone Company, Inc., Karnak Telephone Company, Kerrville Telephone Company, Knippa Telephone Company, Lake Telephone Company, Lake Dallas Telephone Company, Inc., Lakeside Telephone Company, La Ward Telephone Exchange, Inc., Lipan Telephone Company, Livingston Telephone Company, Lueders Telephone Company, Mid-Plains Rural Telephone Co-op., Inc., Mid-State Telephone Company, Mid-Texas Telephone Company, Montague Telephone Company, Mustang Telephone Company, O'Donnell Telephone Company, Peoples Telephone Co-op., Riviera Telephone Company, Inc., Rhome Telephone Company, Romain Telephone Company, Inc., Saint Joe Telephone Company, San Marcos Telephone Company, Inc., S. W. Arkansas Telephone Co-op., Inc., Sweeny-Old Ocean Telephone Company, Tatum Telephone Company, Tri-County Telephone Company, Inc., United Telephone Company,

Valley View Telephone Company, Warren Telephone Company, Waterwood Telephone Company, Inc., Wes-Tex Telephone Co-op., West Texas Rural Telephone Co-op., Inc., Wise Co. Telephone Company, Inc., General Telephone Company of the Southwest

The staff of the Commission participated on behalf of the public interest of the people of Texas and though not a party to the proceedings per se, did fully participate in such proceedings.

The hearing began on November 1, 1976, and continued through November 24, 1976. The Commission, based on the evidence, oral testimony, exhibits and pre-filed testimony, and official notice of the contents of the entire rate filing package submitted by Southwestern Bell including the work papers in connection therewith, all responses to requests for information submitted by the Commission staff to Southwestern Bell, together with all complaints received from rate payers up to the final date of said hearing as well as the Commission's records involving Southwestern Bell and all reports received from said company, the Commission's Substantive Rules, and The Public Utility Regulatory Act, makes the following Conclusion, supported by the Findings of Fact and Conclusions of Law below with the findings of fact being based upon evidence received and information officially noticed:

Conclusion

Based on the Test Year Southwestern Bell has a revenue deficit of \$57,828,000 and should be allowed to adjust its proposed rates so as to standardize rates statewide and produce the required revenue to eliminate the deficit.

The findings of fact and conclusions of law supporting this conclusion are:

Findings of Fact

- I. The invested capital of Southwestern Bell is \$3,030,707,000 based on original cost as reflected by the books of the company as:
 - A. Computed by the staff in the amount of \$3,237,592,000 adjusted to remove construction work in progress in the amount of \$219,024,000 from the rate base because under the central pool of funds provided by American Telephone and Telegraph Co., hereinafter referred to as AT&T, for construction and operating purposes, it is not necessary to the financial integrity of the company to include such work in the rate base.
 - B. Adjusted to restore the \$18,000,000 of reusable office equipment to the rate base and making a corresponding reduction in working capital because of such reduced need.
 - C. Adjusted to restore \$1,258,000 of account 100.3 "property held for future use" to the rate base representing investment in central office equipment, underground facilities, and other property but not land because taxes on land are borne by rate payers which

should be sufficient where some of such property will not be put to public use for up to 20 years.

- D. Adjusted to restore \$10,881,000 to rate base attributable to the deferred federal income tax effects of capitalized relief and pensions and social security tax which were flowed through until normalized under this order, in accordance with Commission Substantive Rule 052.02.03.032(a)(4).

