(Decision No. 3[illegible]593)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

IN THE MATTER OF THE APPLICATION OF THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, A CORPORATION, DENVER, COLORADO, FOR AN ORDER TO ASCERTAIN THE FAIR VALUE OF THE APPLICANT'S PROPERTY WITHIN THE STATE OF COLORADO, TO DETERMINE THE FAIR RATE OF RETURN THEREON, THE REVENUES TO WHICH APPLICANT IS ENTITLED, AND FOR SUCH FURTHER FINDINGS AND ORDERS AS MAY BE JUST AND PROPER.	APPLICATION NO. 11245

May 6, 1952

Appearances: John R. Turnquist, Esq., Denver, Colorado, and
Elmer L. Brock, Esq., Denver, Colorado, for applicant;
Harry M. Howard, Esq., and
Joseph A. Riggenbach, Esq., for the City of Monte Vista, Colorado;
Frank A. Hoisington, Esq., for the City of Grand Junction, Colorado;
L. R. Kuiper, Esq., for the City of Delta, Colorado;
Leonard M. Campbell, Esq.,
Leland E. Modesitt, Esq.,
Mitchel Johns, Esq., and
Malcolm Crawford, Esq., for the City and County of Denver, Colorado;
F. T. Henry, Esq., and
Louis Johnson, Esq., for the City of Colorado Springs, Colorado;
Eric T. Kelly, Esq., for the City of Pueblo, Colorado;
Earl W. Haffke, Esq., for the City of Fort Morgan, Colorado;
John C. Banks, Esq., for the City of Grand Junction, Colorado;
John A. Hughes, Esq., for the City of Montrose, Colorado;
Ralph Sargent, Jr., Esq., Denver, Colorado, for the Commission.

By the Commission:

On [illegible], 1951, The Mountain States Telephone and Telegraph Company (hereinafter referred to as the "Company," or "Applicant"), filed with this Commission an application requesting the Commission to fix a date for a hearing for the purpose of receiving evidence to enable the Commission to ascertain the fair value at the present time of Applicant's property devoted to public service within the State of Colorado, and to ascertain the facts which may have a bearing on such value, to determine the fair rate of return thereon, and the revenues to which Applicant may be entitled, to the end that Applicant can be afforded relief in the most expeditious manner through the appropriate regulatory channels, and to make such other findings and orders as may be just and proper.

The Commission set the matter for hearing on September 4, 1951, and on that date, due notice having been given to all interested parties, hearings commenced. At these hearings, representatives of the following cities and towns appeared: The City and County of Denver; Monte Vista; Grand Junction; Delta; Colorado Springs; Pueblo; Fort Collins; Fort Morgan; Boulder and Montrose. The People of the State of Colorado were represented by the staff of the Commission, which staff, prior to the commencement of the hearings, made extensive investigation of the books and records of the Company and its properties within the State of Colorado. The Municipal League of Colorado was also represented and it presented three expert witnesses.

Hearings continued through September 17, 1951, at which time the Commission's staff and the municipalities requested a recess for the purpose of preparing further cross examination and rebuttal, which request was granted.

Hearings resumed on December 6, 1951, and continued through December 14, 1951, at which time the case was taken under advisement by the Commission.

On April 8, 1952, the Commission ordered a further hearing of the case, directing the applicant to present exhibits showing further

information for the full Year 1951, and for the twelve months ending January 31, 1952.

Hearings were held on this reopening on April 28, 1952. In all, the hearings consumed eighteen days, and the record consists of approximately two thousand pages and one hundred fifteen exhibits.

The Regulatory Situation in Colorado

Applicant has alleged in its application that it is in dire financial straits in Colorado. It also alleged that the matter of regulation of public utility rates, and particularly telephone rates in Colorado, has been in a confused state for many years, and has grown progressively more confused in recent years. From a review of the evidence, it is apparent to the Commission that the confused state of regulation in Colorado is, to a large extent, responsible for applicant's financial condition. This state of confusion originated with a Supreme Court Decision in 1919, wherein the Court held that this Commission had no jurisdiction to regulate the rates to be charged by applicant in its local service within the City and County of Denver. This decision lead to a long series of litigation involving a number of utilities, including applicant, culminating in a decision in 1949, wherein the Supreme Court held that only the people in Denver, in effect, had the power to regulate rates in Denver. A suit for refund of certain of the rates of applicant being collected in Denver was commenced by two subscribers. This Commission, recognizing that service within the Metropolitan Area of Denver over which it had unquestioned jurisdiction (which service was in the public interest) was being jeopardized, brought an action in the District Court in the City and County of Denver, asking that Court to declare just what its jurisdiction was in the premises. This action prosecuted through the Supreme Court of the State, finally resulted in that Court reversing the 1919 decision, and holding that this Commission is the sole agency that has jurisdiction over intrastate telephone rates throughout the State of Colorado, and that so-called "home-rule cities" have no jurisdiction over such rates. This decision has now been made final, and therefore, the confused state of regulation in Colorado has been clarified. Prior to the rendition of that decision, however,

applicant, apparently feeling that no one else in the State of Colorado was in a position to make the proper investigation and hearings, brought this action, and hearings were held, as hereinabove set forth. As may be seen, Denver and other cities voluntarily appeared before this Commission and participated in the hearings, which was commendable cooperation on their part, and fortunate in view of the developments. Pending final determination of the case in the Supreme Court, however, it had been agreed that the instant case should be held in status-quo, and this Commission has not felt that it was in a position to act until the present time. It has, however, during this interval, been giving careful consideration to all of the evidence presented in the case.

History of the Company and Nature of its Operations

The Mountain States Telephone and Telegraph Company is a Colorado corporation, with its principal offices located at 931 Fourteenth Street, Denver, Colorado. It is duly authorized to engage as a public utility, and is engaged in the business of furnishing communication services; namely, local and toll telephone service in the States of Arizona, Colorado, Montana, New Mexico, Utah, Wyoming, Idaho south of the Salmon River, and in El Paso County, Texas. The Company is a subsidiary of American Telephone and Telegraph Company, a New York corporation (hereinafter referred to as the "American Company"), which owns approximately eighty-five per cent of the outstanding capital stock of the applicant company.

Intercorporate Relationship

1. As noted above, the American Telephone and Telegraph Company owns a controlling interest in applicant. It also owns the Western Electric Company, and it and Western Electric Company own the Bell Laboratories. The American Company furnishes to applicant under contract certain services, and applicant also purchases practically all of its plant and equipment from Western Electric. Because of this relationship, contractual arrangements under which the applicant purchases materials and supplies from Western Electric, and where applicant pays certain fees to the American Company, are carefully examined by this Commission.

