(Decision No. 72385)

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, 931 - 14TH STREET, DENVER, COLORADO, FOR AN ORDER OF THE COMMISSION DETERMINING THE FAIR VALUE OF APPLICANT'S PROPERTY DEVOTED TO THE RENDITION OF INTRASTATE TELEPHONE SERVICE IN COLORADO, A FAIR, REASONABLE, AND ADEQUATE RATE OF RETURN TO BE APPLIED THERETO, AND THE RESULTING AMOUNTS OF NET EARNINGS AND REVENUES REQUIRED IN THE FUTURE; AND, UPON SUCH DETERMINATION BY THE COMMISSION AND THE FILING OF A PROPOSED TARIFF AND ADDITIONAL HEARINGS THEREON FOR AUTHORITY TO FILE A SCHEDULE OF JUST AND REASONABLE RATES TO PRODUCE THE REQUIRED REVENUES.	APPLICATION NO. 23116

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January 7, 1969
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Appearances: Akolt, Shepherd & Dick, Esqs.,
Denver, Colorado, by
Luis D. Rovira, Esq., Denver, Colorado, and
Denis G. Stack, Esq., Denver, Colorado,
for Applicant;
Howard J. Otis, Esq., Denver, Colorado, and
James J. Keough, Esq., Arlington, Virginia,
for the Department of Defense and
General Services Administration,
Protestants;
Leonard M. Shinn, Esq., Washington, D.C., and
David M. Lewis, Jr., Esq., Washington, D. C.,
for Executive Agencies of the U.S. Government;
H. Leroy Thurtell, Esq., Denver, Colorado,
Thomas J. O'Reilly, Esq., Denver, Colorado, and
Iris Bell, Esq., Denver, Colorado,
for the General Services Administration,
Protestant;
Gorsuch, Kirgis, Campbell, Walker & Grover, Esqs.,
Denver, Colorado, by
Leonard M. Campbell, Esq., Denver, Colorado, and
Nicholas Mueller, Esq., Denver, Colorado,
for the Colorado Municipal League and the
City and County of Denver, Protestants;
Max P. Zall, Esq., Denver, Colorado, and
Brian Goral, Esq., Denver, Colorado,
for the City and County of Denver, Protestant;
Charles Howe, Esq., Boulder, Colorado,
for the Colorado Municipal League, Protestant;

Appearances continued:

Sonheim, Whitworth & Helm, Esqs.,
Arvada, Colorado, for the City of Arvada
and the Colorado Municipal League;
John F. Edwards, Esq., Sterling, Colorado,
for the City of Sterling;
Albert A. Riede, Denver, Colorado,
for the Colorado-Wyoming Hotel Association;
Frank Thompson, Denver, Colorado,
for the American Hotel and Motel Association;
Buron Keith Watson, Esq., Denver, Colorado,
for the American Brief Company;
Robert L. Pyle, Esq., Denver, Colorado,
Robert Lee Kessler, Esq., Denver, Colorado, and
Girts Krumins, Esq., Denver, Colorado,
for the Staff of the Commission.

PROCEDURE AND RECORD

The above-entitled application was filed with the Commission by Mountain States Telephone and Telegraph Company (hereinafter sometimes referred to as Applicant or Mountain States) on April 2, 1968. By said application, Applicant seeks Commission authorization to file new schedules of rates for intrastate telephone service in the State of Colorado based upon Commission determination, after hearing, of the value of Applicant's property devoted to such service, a fair return thereon, and the resulting amounts of net earnings and revenues required therefor.

After due and proper notice to all interested persons, firms or corporations, the above-entitled matter was initially set for hearing to commence on May 13, 1968. A petition to intervene was filed by the City of Sterling and was granted. Additional appearances protesting the application were made by the Colorado Municipal League and its member municipalities, the City and County of Denver, and the United States of America by and through the Department of Defense and the General Services Administration. The Commission hereby rules that the aforesaid parties are directly affected by this proceeding and are proper parties hereto in accordance with Rule 7 of the Rules of Practice and Procedure before this Commission.