- 2. The invested capital of Southwestern Bell is composed of:
 - A. \$1,334,723,000 of long term debt having an average annual interest cost of 7.06%.
 - B. \$1,695,984,000 of common stock and retained earnings, all of which is owned by AT&T.
- 3. That a fair rate of return on the common stock of Southwestern Bell can only be computed by considering what constitutes a fair rate of return to AT&T on its investment in Southwestern Bell.
- 4. That a fair rate of return to AT&T on its investment in Southwestern Bell can be determined by finding what constitutes a fair rate of return on all of AT&T's invested capital including debt.
- 5. That AT&T's invested capital in Southwestern Bell is comprised of:
 - A. 16.6% of debt on which there is an average annual interest cost of 6.44%.
 - B. 5.7% of preferred stock on which there is an average annual dividend cost of 7.83%.
 - C. 77.7% of common stock equity on which a fair rate of return so as to ensure financial integrity, to attract capital and to allow a return comparable to other companies with corresponding risks is 12.75%.
- 6. That Southwestern Bell has the burden of proof of showing that the average cost of capital to AT&T should not be used in determining the cost of common equity capital for Southwestern Bell and they failed to carry that burden. Therefore, a fair rate of return on AT&T's invested capital in Southwestern Bell, one sufficient to ensure the financial integrity of the company, to attract needed capital and to allow it to earn a return comparable to other companies with corresponding risks is 11.42%.
- 7. That the value of Southwestern Bell's assets computed on a current cost basis is \$4,371,779,000, using the Commission staff's method of trending

original cost, adjusted for age and condition by a factor consistent with book depreciation.

8. That the adjusted value of Southwestern Bell's assets is \$3,441,075,000 computed on 69.4% original costs and 30.6% current costs.
9. That a fair rate of return on the adjusted value of capital invested in Southwestern Bell is 8.37%.
10. That the annual costs of operations for Southwestern Bell is \$1,045,025,000 as computed by the Commission staff adjusted to:
 - A. Reflect the restoration of \$3,588,000, originally deducted as adjustments to the advertising account because such account had already been adjusted to reflect the effects of the Separations Manual.
 - B. Reflect the restoration of \$1,568,000 to cover ad valorem taxes, so as to make them conform more closely to taxes actually to be paid.
 - C. Reflect the restoration of \$711,000 for loss in revenues for uncollectible accounts.
 - D. Reflect the restoration of \$685,000 to cover increased federal income taxes caused by additional revenue requirements herein.
 - E. Reflect the restoration of \$325,000 to cover increased revenue related taxes caused by additional revenue requirements herein.
11. That the annual cost for depreciation on assets is \$210,650,000.
12. That the annual cost for interest allowed on debt capital is \$112,336,000.
13. That the annual cost allowed on preferred stock capital is \$7,617,000.
14. That the annual return allowed on equity capital including common stock and retained earnings is \$167,964,000.
15. That the annual return on capital is \$287,917,000, which yields a 9.5% return on Southwestern Bell's invested capital.
16. That the annual revenue requirements for Southwestern Bell, including cost operations is \$1,543,592,000.
17. That the revenues for all services by Southwestern Bell on end of Test Year adjusted basis for the Test Year is \$1,485,764,000.
18. That the revenue deficit for Southwestern Bell is \$57,828,000.
19. That the overall rate of return on Southwestern Bell's adjusted value of invested capital required to produce additional revenues equal to the revenues deficit is 8.37%.

20. That a return on Southwestern Bell's common equity of 14% as requested by the company would result in a rate of return to AT&T in excess of 16%, which is in excess of a reasonable and fair rate of return based on comparable earnings of like companies having the same general risks and is more than is required to preserve the financial integrity of the company, and attract the capital necessary for the proper discharge of its duties as a public utility.
21. That the common stock of AT&T is in a class by itself and that there is no real comparable company and the common stock of AT&T has little risk when compared to common stocks of major companies on the market today, and no unusual return on its investments is required to attract future capital, or to ensure the financial integrity of such company.
22. That the determination of rate patterns is primarily an internal management affair for the company and should not be determined by the Commission unless there is a compelling reason for the Commission to make an adjustment to protect the public interest in the proposed rate pattern.
23. That the value of service concept in the telephone industry is an historical concept and is widely accepted as a proper pattern for rate design and should not be discarded by the Commission without concrete cost data to support such change.
24. That there is insufficient cost data presently available for the restructuring of rates generally and equitably among the various services offered by Southwestern Bell and the cost data available are so imprecise because they are grounded on judgmental decisions, which to a great extent, predetermine their results, therefore, the value of service concept still has validity in the formation of rate patterns.
25. That the value of service concept contemplates that universal telephone service is desirable and that the basic local residential and business rates should be kept at a minimum level consistent with the concept that the company earns a fair rate of return on its invested capital.
26. That there are many ways of grouping rate payers for the application of various rate patterns, but there is insufficient evidence to suggest that the proposed rate bands constitute a more arbitrary grouping for rate purposes, than any other suggested grouping.
27. That in order to reduce revenues an estimated \$68,393,000, and to bring some uniformity to the basic residential and business rates on a statewide