A. General Services and License Costs:

One of the items claimed as an operating expense is an amount paid by applicant to the American Company pursuant to the terms of a license agreement which has long been in effect between the two companies with modifications made therein from time to time. The amount to be paid is determined by taking one per cent of the gross operating revenues less uncollectible revenues of the operating company. This method of payment is frequently criticized because it has no direct relationship to the cost or value of the services rendered. Under the agreement, the American Company continuously carries on fundamental work of research, investigation and experimentation in the art of telephony and in the development of plans, methods and systems designed to improve telephone service and to reduce costs. All of the benefits derived from such work are made available to applicant. The applicant receives the benefit of all of the research and development work of the Bell Laboratories. It also receives the benefit of the services of the American Company's General Department which include advice and assistance regarding the construction, maintenance, etc., of plant and equipment, traffic operations, both exchange and toll, administration of business offices, relations with customers, sales, advertising and servicing work, accounting principles and methods, personnel and training matters, taxes, patent, legal and financial matters. In regard to patents, applicant is given full use of all the patents held by the American Company, and is protected against suits from patent infringements which may arise from its use of these patents. These services also include negotiations and discussions with governmental agencies, such as the Armed Services, the Federal Communications Commission, the Internal Revenue Bureau, the Securities and Exchange Commission, etc. The applicant contends that these services are of great value to it, and that if this common source were not available to it, it would have to expend a great deal more than it is currently paying for the services. Applicant states that it is a policy of the American Company to maintain a reasonable relationship over a period of years between the payments received and the costs incurred. It would appear that over a ten-year period, without taking into consideration the factor of the capital used by the American Company in [illegible]

the service, the expense reasonably approximates the amount of the payment therefor. It would appear from the evidence that these services are necessary and have a real value, and had it not been for many of the technological improvements which have resulted from these services over the years, telephone rates would need to be much higher than they are presently. These improvements resulted from continuous efforts, experimentations, and research, and consisted of such items, among others, as reducing the size of wires, thereby increasing the number of wires that could be placed in a cable; the development and improvement of [illegible] tubes resulting in lower power consumption and large savings in maintenance and replacement and in battery facilities; development of the transistor which is presently in its infancy, but promises impressive results and economies; development of the carrier systems, whereby a greater number of messages may be carried over fewer wires.

This includes only a few of the vast number of improvements which have been made available to applicant under the license contract. The evidence indicates that these savings have been real and material.

B. Western Electric Prices.

Most of the materials which applicant uses in the construction and maintenance of its telephone plant are purchased from Western Electric Company, Inc. (hereinafter referred to as "Western"). Western is, in effect, the manufacturing and supply department for all of the operating companies of the Bell System. Broadly speaking, applicant's purchases from Western consist of telephone apparatus and equipment and outside plant material. Both telephone apparatus and equipment include those materials used at central offices and at private branch exchanges, including switchboards, dial equipment, toll terminal equipment and associated apparatus. It also includes such items as telephone instruments, coin collectors and telephone booths which are used on the subscriber's premises. All of these materials and the lead-covered cable are generally manufactured by Western. Other outside plant materials, such as poles, cross-arms, wire, underground conduit and hardware, are generally purchased by Western from other operators. When applicant

installs a new central office or large private branch exchange, or makes a major addition to an existing one, it generally employs Western to install the equipment, this being the final stage of the manufacturing processes. On large installation jobs, Western is generally employed to do the detailed engineering. Apparatus and equipment installed and other materials represent about ninety-seven per cent of applicant's total purchases from Western. Western also performs for applicant at its Denver distributing house, certain relatively minor services, which together account for the remaining three per cent. These services consist of receiving, classifying, storing, and repairing materials removed from the telephone plant and disposing of them as directed by the Telephone Company. All of this is done under the "Standard Supply Contract," under which Western agrees, on order of applicant, and to the extent reasonably required by applicant's business, to manufacture materials, to purchase and inspect materials manufactured by others, to sell such materials to applicant, to prepare equipment specifications, and to perform installations of equipment. Western also agrees to carry reasonable stocks of materials and perform the services previously mentioned in connection with the recovery of used materials. The contract does not require applicant to purchase its materials from Western, but on the contrary, specifically states that applicant does not have to make any purchases from Western if it does not wish to do so. The contract specifically provides that Western's prices and terms to applicant shall be as low as to its most favored customers for like materials and services under comparable conditions. A comparison of Western prices with the prices of other manufacturers shows that Western prices generally are on the whole lower. For example, Western's prices to applicant for telephone sets have, at all times, been substantially below the lowest price at which the same or equivalent sets have been available to the general trade. It appears also that there is a direct benefit to all of the operating companies in having uniformity in the materials being supplied to them. Particularly is this true in cases of emergency, such as severe storms, flood damage, etc., when it is necessary to transfer

crews from one operating company to another to restore service.

C. Western Electric Company Earnings.

Western Electric Company earnings have fluctuated widely over the years, and during the depression it incurred repeated deficits. For the twenty-six-year period from 1925 through 1950, the Western Electric margin of profit per dollar of sales has averaged 4.4 cents, and for this same period, Western's rate of return on net investment averaged 7.7%. Western is a manufacturing company, and while during World War II the bulk of its sales was to the United States Government, and some of this business continues, over the past twenty years, excluding war years, about 90% of Western's sales have been to Bell customers. A comparison of Western's earnings with those of fifty other companies which cover a broad cross-section of the manufacturing industry, shows that these fifty companies, for the period from 1925 through 1950 had a margin of profit of 6.4 cents per dollar of sales, as compared with 4.4 cents for Western of its business with Bell customers for the same period, and the return on net investment for these other companies was 10%, compared with Western's earnings of 7.7% on its business with Bell customers. While this Commission does not consider that this is an unreasonable average rate of earnings for a manufacturing company, we are aware that in recent years Western's earnings have substantially exceeded this rate. The special Cooperating Committee of the NARUC-FCC is giving continuing attention to these earnings, and is making periodic reports to which this Commission will give continuing consideration.

Separations of Interstate and Intrastate
Property and Operations

Much of the Colorado property of applicant is used in the rendition of both intrastate and interstate service. Applicant in its exhibits as originally presented in this case, separated the intrastate plant and operations from its total plant and operations by the use of what is known as the "Separations Manual" prepared by a Sub-Committee of the Cooperating Staff Committee of the National Association of Railroad and Utility Commissioners and Federal Communications Commission. This manual has never been officially adopted by this Commission, and there has been some

criticism of the [illegible]. As a result, various studies have been conducted by regulatory groups, such as the Telephone Committee of the National Association of Railroad and Utilities Commissioners, the Federal Communications Commission, and others, with the view of devising a plan for separations which would be more equitable and generally acceptable to all concerned. During the interval between the original hearings in this case and the resumption of those hearings in December, the National Association of Railroad and Utilities Commissioners and the Federal Communications Commission agreed upon what is generally referred to as the Charleston Plan, and at the hearings in December, applicant placed in evidence exhibits based upon that Charleston Plan, being Exhibits 58, 59, 60, 61, and 62. These exhibits reflected the changes in separations procedures. In our review of the operating results of applicant, we shall, for the purposes of this case, adjust all plant items, operating revenues, and operating expenses to reflect the use of the procedures of separations as outlined by the Charleston Plan.