The hearing began, pursuant to proper notice, at 10 o'clock A.M. on May 13, 1968, in the Commission Hearing Room, 1845 Sherman Street, Denver, Colorado. At that time, the direct testimony of Applicant's witnesses, Messrs. Pringle, Kesselman, Travers, Kutzler, Hatfield, Heckman and Doctors Brown, Coolidge and Kolb, was presented. The hearing was then recessed to May 16, 1968, in order to accommodate an additional witness of Applicant. On May 16 and 17, 1968, the direct testimony of Applicant's witness, Mr. Youmans, was received and clarification examination was conducted of all of Applicant's witnesses. At the conclusion of the direct case of Mountain States, the Colorado Municipal League, the City and County of Denver, and the Staff of this Commission, by and through their respective attorneys, made oral motions requesting additional information to be furnished by Applicant alleging that the information contained in the Applicant's direct case had been inadequate. The respective attorneys were instructed by the Commission to state their requests in writing and, as a result thereof, the hearing was recessed until further notice.

On May 28, 1968, a request for specified information and additional data was filed by the Staff of the Commission, and, on May 31, 1968, a similar motion was filed by the Protestants. On July 1, 1968, the response to the aforesaid request and motion was filed by the Applicant. Upon due and proper notice, the oral argument, with respect thereto, was heard by the Commission on July 15, 1968, and an Order of the Commission in this regard was issued on July 18, 1968. This Order granted and denied some of the requests, and--in addition--ruled that other requests made by Protestants' motion were premature. The aforesaid premature requests were not renewed during the course of this proceeding and therefore no further ruling by the Commission is now necessary. No ruling was made with respect to the motion of the Commission staff since Applicant had agreed to furnish the information requested. Applicant also agreed by stipulation, and without ruling of the Commission, to furnish certain other information requested by the Protestants. Commission Decision No. 71607 more fully sets forth the details of this situation. Also, upon due and proper notice, hearings for the purpose of cross examination of the Applicant's witnesses were held on August 6, 7, 8, 12, 13, 14, 15, and 17, 1968. During the course of these hearings, additional direct testimony was presented by Applicant because of and to support revised exhibits. Such witnesses included: Mr. Travers, Mr. Heckman, Mr. Kutzler, Dr. Kolb and Mr. Robichaux. On August 17, 1968, the hearing was continued to a future date to be determined by the Commission. After due and proper notice to all interested parties, the hearing was resumed on October 7, 1968, and the direct testimony of Protestants and Staff witnesses, as well as the clarification and cross examination of Staff witnesses, was heard on October 7, 8, 9, 10, and 11, 1968. Ten public witnesses were also heard at that time wherein (a) eight opposed the application (b) one favored the application and (c) one neither opposed nor favored the same. Numerous letters of protest were also received by the Commission and placed in the official file. Mr. Melwood Van Scoyoc, independent expert witness, testified for Protestants, the City and County of Denver and the Colorado Municipal League, and Messrs. Garrison, Thompson and McNulty testified for the Staff. On October 11, 1968, the hearing was continued to October 21, 1968, for the purpose of further direct and cross examination of Protestant and Staff witnesses, as well as rebuttal testimony from the Applicant.

The hearing was duly resumed on October 21, 1968, and continued until October 25, 1968, during which time Mr. David A. Kosh, independent expert witness, testified on behalf of Staff and was cross examined. Direct and cross examination of Mr. Lipske, testifying on behalf of the General Services Administration, a Protestant, and further direct and cross examination of Mr. Van Scoyoc was presented. Rebuttal testimony by Applicant was presented by Messrs. Travers, Schneider, and Kesselman. A total of 23 days were spent in hearings which produced 3,567 pages of transcript.

The evidence was heard by Chairman Zarlengo, Commissioner Bjelland and Commissioner Lundborg, with the exception of the period October 21 through 25, 1968, during which time Chairman Zarlengo was necessarily absent and the matter was heard by Commissioners Bjelland and Lundborg. At the conclusion of the hearing, October 25, 1968, the matter was taken under advisement by the Commission.

Applicant offered a total of 125 exhibits, all of which were admitted into evidence. These exhibits included Applicant's Exhibits Nos. 1 through 113 and Applicant's Exhibits Nos. 19A, 20A, 23A, 24A, 25A, 26A, 27A, 28A, 65A, 66A, 67A, and 68A. Staff presented 8 exhibits, numbered Staff Exhibits 1 through 8, all of which were admitted into evidence. Protestant, General Services Administration, presented two exhibits, No. GSA-1 and GSA-2, both of which were admitted into evidence. Protestant, City and County of Denver, offered exhibits marked Protestant's Exhibit A, Protestant's Exhibits D through S and Protestant's Exhibit K-1. All except Protestant's Exhibit D were admitted into evidence. Public witness Exhibit No. 1 was offered and admitted, but was subsequently withdrawn after the witness read the entire exhibit into the record. The bulk of the direct testimony was prepared in writing beforehand, and, by stipulation of the parties, was admitted as so prepared without being actually read into the record.