basis, the following rate bands and charges should be adopted for residential and business local service before extended area service additions, if any:

Residential Rates

Rate Bands	Number of Exchange Access Arrangements		Flat Rate		Suburban 4-Party	Rural 8-Party	PBX Trunk
			1-Party	2-Party			
1	0 -	3,200	\$ 4.75	\$ 3.15	\$ 2.35	\$ 1.90	\$ 5.70
2	3,201 -	8,000	5.00	3.25	2.40	1.95	6.15
3	8,001 -	13,000	5.25	3.40	2.45	1.95	6.60
4	13,001 -	30,000	5.50	3.50	2.50	2.00	7.00
5	30,001 -	60,000	5.75	3.65	2.55	2.05	7.45
6	60,001 -	120,000	6.00	3.75	2.66	2.10	7.90
7	120,001 -	220,000	6.50	4.00	2.75	2.15	8.75
8	220,001 -	450,000	7.00	4.25	2.90	2.20	9.65
9	450,001 -	850,000	7.50	4.50	3.00	2.25	10.50
10	850,001 -	1,150,000	8.00	4.75	3.15	2.30	11.40

Business Rates

Rate Bands	Flat Rate 1-Party	Measured 1-Party	PBX Trunk	Suburban 4-Party	Rural 8-Party	Semi-Public 1-Party
1	\$ 9.75	\$ 6.45	\$14.45	\$ 3.55	\$ 2.55	\$ 4.00
2	10.50	6.90	15.75	3.75	2.65	5.10
3	11.25	7.35	17.10	3.95	2.75	5.40
4	12.00	7.80	18.40	4.15	2.85	5.70
5	13.00	8.40	20.15	4.40	2.95	6.10
6	14.00	9.00	21.90	4.65	3.10	6.50
7	16.00	10.20	25.40	5.15	3.30	7.30
8	19.00	12.00	30.65	5.90	3.70	8.50
9	22.00	13.80	35.90	6.65	4.05	9.70
10	25.00	15.60	41.15	7.40	4.45	10.90

Extension Rates

Residential	\$ 1.50
Flat Rate Business	1.50
Measured Business	1.50
Semi-Public	
With coin collecting	2.25
Without coin collecting	1.50

All mileage charges shall be reduced by one-half.

None of the above rates include any charge for extended area service, and none shall be applied to the above rates.

28. That in order to produce an estimated \$121,264,000 in additional revenues the following increases are adopted:

<u>Service</u>	<u>Revenue Increase</u>
Twenty Cent Coin	\$ 8,165,000
Service Connection, Moves and Change Charges	13,246,000
Key Telephone	11,638,000
Miscellaneous	3,141,000
Private Branch Exchange	7,086,000
Centrex	2,870,000
Private Line	-0-
Touch-Tone	3,759,000
Other	2,775,000
Long Distance	65,059,000
Wide-Area Telecommunications	3,525,000
	<u>\$ 121,264,000</u>

That rates for such services shall be computed as a per centage of the requested rates with allowance for repression, except long distance rates which shall be as requested.