Fair Value of the Property of the Company in Colorado

The applicant presented considerable testimony of various witnesses as to the fair value at the present time of applicant's property devoted to public service within the State of Colorado. Applicant presented witnesses who testified as to the reproduction cost new less depreciation value of telephone property. In addition, evidence was submitted by applicant showing the average net investment of applicant in telephone property which figures were based on the original cost of the property less allocated depreciation reserve. In addition to these figures, the applicant submitted exhibits showing the average investment in telephone property with no deduction for allocable depreciation reserve, as well as the average investment in telephone property less one-half of the allocated average depreciation reserve.

Counsel for the applicant, however, maintained throughout the hearing that in arriving at a value this Commission should give weight to both the present value of the telephone property of applicant which is being devoted to public use and to the reproduction cost new less

depreciation value. To support this contention, counsel for applicant cited the case of Ohio and Colorado Smelting and Refining Company vs. Public Utilities Commission, 68 Colo. 137, decided by the Colorado Supreme Court in 1920.

Mr. Boggs, who is employed by applicant, testified that the present value of the telephone property of applicant in the State of Colorado was the reproduction cost new less depreciation value, and he testified that the average appraised value of the Colorado intrastate property for the year ending May 31, 1951, was $86,629,000.00. Mr. Theodore E. Seelye, Vice-President of the engineering firm of Day and Zimmerman, Inc., testified that the present value on January 1, 1951, was $85,164,666.00. As adjusted for the Charleston Plan, the value as of December 31, 1951, in the case of Mr. Boggs' testimony, was found to be $88,076,000, and Mr. Seelye's figures as of that date, $86,551,000. As of January 31, 1952, the corresponding figures were $88,524,000.00 and $86,990,000, respectively.

In contrast to these figures, the applicant also introduced exhibits showing the average intrastate net investment for the twelve months ending May 31, 1951 -- that is, the total investment less allocable depreciation reserve. This figure amounted to $50,221,014.00. The actual intrastate net investment as of May 31, 1951, was $52,664,820.00. The average intrastate net investment for the twelve months ending December 31, 1951 was $53,582,626.00, and the actual intrastate net investment as of December 31, 1951, was $57,650,932.00. The average for the twelve months ending January 31, 1952, was $54,201,058.00, and the actual net investment as of January 31, 1952, was $58,571,638.00.

The cities represented at the hearing and the Colorado Municipal League vigorously protested the arguments by counsel for applicant that this Commission should give particular weight to the valuation of the telephone company's property based on a reproduction cost new less depreciation theory in determining present valuation. Mr. Butler, a Consulting Engineer of wide experience, testifying for the Colorado Municipal League, stated that the legitimate original cost in net invest-

ment (which is the over-all cost of the property, less the depreciation reserve) is the appropriate rate base, and that the appraised present value is in his opinion of no significance. Mr. Butler testified that increases in the earning requirements of utilities during inflationary periods can best be reflected by a higher rate of return, rather than by increasing the rate base above the recorded original cost.

This Commission does not agree at all with the contention by counsel for the applicant that the Colorado Supreme Court in the Ohio Refining Case, supra, has in any way limited this Commission under one theory or another as to the proper rate base that should be set by this Commission in a valuation proceeding. It is the statutory responsibility of this Commission to see that public utilities under the jurisdiction of this Commission in this state charge just and reasonable rates for their services. Such rates contemplate the production of revenue to a public utility which will yield that utility a fair return upon reasonable value of its property at the time that property is being used for the public. This the Colorado Supreme Court has clearly recognized in the Ohio Refining Case, supra, as indicated by the language of the Court on Page 146.

The Court, in that opinion, goes on to say as follows:

> "To ascertain such reasonable value for the purpose of fixing rates and in addition to its net earnings, it is the rule of law that there are four different theories for the determination of what constitutes a reasonable value under the facts of any particular case. 'These theories are generally defined by terms which indicate the method of ascertaining what would be a fair return on the reasonable value of the property, and are thus expressed -- original cost; cost of reproduction; outstanding capitalization, and present value. Since the authorities are not agreed as to the proper theory for determining rates nor as to the manner of applying the legal principle established for that purpose, it is impossible that they should agree on what constitutes a reasonable rate in any case or that a decision in any state should control in other states, although the facts of the case may be similar or even identical because the courts are not agreed as to the proper theory to be applied for the solution of the question.' *** The adoption of any one of these four theories in a given case is attended with great difficulty and in some cases impossible for any one

> of them to prevail and justice be done. But so many decisions have been rendered in relation to the proper method of ascertainment of the reasonable value of the property, that commissions of this character may be presumed to be fairly enlightened when considering the particular case as to whether any one or more of these theories may be justly adopted and for such reason, so that in this case a further discussion of this subject is not important."

The Court then concludes that in any case:

> "it is a prerequisite that a reasonable value of the property at the time it is being used be established."

Far from binding the Commission to any one approach in the question of valuation of the property of a public utility, it seems to this Commission that the Colorado Supreme Court has recognized that there are various approaches.

Subsequent to the Ohio Refining Case in Colorado, the United States Supreme Court handed down its decisions in 1941 and 1943 in the Case of Federal Power Commission vs. Natural Gas Pipe Line Company, 315 U. S. 575, 62 S. Ct. 736, and Federal Power Commission vs. Hope Natural Gas Company, 320 U. S. 591, 64 S. Ct. 281. These decisions interpreted the power of the Federal Power Commission under the Natural Gas Act, which prescribes a statutory standard of just and reasonable rates similar to the statute under which the Colorado Public Utilities Commission obtains its authority. In these decisions, the U. S. Supreme Court recognized that a commission is not bound to the use of any single formula or combined formulae in determining just and reasonable rates. The Court said, in Federal Power Commission vs. Hope Natural Gas Company, supra, 287 (64 S. Ct.):

> "Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controling."

Therefore, this Commission recognizes that while its responsibility might be to give consideration to the reproduction cost new valuation of the telephone company's property as appraised by witnesses of the Telephone Company, it agrees with the Colorado Municipal League that it is not bound to set the present valuation of the Telephone Company's

property entirely on such a basis. This Commission believes that it may fix the valuation of a public utility's property as its original cost, less depreciation, and may set a fair rate of return on that valuation, so that it will produce revenues enabling the utility to maintain its credit and attract the capital necessary for the proper discharge of its public duties. This Commission will then have satisfied its obligation to the public and to the utility which it regulates.