At the conclusion of the hearing, all parties were allowed to file single, simultaneous briefs which were to be due on or before December 2, 1968. The Staff declined the opportunity to file such brief. On December 2, 1968, briefs were filed by Mountain States, the General Services Administration on behalf of The United States, and by the Colorado Municipal League and the City and County of Denver. The Commission in considering all the evidence in this record has also taken official notice of its own Decisions Nos. 41363 and 67393.

THE RATE-MAKING PROCESS

The rate-making process involves the determination of fair and reasonable rates that will allow the utility in the future to recover from its ratepayers all the proper and necessary costs of doing business including capital costs. Capital costs are normally expressed as return on investment.

The first step in the rate-making process is to determine the proper period of time for which the revenue required to recover costs of doing business, as stated above, is tested. This involves the use of a "test year." The test year is normally a past period for which all financial and operating results are known. The advantage of using a past period is that actual results rather than estimates are presented. The next step is to adjust the actual test year results for known changes during the year and to normalize revenues, expenses and investment during the year as necessary. Thus, for instance, for a utility, the revenues of which are dependent upon the weather, such revenues must be adjusted to reflect a normal weather year and the same must in like manner be done with expenses. A telephone utility, of course, is not weather oriented, but there are still a number of adjustments that must be made. Any abnormal expense or revenue item must be eliminated, any booked costs that refer to an earlier period must be properly adjusted, and any major changes that occurred during the test year period must be annualized to reflect their effect for the entire period. These are known as "in-period" adjustments. Once a correct matching of revenues, expenses and investment in property is made, it is reasonable to assume that a projection of rates based on the test year conditions will continue to produce sufficient revenues. This is not to say that other factors may not be present that may affect future results. Therefore, occasionally adjustments for changes occurring after the test year must be made. Such adjustments are known as "out-of-period" adjustments. In this category one particular item is taxes. The utility has little or no control over the taxes it must pay, and a change in tax rates, for instance, would distort the future results if no adjustment were made for test year expenses.

The rationale of using a test year may be summarized as the Maine Commission did in RE Central Maine Power Co. 29 PUR 3d 113, 125:

> "A test year is justified as a basis for forecast of future rate of return on the assumption that the growth of revenues and of income will tend to take care of the growth in the rate base; and that the factors which interfere with this corrective tendency can be allowed for by measurement or judgment."

The next step is to determine the value of the property devoted to utility service, or the so-called rate base. This figure should reflect the investment in property that was actually used in the utility operations during the test year. Next the actual revenues and expenses are scrutinized to determine their propriety and reasonableness, making any adjustments that are necessary. The difference between revenues and expenses is the net operating income of the utility which produces the return on rate base. The rate of return in percent may be computed by dividing such net operating income by the rate base. The rate of return is a crucial determination, as it is the dollars produced by this rate of return that compensate the utility for its costs of capital. The costs of capital consist of interest on long term debt and associated expenses of debt service (fixed charges), costs of preferred stock, if any, with the balance of net operating income being available to the common equity investors. This balance must be such that capital may be attracted on reasonable terms and must therefore be sufficient to provide for a reasonable and adequate dividend, for a reasonable accumulation of surplus, and for the maintenance of the financial integrity of the utility. The total revenue requirements then consist of all the expenses that may be determined proper, including adjustments, and the above mentioned return or capital costs.

As can be readily seen, the cost of equity capital in a rate proceeding involves the single most important determination to be made by the regulatory body as judgment must be exercised to determine investor expectations. The revenue requirements as determined must be tested against the actual test year revenues with the result that either a deficiency or excess in revenues is found to exist. At this point the first phase of the rate-making process is completed.