29. That in order to produce an estimated \$4,957,000 in additional revenues and to standardize the rates statewide, and reduce the burden on the basic residential and business rate payer for the costs generated by parties who use such service excessively, some up to 10,000 calls per month, a schedule of rates for directory assistance service should be adopted for single line telephones as follows:
- A. For the first ten (10) calls per month, no charge
 - B. For each call in excess of ten (10) per month, 20¢
 - C. That there shall be no charge to the visually handicapped or physically handicapped certified so by any physician or by any agency recognized by the State as having the authority to certify such handicaps and the company shall issue a credit card to such disabled person upon presentation of such certificate
 - D. There will be no charges to hospitals or pay stations
 - E. That parties with multiple-line service shall be allowed one additional call per month per line up to the first twenty-five additional lines and thereafter 1/2 call per month for each additional line rounded upward to an even number
 - F. That other provisions of the proposed tariff on directory assistance charging shall be as proposed
 - G. That the company shall report to the Commission quarterly as to the gross receipts produced from such charges and shall furnish to the Commission at the time of submission of the next rate request a detailed cost study covering such service
 - H. That the adoption of such rates should reduce excessive use for such use so as to eliminate the need of some \$16,039,000 which would have to be allowed for cost growth if no plan is adopted.
 - I. That, in addition to the ten (10) call allowance, one home area toll directory assistance inquiry be allowed at no charge for each home area toll call completed.
30. That the rate changes made in this order affect a major number of rate payers and because of those changes and because of the transition to statewide regulation, rate payers should be informed as completely as

possible of their rights and responsibilities. To so inform rate payers, the company shall in all telephone books printed after the effective date of this order, state in the "call guide" section of the directory company policies toward credit, installation charges, deferred payment plans, discontinuance of service, types of rates available and methods by which complaints can be made to the company and to the Commission.

31. That it is desirable that customers of Southwestern Bell have available all information which will be helpful in determining the extent to which they might want to use long distance service, therefore, after February 1, 1977, all newly published directories issued for Southwestern Bell subscribers in Texas shall, on a page in the "call guide" portion of the directory, publish information on long distance rates applicable in the exchanges served by the directory (long distance rates need not be shown for every exchange). The information shall include the following:
 - A. An example showing specific initial period and overtime rates at various times of the day for a long distance call to:
 - (1) a nearby intrastate long distance exchange (25 to 75 miles)
 - (2) a medium distant intrastate long distance exchange (150 to 300 miles)
 - (3) a far distant intrastate long distance exchange (400 miles or further)
 - (4) New York City, New York
 - (5) San Francisco, California
 - B. An explanation of the discounts and applicable times on Direct Distance Dialed calls.
32. That Southwestern Bell shall revise its proposed tariff to reflect the rate changes approved herein, and to reflect the service requirements of this Order, which revised tariff shall be subject to review by the Commission for compliance.
33. That in rate bands approved for basic local residential and business services there shall be no change in the rates charged to the residences or rate payers in any band because of growth in population of a given area or city without prior approval by the Commission.
34. That as to additional charges for extended area service, no additional rate shall be charged as to service presently existing, and as to future extended

area service the rates therefor shall be established in accordance with the Commission's policy thereon, and the amended tariff shall so reflect.

35. That the approved rates do not include any sum for attrition because future investments and increased costs are recovered through increased revenues which exceed the estimated increase in costs from investment, operations and inflation, and therefore none is required.

Conclusions of Law

That based upon the evidence of record and the information of which the Commission took official notice, the Commission makes the following conclusions of law:

1. That the Commission has jurisdiction of this matter and of Southwestern Bell and authority under The Public Utility Regulatory Act to conduct the hearing in question and make a decision therein.
2. That all parties were present in person or by counsel and announced ready for the hearing which began on November 1, 1976.
3. That Southwestern Bell has the burden of proof to establish its revenue deficit under its present rates, and the amount of such revenue deficit which will be collected under the proposed rates including any repression and attrition resulting therefrom.
4. That the intervenors all represented classes of rate payers, except the Communications Workers of America, and their justiciable interest is limited to the issues of discrimination of rates as between the class represented and other classes of rate payers, and to whether the rate of return approved will yield more than a fair return upon the adjusted value of the company's invested capital used and useful in rendering service to the public.
5. That the Communications Workers of America intervened to protest a decrease in Directory Assistance operators alleged to occur as the consequence of institution of Directory Assistance Charges.
6. That The Public Utility Regulatory Act, Section 39 requires the Commission to fix rates which will produce overall revenues that will permit Southwestern Bell to recover its operating expenses together with a reasonable return on its invested capital.
7. That the invested capital of Southwestern Bell is the actual money cost, or the actual money value of any consideration paid other than money, for the property at the time it shall have been dedicated to public use, less depreciation.

8. That The Public Utility Regulatory Act, Section 40, requires that the Commission shall not prescribe any rate which will yield more than a fair return upon the adjusted value of the invested capital used and useful in rendering serving to the public.
9. That to be confiscatory rates set by the Commission must be insufficient under current dividend practices and overall earnings to maintain a price for the company's common stock at book value plus cost of issue and repression from contemplated issues.
10. That Southwestern Bell's current practice of retaining approximately 38% of earnings which are compounded annually at the earned rate of return is sufficient to ensure the growth required to avoid confiscation when coupled with the maintenance of book value of common stock as stated above.
11. That since the settlements between Southwestern Bell and the intervening telephone companies for long distance and private line telephone service are contract matters negotiated between the parties and subject to constitutional protection until termination they are not examined here, but all parties are notified that any new contracts negotiated or any contracts extended shall be subject to the rights of this Commission to examine and alter such contracts in the public interest.
12. That construction work in progress can only be approved for inclusion in the rate base when there is a positive showing that such inclusion is necessary for the financial integrity of the company.
13. That as imprecise as it is, the Separations Manual is the best presently available guide for the allocation of revenues and costs between intra-state and interstate toll facilities.
14. That a reasonable rate of return is less for a stable dividend yield stock purchased for income purposes than for a high growth stock purchased for speculation purposes.
15. That the average monthly balances due in thirty days to Western Electric Company and other suppliers of Southwestern Bell should not be deducted from the rate base as cost free capital, but should be considered for what they are, reductions in need for additional working capital.
16. That it is proper to consider customer deposits as cost free capital if the required interest costs therefor are included in operating costs, or if this is not done the cost of such debt should be averaged into the cost of capital to Southwestern Bell.

17. That trending of original cost of property by widely used and accepted trend factors to arrive at current cost of such property is permissible, acceptable, and in the absence of a preponderance of evidence to the contrary, preferable.
18. That the extra costs for extended area service should be borne by the rate payers in the extended area because it is the rate payers in such outlying areas who desire to call into the central city rather than the rate payers in the central city who desire to call out.
19. That the Commission has established a procedure for determining the costs of extended area service, and the willingness of a majority of the rate payers to pay for such additional costs, and therefore there is no need to set specific rates for extended area service in this order.
20. That the rates approved herein shall not become effective until the first billing period after a revised tariff has been completed and filed with the Commission reflecting the approved rates and conditions of service set forth herein.
21. That the proposed tariff proposed and filed by Southwestern Bell as amended by this order is approved.

ORDER

It is, therefore, the Order of this Commission that the proposed tariff of Southwestern Bell Telephone Company as modified hereinabove be approved, and Southwestern Bell Telephone Company is ORDERED to revise said tariff accordingly and to refile same before putting said rates into effect.

Entered at Austin, Texas this 14th day of December, 1976.

PUBLIC UTILITY COMMISSION OF TEXAS

SIGNED: _____

Garrett Morris
GARRETT MORRIS

SIGNED: _____

Alan R. Erwin
ALAN R. ERWIN

SIGNED: _____

George M. Cowden
GEORGE M. COWDEN

ATTEST:

Roy J. Henderson
ROY J. HENDERSON
COMMISSION SECRETARY
AND DIRECTOR OF HEARINGS