In the instant matter, the Commission is of the opinion and believes that the fair valuation of the property of applicant can best be determined on the basis of its net original cost on its total Colorado intrastate investment, less the allocated depreciation reserve.

As hereinbefore stated, the record in this matter contains the figures showing the Colorado intrastate investment of applicant less the allocated depreciation reserve for various periods between May 31, 1951 and January 31, 1952. In addition to the telephone plant in service (Account 100.1), the figures showing the total investment include property held for future telephone use (Account 100.3), telephone plant acquisition adjustment (Account 100.4), telephone plant under construction (Account 100.2), materials and supplies (Account 122), and cash working capital. Then from the total investment is deducted the allocated depreciation reserve to arrive at the net investment rate base.

Property Held for Future Telephone Use.

The amount claimed by applicant as part of its rate base designated as "property held for future telephone use" consists, as we understand it, of two pieces of property purchased by applicant which applicant is holding for use in connection with the installation of two new central offices in the near future. In view of inflationary trends and the tremendous increase in real estate values in recent years, we think that applicant has shown proper foresight in purchasing that property and such property should be included in the rate base.

Telephone Plant Acquisition Adjustment

The Telephone Plant acquisition adjustment, included in the

total [illegible] figures of applicant, represents an [illegible] amount which is the [illegible] paid for said [illegible] property over and above the original cost thereof. Since this amount represents an amount over and above the original cost of the property, the Commission does not believe that this account is properly allowable in a net original cost rate base.

Telephone Plant under Construction

The amounts shown as "telephone plant under construction" include plant which is being constructed, but which has not yet been placed in service. Witness Knapp, testifying on behalf of the Colorado Municipal League, took the position that telephone plant under construction should not be part of the rate base because it is not yet in service and because, since interest is charged during construction and is included in the amount showing telephone plant under construction, to allow the applicant to earn on that interest charged during construction, would amount to a double return.

The applicant anticipates that plant under construction will in the foreseeable future continue to be an item substantial in amount during this period of expansion. In view of that fact, this Commission will allow telephone plant under construction in the rate base, but will require that the related interest charged to construction be included as an addition to revenue in computing the net operating earnings.

Materials and Supplies

There has been no disagreement among the parties as to the inclusion of this account in an original cost rate base, nor has there been any disagreement as to the reasonableness of these amounts, and we believe the request of allowance for materials and supplies is reasonable and proper and should be included as a part of the rate base.

Cash Working Capital

Cash working capital is usually defined as the amount of cash necessary to meet operating expenses before the revenues become sufficient to pay these expenses. These funds are supplied by the owners of a utility, and consequently are an element of the rate base upon which the

allowable return is predicated. Applicant bills for exchange revenues in advance; however, toll revenues are billed in arrears, and there is a lag in collection, so there is no actual net prepayment for service by the customers. Applicant, as a member of the Bell System, is in an advantageous position, in that it can borrow money pursuant to the terms of the license contract from the American Company on short notice, thus transferring the need for retention of large cash balances from applicant to its parent. While applicant has large amounts of accrued and unpaid taxes, it would need still larger cash balances except for this arrangement with the American Company. The Commission considers that cash working capital is properly includible in the rate base, and that the amount so claimed by applicant, which is based on its actual working cash, is not excessive.

Total Net Investment

Excluding the telephone plant acquisition adjustment, which the Commission has disallowed, and after deducting the allocated depreciation reserve, the net investment of applicant is as follows:

Average for year ended May 31, 1951	$50,216,149
Actual at May 31, 1951	52,660,941
Actual at September 30, 1951	55,366,454
Average for year ended December 31, 1951	53,578,838
Actual at December 31, 1951	57,647,865
Average for year ended January 31, 1952	54,197,378
Actual at January 31, 1952	58,568,550

Operating Results

Applicant has maintained its accounts in accordance with a system of accounts first prescribed by the Interstate Commerce Commission in 1913, and since 1935 has followed a uniform system of accounts prescribed by the Federal Communications Commission. Applicant also makes regular reports to this Commission, the Federal Communications Commission, and state commissions in other states in which applicant operates. The staff of the Commission has made a careful check of the original books of entry of applicant, and no question has been raised

as to the accuracy of these accounts, but all parties to this action have accepted them as being correct. The accounts have been audited annually by Lybrand, Ross Bros. & Montgomery, independent public accountants, since 1935, and at the time of their original audit in 1935, that firm reviewed the records of applicant since its formation in 1911, and expressed satisfaction as to the accuracy of the telephone plant and other accounts of the applicant. Applicant regularly prepares reports of plant investment, revenues and expenses by states, since each state area is an operating unit under the direction of different operating officials. These state reports reduce its revenues and expenses to a figure for net operating earnings and show the investment of telephone property applicable to each state, thereby providing a means of measuring operating results. On the books of applicant, the primary accounts are sub-divided so as to obtain directly therefrom as nearly as possible the data required for reports by states. Revenues of each state, including the proper portion of interstate revenues, are recorded separately for each state. The investment in telephone plant applicable to each state is recorded separately. Expenses directly applicable to a particular state, together with the proper portion of division and general expense, is included for each state. These operating reports for state areas cover all operations in the state, including those pertaining to interstate business. Since the telephone plant of applicant in each state generally is used for both intrastate and interstate operations, and the same employees handle both types of operations, it is necessary for the applicant to make a separation of the plant operating expenses and all other factors by means of studies of the usage of the two types of service — that is, intrastate and interstate. When the hearings first commenced in this case, these separations were made in accordance with the principles set forth in the Separations Manual covering Standard Procedures for Separating Telephone Property, Revenues and Expenses prepared by a Sub-Committee of the Cooperating Staff Committee of the National Association of Railroad and Utility Commissioners and Federal Communications

Commission, which is the manual heretofore referred to under Separations of Interstate and Intrastate Property and Operations. Presently, the separations studies are made in accordance with the so-called Charleston Plan hereinbefore referred to.