In the instant proceeding we are now at such a point and we have determined a certain deficiency in revenues. The next phase, which will possibly be the subject of further hearings, will be to determine how the deficiency in revenues determined herein will be applied to the various classes of service or the so-called "spread of the rates." Here again, the deficiency in revenue will be apportioned on the basis of the actual test year customers or units of sales. In other words, the new rates will be developed so that, when applied to the test year conditions month by month, such rates would have produced the total revenue requirements including any deficiency previously determined. Obviously, in the future both the revenue requirements and the revenue produced by the new rates would be higher if the utility is expanding by increasing the number of customers and by selling more units of the utility service involved. However, the relationship between revenues, expenses and investment in plant should remain approximately the same if the rates are properly designed.

FINDINGS OF FACT

After careful reviewing the entire record herein, the Commission finds as fact from such record that:

1. Applicant is a public utility engaged in the business of providing telephone utility service both intrastate and interstate within the State of Colorado and other states. The Applicant's intrastate telephone business within the State of Colorado is under the jurisdiction of this Commission, and the Commission has jurisdiction over the subject matter of this application.

2. The Applicant is a subsidiary of the American Telephone and Telegraph Company which owns in excess of 86% of Applicant's outstanding common stock. The American Telephone and Telegraph Company has a number of other operating subsidiaries similar in nature to Mountain States and, in addition, has a manufacturing subsidiary, the Western Electric Company, and a research subsidiary, the Bell Telephone Laboratories. The entire group of companies, including American Telephone and Telegraph Company, Mountain States Telephone and Telegraph Company, Western Electric Company, Bell Telephone Laboratories, and other operating companies, which are subsidiaries of the American Telephone and Telegraph Company, comprise what is known and generally referred to herein as the Bell System.

3. The separation of revenues, expenses, plant and investment of the Applicant located in the State of Colorado between interstate and intrastate use is determined by the use of the Separations Manual promulgated by the Federal Communications Commission and the National Association of Regulatory Utility Commissioners. This Separations Manual, for the purposes of this proceeding, is approved by this Commission as the proper method of determining the proportionate share of intrastate revenue, expenses, plant and investment, and the actual accounting data presented by Applicant in this proceeding correctly reflect the application of said Separations Manual to determine the amount applicable to intrastate telephone service. A change in the Separations procedures as provided for in the Separations

Manual was made by the Federal Communications Commission in December 1967, resulting in the adjustments made in Findings No. 6 and No. 11 as set forth below.

4. The test year for determination of revenue requirements for the Applicant in this proceeding is the calendar year 1967.

5. The rate base of the Applicant for the test year, for the purposes of this proceeding, properly consist of:

a. Average plant in service of $364,579,041.

b. Average property held for future use of $225,927.

c. Average materials and supplies of $1,722,288.

d. Average plant under construction of $10,089,155.

e. Deduction of the average accumulated reserve for depreciation of $66,854,035.

6. The rate base of the Applicant, for the purposes of this proceeding, must be further properly adjusted by annualizing a change in the intrastate-interstate separations procedures (see Finding No. 3) by deducting therefrom $2,037,572.

7. The total value, for the purposes of this proceeding, of the Applicant's property devoted to intrastate telephone service in the State of Colorado consists of all the rate base items stated in the above Findings No. 5 and No. 6 and is $307,724,804.

8. The actual revenue of the Applicant derived from its intrastate telephone operations in the State of Colorado in the test year 1967 is $119,849,530 less uncollectible revenue of $388,754, or $119,460,776. The actual expenses, including taxes, of the Applicant applicable to its intrastate telephone operations in the State of Colorado for the test year 1967 is $97,332,709. After deducting the actual expenses, including taxes, from the total actual operating revenues, Applicant's net operating income derived from its intrastate telephone operations in the State of Colorado in the test year 1967 is $22,128,067.

9. The interest charged to construction during the test year 1967 and applicable to Applicant's Colorado intrastate operation is $501,546, which amount must be added to the net operating income of the Applicant if telephone plant under construction is included in the rate base. Therefore, the actual net operating earnings applicable to the rate base found in above Findings No. 5 to No. 7 is $22,629,613.

10. The net operating earnings of the Applicant derived from its Colorado intrastate operations for the test year 1967 must be further adjusted by subtracting therefrom the effect on net operating earnings of certain items booked in 1967 applicable to prior years, to wit:

a. Investment credit applicable to prior years - $63,468.

b. Ad valorem tax - $57,383.

c. Income tax accrual adjustment for previous years - $4,518.

11. The net operating earnings of the Applicant derived from its Colorado intrastate operations for the test year 1967 must further be adjusted by annualizing the effect on expenses of a change in separations procedures made in December of 1967 (see Finding No. 3), which effect is to increase the net operating earnings by $190,758.

12. The net operating earnings Applicant derived from its Colorado intrastate telephone operations in the test year 1967 must further be adjusted by annualizing of the directory advertising rate increase during 1967, the effect of which is to increase the net operating earnings by $25,167.

13. The net operating earnings of Applicant derived from its Colorado intrastate telephone operations in the test year 1967 must further be adjusted by annualizing the increase in franchise and license taxes in 1967, the effect of which is to decrease the net operating earnings by $17,187.

14. Effective January 1, 1968, Applicant is subject to an increase in Social Security taxes and an increase in postage rates. These increases in the cost of doing business are beyond the control of Applicant and, for the purposes of this proceeding, an adjustment to net operating earnings for the test year 1967 derived from Applicant's Colorado intrastate operations,

should be made as if said tax and postage increases had been in effect in 1967, the effect of which adjustment is to decrease the net operating earnings as follows:

a. Social Security tax increase - $39,215.

b. Postage increase - $29,353.

15. After making the necessary and proper adjustments stated in Findings No. 10 to 14 above, the adjusted net operating earnings of the Applicant derived from its Colorado intrastate operations in the test year 1967 is $22,634,414.

16. At the time this Order will become effective, Applicant will be subject to a 10% Federal income tax surcharge which was not effective in 1967 and which is scheduled to expire on June 30, 1969, unless extended by law. On the basis of the 1967 adjusted net operating earnings of $22,634,414, such tax surcharge is $1,591,919.

17. The Applicant has not taken advantage of the provisions of Section 167 of the Internal Revenue Code regarding accelerated methods of depreciation for tax purposes, and this Commission will not in this proceeding impute any tax benefits that might have accrued had Applicant used the provisions of accelerated depreciation.

18. The prices charged to Applicant for telephone equipment by the Western Electric Company, affiliated manufacturer, are and have been fair and reasonable.

19. The fair rate of return applicable to the rate base and valuation of property of Mountain States Telephone and Telegraph Company devoted to intrastate telephone service in the State of Colorado is 7.5%, which rate of return is, and will be, necessary and adequate to cover the costs of debt capital of Applicant and to provide for a reasonable return on the equity capital of Applicant.

20. The fair and reasonable requirement of net operating earnings, after applying the fair rate of return of 7.5% to the value of the Applicant's property devoted to intrastate telephone service in the State of Colorado in the test year 1967, is $23,079,360.

21. The difference between the required net operating earnings based upon the fair and reasonable rate of return as applied to Applicant's Colorado intrastate telephone operations in the test year 1967 and the actual net operating earnings, as adjusted for the same period, amounts to an earnings deficiency of $444,946. In order to produce $1 of net operating earnings, a revenue increase of $2.0816 is required using the applicable income tax rates in the test year 1967. Therefore, an increase in revenue of Applicant in the amount of $926,200 is required to produce the net operating earnings deficiency stated.

22. The unusually high rate of inflation in the general economy is presently well above the average rate of inflation during the fourteen years since the last rate case involving Applicant before this Commission in 1953. Accordingly, we find that an additional adjustment for revenue requirements to compensate for economic inflation is necessary at this time to the extent of one percent (1%) of the total revenue requirements based on the 1967 test year, or $1,207,757, which, in addition to the revenue deficiency stated in Finding No. 21 above, amounts to a total revenue deficiency of $2,133,957.

23. The 10% Federal income tax surcharge, as stated in Finding No. 16, while not effective in the year 1967, is a cost of doing business and is a proper tax expense over which the Applicant has no control during the period that the surcharge is in effect. Applicant's Colorado intrastate telephone revenues must be increased to cover the cost of the income tax surcharge by a special adjustment of Applicant's rates, such adjustment to be in effect as long as the tax surcharge is in effect to prevent a further deficiency in the net earnings of the Applicant during this period. Any revenue collected by Applicant to compensate for the 10% Federal income tax surcharge is further subject to both federal and state income taxes and other charges and, for each $1 of such surcharge, $2.29333 of gross revenue is required. The equivalent of the Federal income tax surcharge applicable to the actual net operating earnings of Applicant, as adjusted, derived from Applicant's Colorado intrastate operations in 1967 is $1,591,919, and the revenue requirement to cover

the said amount of income tax surcharge, taxes and other charges on the additional revenue is $3,650,796 ($1,591,919 x 2.29333). The revenue requirement to cover the effect of the said 10% income tax surcharge applicable to the deficiency of net operating earnings as stated in Finding No. 21 is $94,208 ($444,946 x (2.29333-2.0816)), for a total revenue requirement attributable to the tax surcharge of $3,745,004.