Applicant introduced Exhibit No. 17, entitled "Colorado Intrastate Operations — Twelve Months Ended May 31, 1951, Net Operating Earnings, Actual Results for the Period." Local service revenues which accrued from the furnishing of local exchange service amounted to $18,723,294. Toll service revenues which are derived from furnishing intrastate message telephone toll service, including revenues from teletypewriter and toll private line service, amounted to $6,093,889. Miscellaneous revenues which result from other services, such as advertising in telephone directories, etc., amounted to $1,807,958. Uncollectible Operating Revenues amounting to $56,856, are deducted from total operating revenues. Total operating revenues amounted to $26,568,285. Operating expenses totalled $21,425,244. These consisted of the following: Maintenance expenses which represent the cost of repairing, inspecting, and maintaining plant used in intrastate telephone service, and the cost of power for transmitting traffic and operating signals, $5,472,771; traffic expenses, which represent the costs incurred in the handling of exchange and interstate toll calls, principally operators' wages, $6,982,483; commercial expenses, which include expenses incurred in business office relations with customers, public telephone commissions, cost of directories and advertising, $3,403,673; revenue accounting expenses, which represent costs incurred in the Accounting Department, $656,856; costs incurred for preparing and mailing customers' bills, preparing revenue settlements with other companies, and preparing the reports from which the above revenues can be determined, are all included in these revenue accounting expenses. General expenses, which are the intrastate portion of other operating expenses, such as the costs incurred in preparing and accounting for payrolls and all other disbursements, and Colorado's proper portion of the expenses of the Executive, Legal, Treasury, and Engineering Departments, amount to $893,539;

depreciation, which is the intrastate portion of the provision to meet the loss of investment when depreciable plant is retired from service, and is based on rates designed to spread this loss uniformly over the service life of the property, amounted to $2,469,706. Operating rents, which represent the intrastate portion of rent expense for the use of buildings, poles, conduits, and other facilities, amounted to $253,871. Relief and pensions, which are the intrastate portion of the costs incurred under the benefit plan, including sickness and accident, disability payments, death benefits, etc., amounted to $1,049,230. General services and licenses which constitute the intrastate portion of the payment to the American Telephone and Telegraph Company for services rendered under the license contract hereinbefore referred to, amounted to $243,115. Total operating taxes amounted to $2,972,184, and consisted of the following:

(a) Property taxes, license taxes and Federal and State Social Security Taxes, $1,807,977; State Income Taxes, $55,170; Federal Income Taxes, $1,109,037. This left a net operating income for the period of $2,170,857, from which was deducted miscellaneous income charges in the amount of $89,295. These charges consist of the intrastate portion of the small part of the payment to the Pension Fund Trustee mentioned above, and also include service club dues and fees, contributions, and the amortization of Account 100.4, Telephone Plant Acquisition Adjustment.

Interest charged construction of $34,056 shown on the exhibit, is an addition to net operating income, and is the interest capitalized on the larger construction projects while they are carried in Account 100.2, Telephone Plant under Construction. The resulting net operating earnings shown are in the amount of $2,115,618, for the twelve months ended May 31, 1951. That period, however, did not reflect certain wage increases granted in June after collective bargaining and an increase in the Federal Income Tax from 47% to 52% which was made in November, 1951, retroactive to April 1, 1951.

The results by Exhibit 17 were also based on the Separations

the full going rate of wage increases, taxes, pension accruals, etc.; after adjustment to exclude rate case expense in excess of one-fifth of the total; and after giving effect to the Charleston Plan of Separation, the adjusted net operating earnings are as follows:

For the twelve months ended May 31, 1951 $1,377,006

For the twelve months ended September 30, 1951 $1,319,789

For the twelve months ended December 31, 1951 $1,192,624

For the twelve months ended January 31, 1952 $1,164,287.

The decline in trend of earnings in face of increasing number of telephones, and increasing revenues, is caused by increasing expenses and investment, due largely to the fact that depreciation, property taxes, and investment relating to the new telephones are higher than for the existing telephones. This declining trend is discussed in more detail in a following section of this order.

Rate of Return

The revenues resulting from the rates charged by a utility subject to public regulation should be sufficient to cover all expenses of operation, including depreciation and taxes, and should also provide a fair return to the owners of the property. Decisions of the U. S. Supreme Court have repeatedly stated that the return should be equal to that being made in other businesses having corresponding risks, should be sufficient to assure confidence in the financial soundness of the enterprise, and should be adequate to maintain its credit and to attract the capital necessary for the proper discharge of its public duties. Accordingly, the return should permit the payment of interest and reasonable dividends, and should leave something to be passed to the surplus account. (Hope Natural Gas Company v. Federal Power Commission, 320 U. S. 591; United Railways and Electric Company v. West, 280 U. S. 250; Bluefield Water Works and Improvement Company v. West Virginia Public Service Commission, 262 U. S. 679).

The rate making process involves a balancing of the investor and consumer interest, wherein the consumer pays no more than is neces-

sary to provide good service and the investor receives no more than the fair rate of return described above. Applicant company is, and has been since 1946, engaged in a tremendous expansion program to meet the unprecedented post-war demands for telephone service. This program has required, and will continue to require, huge amounts of new capital to be attracted from the investors. Without this expansion, the present and prospective customers cannot be provided with the service they desire. It is therefore in the interests of consumers, as well as investors, that the utility be granted earnings which will make additional investment attractive.

Five witnesses testified on the subject of required earnings or fair return. The applicant presented testimony by Eugene S. Merrill, Vice-President of Standard Research Consultants, Inc., a subsidiary of Standard and Poor's Corporation of New York City; by William F. Schmausser, Vice-President in charge of the investment portfolio by the Capitol Life Insurance Company of Denver, Colorado; by P. E. Remington, Comptroller of the Company. The City of Denver, and other cities which are members of the Colorado Municipal League, presented testimony by Charles W. Knapp, Certified Public Accountant of Hartford, Connecticut, who was formerly a member of the staff of the Federal Power Commission, and by Reuben Arthur Zubrow, Assistant Professor of Economics at the University of Colorado.

Mr. Merrill pointed out that during the five years from 1946 to 1950, the applicant company has raised 98.6 million dollars of new capital, which was considerably more than it had raised throughout its history prior to 1945. He stated that in raising equity capital the applicant has offered its stock for subscription at its par value of $100 per share 5 times in the last 6 years, and while the 1946 offer was successful, the four offers made in 1948, 1949, 1950, and 1951 failed of wide acceptance by minority stockholders and the public generally. Mr. Merrill contended that the annual dividend rate of $6 per share, and the average annual net earnings of about $7 over the past few years, were not sufficient to cause the common stock to sell substantially above

lost confidence in the ability of the company to support additional investments. Applicant's parent, the American Telephone and Telegraph Company, owning approximately eighty-five per cent of the common stock, subscribed to its share of these stock offers, which substantially increased applicant's equity capital and enabled it to go forward with its construction program in spite of the failure of its public offerings. Mr. Merrill took the position that the applicant is dependent for its equity capital upon the American Company as parent of the Bell System, and reached his conclusion as to applicant's required rate of return by a consideration of the requirements of the Bell System as a whole. In his judgment, the $9 per share dividend of the American Company should be protected by a 40% margin of retained earnings for the next few years until the surplus has been built up substantially. In other words, it was Mr. Merrill's opinion that the earnings of the Bell System should be $15.00 a share. On the book equity per share of $138.09, this would represent a return of about 11%. Mr. Merrill felt the long-term average Bell System debt ratio of one-third should be continued as an objective, although the present debt ratio is about 45%. He stated that the present historical cost of debt capital to the Bell System is 3%. The composite rate of return of 11% on equity, representing two-thirds of the capital structure, and 3% on debt to extent of one-third of the capital structure, produces an over-all rate of return of 8-1/3%. This is the basis of Mr. Merrill's judgment that the rate of return of the Bell System should be at least 8%, and that such a rate of return applied to a net investment rate base is applicable and proper for applicant.