24. Wage increases outside of the test year are not proper and necessary adjustments to net operating earnings during the test year.

25. No adjustment of net operating earnings by the utilization of price level depreciation is proper in this proceeding.

26. The last previous rate case involving the Applicant's Colorado intrastate operations was in 1953 and the Applicant has not suffered attrition or erosion in earnings since the rates prescribed in the said proceeding went into effect. Based on this past history, no allowance for attrition or future erosion of earnings is necessary at this time, and the probability of attrition in the future has not been established in this record.

27. For the test year 1967, the number of common stock shares of Applicant applicable to its Colorado intrastate operations was 11,304,429 with an average book value of $18.65 per share.

28. The fixed charges applicable to Applicant's Colorado intrastate operations during the test year 1967 is $3,680,589.

29. Of the net operating earnings of $23,079,360 found to be fair, reasonable and necessary in Finding No. 20, after subtraction of fixed charges as stated in Finding No. 28 above, the amount available for the common stock applicable to Applicant's Colorado intrastate operations in 1967 is $19,398,771 or $1.72 per share. Earnings of $1.72 per share on a book value of $18.65 per share results in the rate of return on common equity of 9.2%, which is a fair, just and reasonable return and is sufficient and necessary to cover dividend requirements, accumulate a reasonable surplus, enable Applicant to maintain its credit and to raise

capital on reasonable terms, and assure the financial integrity of Applicant; and that such return is commensurate with returns on investments in other enterprises having corresponding risks.

30. The total revenue requirements, excluding interest charged construction and including uncollectible revenue, of the Applicant to be derived from its Colorado intrastate telephone operations on the basis of test year 1967 conditions is $121,983,487.

31. To compensate for the 10% Federal income tax surcharge, Applicant's revenue requirements stated in Finding No. 30 must be increased by the amount stated in Finding No. 23 of $3,745,004 during the period the said tax surcharge is in effect. This increase amounts to 3.07% of the total revenue requirements without the tax surcharge as stated in Finding No. 30 above.

32. The present annual and quarterly reports by Applicant to this Commission are inadequate and do not contain the detailed financial information regarding Applicant's Colorado intrastate telephone operations necessary for this Commission.

33. Applicant pays to American Telephone and Telegraph Company a general service and license fee equal to one percent of revenues except uncollectible and miscellaneous revenues, which license fee is a fair and reasonable charge for services furnished to Applicant by American Telephone and Telegraph Company, including the use of its patents, and said fee is a necessary and proper business expense of Applicant.

34. Various municipalities in the State of Colorado levy a franchise or license tax upon the local service revenues of Applicant within the respective municipalities. Such franchise or license taxes in the year 1967 did in no case exceed 3% of local service revenue, which is a reasonable charge for the use of streets and alleys of municipalities. A franchise or license tax in excess of 3% of local service revenue would not be such a reasonable charge and unless surcharged to the customers, the revenue from which is subject to these taxes, would constitute discrimination against customers outside of such municipal boundaries.

DISCUSSION

Test Year

The test year must necessarily be a past period for which all information is available if needless estimating and speculation is to be avoided. In this proceeding, most of the financial information presented by Applicant concerns its operations during the calendar year 1967. This is quite reasonable since the Application was filed on April 2, 1968. Therefore, since the only detail figures relating to a complete twelve-month period in this record are for the calendar year 1967, we have used such calendar year as the test year in our determinations.

Rate Base

The controversial items in this proceeding with respect to rate base may be classified as follows: (1) whether the rate base should be derived from original cost or the so-called "present value," (2) whether a year end or average rate base should be used, and (3) what are the proper elements of rate base that should be included.