Mr. Schmausser pointed out that applicant is faced with the necessity of raising about $100,000,000 within the next few years for capital expenditures to meet the growing telephone needs of its territory. He stated that these funds must be raised in competition with other types of businesses which now have the advantages of larger earnings and dividend rates, low ratio of wage costs to revenues, low debt ratio, and adequate surplus. In his opinion, to raise this capital ap-

plicant must not only show adequate present earnings and pay satisfactory stable dividends, but there must be an outlook for good future earnings which will enable Company to improve its inadequate surplus and lower its debt ratio. In his judgment, this requires earnings of not less than 8% on the net investment rate base of the future. Mr. Schmausser, in his study, considered the Mountain States Company, the American Company, and the Bell System as an integrated unit. However, he based his conclusions upon separate consideration of applicant as a financial entity.

Mr. Schmausser stated that to assure that new stock offers will be attractive to the public, the Company should, under present conditions, be paying a dividend of $8 per share per annum, and be adding $4 to $5 to surplus. On cross-examination, however, he stated that a $7 dividend properly protected might possibly make the stock attractive.

Mr. Remington traced the financial history of the Mountain States Company for the past three decades. He pointed out that in the face of adverse earnings, dividends have been repeatedly cut, and the per cent of surplus to telephone plant remains at a point too low for financial safety. He stated that in his opinion a dividend of $8. per share of $100 par value is necessary to cause the market price of the stock to rise sufficiently so that the required future stock offerings will be assured of success. In addition, he advocated that earnings be sufficient to build the surplus to 12½% of plant over a period of 5½ years in order to safeguard the dividend rate and to provide earnings which would enable the Company to compete for capital. These requirements for dividends and surplus, together with the annual fixed charges on the funded debt, are equivalent to 8.2% on the company's net investment.

Mr. Knapp, testifying for the Colorado Municipal League, stated that, in his opinion, the fair and reasonable rate of return for applicant is not more than 6.15% and not less than 5.65% on a net investment rate base consisting of telephone plant in service less full amount of depreciation reserve, plus allowances for materials and supplies and

cash working capital, but excluding telephone plant under construction, property held for future telephone use, and telephone plant acquisition adjustment. He arrived at his higher figure of 6.15% as his estimate of the over-all current cost of capital predicated on an estimated 3.45% current cost of debt capital with a 44.35% debt ratio and an estimated 8.25% current cost of equity capital with a 55.65% equity ratio. The figure of 3.45%, representing the estimated current cost of debt capital to the Telephone Company, included an allowance for concessions to purchasers of new bond issues and an allowance for cost of financing. The cost of equity capital of 8.25% was a judgment figure arrived at chiefly from a study of the earnings-price ratios of specific offerings of Bell System companies and a number of electric operating utilities which sold common stock during the Years 1948 to 1951.

Mr. Knapp arrived at his lower rate of return of 5.65% by determining the rate of return required on the entire capitalization of the Mountain States Telephone and Telegraph Company in order to permit the applicant to earn the return required by its parent American Company on the latter's investment in the applicant, as well as the return required by the minority stockholders and bond holders of the applicant on their investments in the common stock and debentures of the applicant. This study was based upon the capital structure of the American Company after giving effect to the conversion of the outstanding convertible debentures, with interest computed at the actual cost on outstanding issues, with dividend requirements of $9.00 per share on the common stock and a dividend pay-out ratio of 90%.

Mr. Knapp further testified that the application of the 6.15% and 5.65% rates of return to the applicant's intrastate average net investment rate base for the twelve months period ending May 31, 1951, would yield a return available for common stock, after meeting interest requirements on debt, which would be equivalent to earnings of 8.53% per share on the basis of an assumed capital structure consisting of 45% debt and 55% equity capital, and earnings of $7.85 per share on the basis of actual capitalization consisting of 32.41% debt and 67.59% equity capital. He testified that over a ten-year period, earnings of $8.53 and $7.85 per share,

respectively, would produce the following amounts of retained surplus per share of applicant's stock allocable to Colorado intrastate operations, depending upon whether the $6.00 dividend rate is continued, or whether the annual dividend rate is increased to $7.00 per share:

	$6.00 Annual Dividend Rate	$7.00 Annual Dividend Rate
Assumed 45% debt and 55% Equity Ratios:		
Earnings per share	$ 8.53	$ 8.53
Retained surplus per share at end of 10 years	$32.10	$22.10
Number of years' dividend requirements	over 5 yrs.	over 3 yrs.
Actual 32.41% debt and 67.59% Equity Ratios:		
Earnings per share	$ 7.85	$ 7.85
Retained surplus per share at end of 10 years	$23.96	$13.96
Number of years' dividend requirements	approx. 4 yrs.	approx. 2 years.

Mr. Knapp testified that the applicant entered the depression of the 1930's with a retained surplus equivalent to $20.88 per share, representing about two and one-half years' coverage of the then annual dividend requirements of $8.00 per share, and that the applicant's last successful common stock subscription offering was made in 1946 at a time when the annual dividend rate was $6.00 per share, after having been reduced from $8.00 to $7.00 in 1937, and from $7.00 to $6.00 in 1943. He concluded that the ability to accumulate retained earnings over a period of ten years sufficient to cover two to five years dividend requirements on the basis of a 6.15% rate of return was further evidence of the reasonableness of such a rate of return.

Mr. Knapp stated that, in his opinion, the period for accumulating surplus of five and one-half years, used by Mr. Remington, was too short, and suggested the use of a ten-year period, in view of the present continuing high level of business activity. Mr. Knapp disagreed with the view that an $8.00 dividend is necessary for applicant, and stated that a $6.00 dividend, if given the approval of this Commission, should be sufficient to restore investor confidence in applicant.

Dr. Zubrow, also testifying for the Colorado Municipal League, pointed out the saving in the form of reduced capital charges and income taxes which would result from a 50% debt ratio, as compared with a 25% debt ratio, stressing the point that with a 50% corporate income tax, the tax saving would be twice as much as the direct saving. He stated that

in his opinion, a reasonable debt ratio for the Mountain States Company would be [illegible]%, and that this is the same as the average prevailing for the Bell System as a whole. Dr. Zubrow disputed testimony of Mr. Merrill to the effect that the Bell System is in a dangerous financial position, and also contended that the period of five and one-half years selected by Mr. [illegible] as appropriate for building the Company's surplus is too short. Dr. Zubrow also pointed out that technological innovations must be recognized as an important factor of decreasing costs, offsetting, at least in part, the tendency toward increasing costs under present inflationary conditions.