We shall now discuss our findings in this regard. We have found that the proper valuation of the Applicant's property devoted to intrastate telephone service in Colorado is derived from the original cost of such property less accumulated provisions for depreciation rather than a value based on the so-called "present value." The reasons for such finding are rather simple. Under the accounting practices of the Uniform System of Accounts prescribed for the use of telephone utilities by this Commission, original cost of telephone property is a readily ascertained figure that is extremely reliable. Accumulated provision for depreciation is the actual amount that over the years has been charged to expense of operating such telephone properties less retirements, and is likewise readily ascertained. The so-called present value involves considerable judgment and conjecture. The Applicant presented evidence to show what the original cost of reconstructing intrastate telephone property would be at current prices. This estimate is not based on an actual pricing of each item of telephone property, but rather on a broad index of telephone property construction costs developed for the entire Bell System. Any index that may be developed is subject to certain infirmities because of the necessity for sampling and eventually ends up as an informed estimate. It is also extremely unlikely that any telephone system would ever be reconstructed in the same manner and utilizing the same equipment as in the past. The determination of value in rate-making proceedings does not necessarily relate to a market value, as utility property is not generally bought and sold in a free market. Fundamentally, utility property acquires value only due to the fact that it produces income, and if it were not producing income it would have little or no value. Therefore, it is impossible for the Commission to use income producing characteristics of such property to determine its value as it is the Commission itself that determines the income that such property must produce. The original cost concept of value certainly reflects accurately and completely the dollar investment that was originally made in such property. This entire matter becomes somewhat academic as the rate of return is applied to the rate base to determine the revenue requirements. A different rate of return would have to be applied to the original cost or net investment valuation than to a rate base derived from the so-called present value. The end result would be approximately the same no matter which method of valuation would be used. Consequently, we have concluded that the proper value of telephone property to be used in the rate base calculations in this proceeding is original cost of such property less the actual accumulated provisions for depreciation (allocated depreciation reserve) and the fair rate of return we have found is applicable only to a valuation on such a basis.

Further, we have used an average rate base rather than a year-end rate base. The revenues and expenses and the resulting net operating earnings for a year are, of course, accumulated month by month and are in fact average figures for the year rather than an annualization of the revenues and expenses as of the last day of the period. For proper matching of revenues, expenses and rate base, it is then also necessary, in our view, to determine the proper rate base on a month-to-month basis and use an average figure. To use the year-end rate base would distort this relationship. We are fully cognizant that this Commission has used a year-end rate base in other proceedings, but this has been done for the express purpose of creating an offset to attrition, recognizing that investment in utility property because of inflation is rising at a faster rate than the net operating income of the utility that provides the return. As we shall discuss later, no such offset is warranted at this time, but we will consider the effects of present abnormal inflation elsewhere herein.

There has been no controversy with respect to the inclusion of telephone plant in service and property held for future use in the rate base, and we have included these items accordingly. Neither is there any controversy in this record that the allocated depreciation reserve should be deducted to arrive at the rate base.

Both Staff and Protestants eliminated telephone plant under construction from the rate base. Telephone plant under construction does not, of course, produce revenues while it is under construction, and therefore under the strict theory of matching revenues, expenses and plant, it is not a proper item of the rate base. It is equally true that a utility company must continuously have plant under construction, especially in a growing situation, and may have considerable investment in such property that is not yet revenue producing. For this reason, the final cost of such plant includes the capitalized interest during the construction period. This interest during construction should represent the capital costs of the utility company that are applicable to investment in plant while such plant is under construction. Thus, the interest during construction is a legitimate cost of property which later forms part of the rate base on which the utility company may earn a return when it is placed in service. The Applicant has included plant under construction in the rate base, but has likewise credited income with an amount equal to the interest charged construction during the year. As long as the rate used for computing interest during construction equals the rate of return applicable to the entire rate base this process would result in a zero effect as to the revenue requirements. It is apparent from the record, however, that over the years Applicant has not charged interest during construction on a rate equal to the allowed rate of return, but rather at the lower rate of 5%. We would strongly urge that interest during construction in the future be charged at a rate comparable to the allowed rate of return. However, since this has not been done in the past, the Applicant, if plant under construction were not included, would not be fairly compensated for its capital costs relating to such plant. Any growing and prospering telephone utility must continuously construct plant improvements and extensions if good service is to be provided. It is therefore entirely proper to include plant under construction in rate base as long as income is credited with interest charged construction.