The determination of what should be a fair rate of return is often the most complex and difficult problem in proceedings of this kind. There is no one formula or set of formulae that the Commission can rely on to arrive at that rate of return, nor can the rate of return be fixed by any mathematical calculation. In this proceeding, this Commission has had the benefit of some of the most competent and responsible witnesses ever to appear before this Commission, both on behalf of the applicant and on behalf of the Colorado Municipal League, and the cities in Colorado. In the opinion of the witnesses testifying for the Telephone Company, the fair rate of return for applicant should be in the neighborhood of 8%, whereas the witnesses testifying for the Colorado Municipal League and the cities believe that the fair rate of return should be in the neighborhood of 6%, in no case lower than 5.65%. Mr. Merrill's judgment was predicated largely on the supposition that the American Company does not today have sufficient earnings to adequately protect the $9.00 dividend. Those earnings for the twelve months ending December 31, 1950, were $12.44, and for the twelve months ending with the first quarter of the Year 1951 were $12.89. In Mr. Merrill's opinion, the earnings of the American Company should be at least $15.00 per share. The record discloses that the present earnings of the American Company are higher than they have been in any time in the last twenty years. Moreover, Mr. Merrill himself has recognized that, during the five and one-half years from January 1, 1946 to March 31, 1951, the American Com

pany raised $[illegible] of additional new capital from the public, and it is difficult for this Commission to see the dangers to the financial position of the American Company expressed in the testimony of Mr. Merrill. Moreover, Mr. Merrill arrived at his estimated cost of equity capital by relating the $15.00 per share earnings to the book equity value of the common stock of the American Company, $138.09. In other words, he arrived at his 11% cost of equity capital using what is known as the earnings equity ratio. Mr. Knapp's approach to the problem was in the use of what is known as the earnings price ratio, that is, the ratio of earnings to market price. If we relate the actual earnings of the American Company for the Year 1950 to the market price of its common stock during that period, we arrive at a return on equity capital of approximately 8%. While this Commission does not intend to adopt any of these particular approaches in arriving at what should be the proper rate of return on equity capital, the Commission is of the opinion that Mr. Merrill's judgment of what should be the over-all rate of return for applicant in this proceeding is based almost entirely on a consideration of the interest of the investors, and he does not balance that interest of the investors with the interest of the consumers.

Mr. Remington's testimony to the effect that the company should have a rate of return of 8.2% was based largely on his opinion that the company should restore its $8.00 dividend on the $100.00 par value common stock of the applicant, and that the company should have earnings sufficient to build the surplus to 12½% of plant over a period of five and one-half years. Mr. Knapp, on the other hand, did not agree that the company had to restore its $8.00 dividend to maintain its credit and to attract new capital. He was of the opinion that a $7.00 dividend, or even a $6.00 dividend, approved by this Commission, would be sufficient to restore the confidence of the investing public in the common stock of the company.

Exhibit No. 46, introduced by Mr. Remington, shows that, in the period 1920 to 1950, the surplus expressed as a percent of the total telephone plant of the company never exceeded 9.50%, and that the surplus of the company for the last fifteen years has not exceeded 2.30% of the

telephone plant. As a matter of fact, this exhibit [illegible], during the period of [illegible]'s greatest prosperity [illegible] 1930, the company [illegible] of between [illegible] and [illegible] of telephone plant and that with [illegible] the company was able to maintain an $8.00 dividend during the years of the great depression in 1931 through 1937.

While this Commission recognizes that the earnings of the applicant must be sufficient to pay a reasonable dividend and to set aside a reasonable amount to surplus each year, the Commission does not agree with Mr. Remington that, if the company is not able to build up a surplus of 12½% of its plant within the next five and one-half years, the company will not be able to maintain its credit and attract capital.

The testimony of both Mr. Knapp and Dr. Zubrow advocating a rate of return of not less than 5.65% and not more than 6.15% was based on an assumed debt ratio of the Telephone Company of 45% debt and 55% equity. This is approximately the present capital structure of the Bell System. Mr. Remington contended, as did Mr. Merrill, that the debt ratio of the Bell System is now unusually high because of the necessity of debt financing during the past few years. They felt that the capital structure of the Bell System over the long run should average about one-third debt and two-thirds equity, and that applicant as a Bell System subsidiary company, subject to the over-riding debt of the American Company, should have a debt ratio of one-fourth or less. At June 30, 1951, applicant's actual debt ratio was about 33%, and as of January 31, 1952, applicant's actual debt ratio was about 30.6%.

This Commission, while it recognizes that it has no jurisdiction over the security issues of the applicant company under the Statutes in Colorado, from which it obtains its powers, believes that it is more realistic to base the required rate of return upon the existing capital structure, rather than upon a hypothetical one, as assumed by Mr. Knapp and Dr. Zubrow.

As we have just stated above, the proper rate of return of a public utility cannot be calculated by any fixed mathematical formula, and this is a question which demands the highest discretion and thoughtful

judgment of the Commission. If this Commission were to allow the applicant a rate of return of 8% on its actual net investment in Colorado intrastate telephone property as of May 31, 1951, after meeting all operating expenses and paying fixed charges on funded debt and on advances from the American Company, the earnings per share on common stock outstanding as of that date allocable to the Colorado intrastate operation would be approximately $11.82 a share, as shown by Staff Exhibit No. 90, and the earnings per share would be approximately $11.21 a share if the 8% rate of return were to be allowed on the average net investment for the twelve-month period ending May 31, 1951. Moreover, an 8% return on the actual net investment of the Telephone Company, as of January 31, 1952, would produce earnings of approximately $12.86 a share, and that rate of return on the average net investment for the twelve months ending January 31, 1952 would produce earnings of approximately $11.74 per share. The highest earnings that this company has enjoyed since 1920 have not exceeded $10.88 per share. The net earnings of the Telephone Company since 1930 have not exceeded $8.30 a share.

After careful consideration of the testimony, the Commission has come to the conclusion, and finds, that a rate of return of 6.35% is adequate, and that such a return should be sufficient to assure confidence in the financial soundness of the applicant company, and should be adequate to maintain the credit of applicant company and to attract the capital necessary for the proper discharge of its public duties. Such a return will produce earnings after payment of all operating expenses and fixed charges of between $8.89 and $9.78 per share of common stock on the total net investment of the Telephone Company in its Colorado intrastate property as of January 31, 1952.

Attrition

As has heretofore been pointed out, the application in this case was filed on June 20, 1951, approximately ten months ago. During the hearings, the witnesses both for the Telephone Company and for the municipalities, pointed out that in these inflationary times, there is

a serious progressive attrition in net earnings, arising chiefly from the fact that the plant extensions required to serve new customers cost a great deal more than the average net plant per telephone now serving present customers. As an example, at December 31, 1950, the intrastate investment per telephone was $168; whereas, during the year ending December 31, 1951, the intrastate investment per telephone added was $384. Accordingly, the amount required for depreciation, taxes, and rate of return with respect to the new customer is more than is required for the old customer, and since the same rates for service apply to both, the new business is not as profitable as the old. Rates are made for the future, and all parties were in agreement that the Commission should make some provision for this attrition by allowing a greater amount of revenues than would be necessary upon strict consideration of the past test period; that is, the year ending May 31, 1951. The Company introduced a computation indicating that the attrition from increasing investment amounts to $365,000 per year, based on the average number of telephones in the test period. The City witness Knapp stated that an allowance for attrition for two years beyond the test period would be appropriate, but that it should be based upon estimates of operating results for such period, rather than on a study of changes involving only one factor of increasing investment. Thereupon, the Company submitted its estimate of operating results for the Year 1952, which is seventeen months beyond the test period. Adjusting the change in operations shown by this estimate to reflect two full years beyond the test period shows an attrition of earnings of $748,000 for the two years, which is $374,000 per year.

In considering this attrition factor, the Commission, before coming to a decision, wished information as to the most recent operating results of the Company, and at the further hearing on April 23, 1952, the showings of the value of the property were brought up to December 31, 1951, and January 31, 1952, with showings of the adjusted net earnings for the twelve months ending with each of these dates. The progressive effect of attrition is shown in the following table of operating results for the various periods now in evidence — that is, all being adjusted to

the present going level of wages, taxes, separations (under the Charleston Plan), pension accruals, and being consistent in their treatment of non-recurring expenses.

12 Months Ended	Revenues	Net Earnings	Net Investment End of Period	Per Cent Net Earnings to Net Investment End of Period
May 31, 1951	$26,641,185	$1,377,006	$52,664,820	2.61
Sep. 30, 1951	27,274,214	1,319,789	55,369,897	2.38
Dec. 31, 1951	27,781,593	1,192,624	57,650,932	2.07
Jan. 31, 1952	27,972,271	1,164,287	58,571,638	1.99

This table shows that there has been a substantial growth in the Company's revenues, as more and more telephones were served. It also shows that there has been a rapid increase in the Company's net investment arising through the plant expansion program necessary to serve these additional customers. Net earnings have not increased with this larger volume, but have declined progressively, and thus the per cent of the net earnings to the investment has substantially declined.

After careful consideration of this problem, having in mind all of the evidence presented at this hearing, this Commission is of the opinion that the valuation of the Telephone Company's property should be determined having in mind this question of attrition. Therefore, the Commission is of the opinion that the valuation of the Telephone Company's Colorado intrastate property should be based on the actual net investment as of the most recent date available to the Commission. The average total net investment of applicant for the period ending January 31, 1952, excluding the plant acquisition adjustment account, amounts to $54,197,378, whereas the actual net investment as of January 31, 1952, is $58,568,550. The Commission believes that by setting the valuation of the Telephone Company's property at $58,568,550, such a valuation will provide some compensation for the attrition in the Telephone Company's earnings. Moreover, in arriving at a rate of return of 6.35%, as adequate for the applicant in this proceeding, the Commission has had in mind this question of attrition. In other words, the Commission is of the opinion that a 6.35% rate of return on a valuation of the Colorado intrastate property of the Telephone Company in the amount of $58,568,550 should yield the Telephone Company in the future on the Colorado intrastate portion of its property

adequate revenues, so that the Colorado intrastate operation can contribute its fair share to the financial stability of the Telephone Company and to the broad expansion program contemplated by the Telephone Company for the near future in Colorado.

Revenue Required for Colorado Intrastate Operations

Applying a rate of return of 6.35% to the actual total net investment as of January 31, 1952, as hereinabove described, and deducting the actual net operating earnings for the twelve months ending at that date, adjusted to reflect for a full twelve-months period changes in rates for employees' wages and Federal Income Taxes, and also adjusted for non-recurring expenses and change in separation procedures, produces a net operating earnings deficiency of $2,554,816, computed as follows:

Net Investment, Jan. 31, 1952		$58,568,550.00
Required Rate of Return	6.35%	
Required Net Earnings		$ 3,719,103.00
Actual Net Earnings, 12 months ended Jan. 31, 1952		1,164,287.00
Earnings Deficiency, 12 months ended Jan. 31, 1952		$ 2,554,816.00.

In the face of the present 52% rate of Federal Income Tax, the State Net Income Tax, and the Cities Gross Receipts Taxes, the increased license contract payments and uncollectible revenues, the Company will retain in its net earnings but 45.79¢ out of every dollar of increased revenue. In other words, there must be a revenue increase of approximately $2.184 for every dollar of net operating earnings improvement. Accordingly, the gross revenue deficiency is 2.184 times the net operating earnings deficiency of $2,554,816, or $5,579,412.

Throughout this proceeding, the Telephone Company has taken the position that approximately $7,000,000 additional gross revenue was required. The Commission, however, is of the opinion that $5,579,412 in additional gross revenue is sufficient to assure the customers of the Telephone Company of improved telephone service, and to assure the investors of the Telephone Company of the protection of their savings and of a reasonable return thereon.

F I N D I N G S

THE COMMISSION FINDS:

1. That the Commission has jurisdiction over and with respect

to the applicant, and has jurisdiction to promulgate these Findings and the following Order.

2. That the fair and reasonable value, as of January 31, 1952, of the property of The Mountain States Telephone and Telegraph Company devoted to intrastate service within the State of Colorado is $58,568,550.00, consisting of the following:

Telephone Plant in Service	$76,041,827.00
Property Held for Future Telephone Use . .	9,501.00
Telephone Plant under Construction	1,807,972.00
Material and Supplies.	1,255,546.00
Cash Working Capital	1,204,409.00
Total Investment	$80,319,255.00
Allocated Depreciation Reserve	$21,750,705.00
Total Investment less Allocated Depreciation Reserve.	$58,568,550.00

3. That a fair rate of return on the above-determined fair and reasonable value of the property of The Mountain States Telephone and Telegraph Company devoted to intrastate service in the State of Colorado, is 6.3%.

4. That the revenue to which said company is entitled to enable it to realize such fair rate of return amounts to $33,551,653.00, being an increase of $5,579,412.00, or 19.95% over and above the total Colorado intrastate operating revenues of said company for the year ending January 31, 1952.

5. That the facts which may have a bearing on such fair value are set forth in the above and foregoing Statement, which by reference is made a part of these Findings and incorporated herein.

O R D E R

THE COMMISSION ORDERS:

That the above-stated Findings should be, and hereby are, adopted as the Findings of The Public Utilities Commission of the State of [illegible] in the above-entitled action, and the same shall become effective twenty-one (21) days from the date hereof.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Commissioners

Dated at Denver, Colorado,
this 6th day of May, 1952.

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