We have not included the acquisition adjustment of $35,511 in the rate base. It appears from the record that this acquisition adjustment resulted from an exchange of property with the Eastern Slope Telephone Company pursuant to our Decision No. 67393. Upon reviewing said Decision, we find no indication therein that an acquisition adjustment was contemplated at that time, but rather that the exchange was on an approximately even basis at book values of the properties. It certainly does not appear that this Commission was advised of the possibility of an acquisition adjustment when it ruled on the public convenience and necessity of such an exchange. Consequently, we have determined that this acquisition adjustment is not properly includable in the rate base, and due to the small amount involved, it should have been written off to surplus immediately after it arose. If the Applicant had any doubts about the treatment of the acquisition adjustment after it arose, it could have, and should have, asked for a ruling of this Commission how it should be treated with respect to the Colorado intrastate operations. There is no evidence that this was done.

Working capital is likewise an item of controversy. Undoubtedly any business, including a telephone utility, requires working capital to appropriately conduct its business. In this regard it must have materials and supplies on hand, and therefore, we have determined that materials and supplies is a proper item to be included in the rate base. In regard to cash working capital, however, we must observe that the Applicant has large amounts of accrued taxes which have been collected as part of the revenue from its customers but remain in the hands of the Applicant until paid to the taxing authority. This free source of funds costs the Applicant nothing and provides a larger sum on an average basis than the cash working capital claimed necessary by the Applicant. We therefore have concluded that no allowance for cash working capital need be included in the rate base. It should be observed that Applicant has not presented in its case any evidence to show what the lag between receipt of revenues is as compared to payment of expenses, but has included as a judgment figure thirty days of expenses excluding depreciation and taxes as cash working capital. This Commission has on occasion allowed as much as forty-five days of expenses, excluding depreciation and taxes, for cash working capital in cases where customers are billed after the service has been rendered. In the case of the Applicant, it is necessary to note that local service revenues are billed in advance and therefore the requirement for cash working capital is radically changed.

Both Staff and Protestants also deducted from the rate base the accumulated deferred investment tax credit. Accumulated deferred investment tax credit arises from the fact that under the Internal Revenue Code Applicant is allowed a tax credit of three percent on investment in qualified property. Applicant credits on its books the amount realized as a deferred item and then amortizes these credits for the life of the property to which the credit refers. Consequently, Applicant's income reflects these credits over the useful life of the property involved rather than in the year in which this credit is actually obtained and applied to the income tax payable. After considering the applicable provisions of the Internal Revenue Code and the intent of Congress as stated therein with respect to federal regulatory agencies, we have found that this is the proper treatment. The question then arises whether or not the accumulated deferred investment tax credit which represents funds that have not been supplied by investors of the Applicant should be included in the rate base. Certainly the funds have not been supplied by investors of the Applicant. On the other hand, it is quite clear that this reserve for deferred credits does not represent any particular piece of property, and it would be improper to reduce thereby the value of property devoted to telephone service. It would, however, be appropriate to take this amount of deferred credits into account when considering the capitalization ratios and perhaps assign a zero capital cost to this portion. However, under the method of determining return on equity that we have used and discussed later herein, only the actual equity capital applicable to Colorado intrastate operations of Applicant is considered and the question of capital supplied by sources other than investors becomes moot.

Adjustments to Rate Base

The only adjustment to the rate base proposed by all parties was the adjustment for a change in the separations procedure that became effective in December of 1967. In general, separations of telephone property between intrastate and interstate usage have been made by Applicant in conformity with the Separations Manual referred to in our Findings above. There has been no controversy in this record with respect to the methods employed, and the separations made by Applicant have been accepted. In addition, however, another adjustment in the separations procedure was made in December 1967, as stated, which resulted in a reduction of the proportionate share of telephone plant applicable to intrastate use. Appropriately, then, this adjustment should be annualized to reflect its effect on the entire test year 1967. There is a slight difference in the computations for this adjustment by Applicant and Staff in Applicant's Exhibit No. 23 and Staff Exhibit No. 5, respectively. Since the adjustment for December was already contained in the test year figures, the method employed by Staff applying only 11/12ths of the annual adjustment is more appropriate and the resulting smaller deduction from rate base will be used by the Commission herein.

The value of Applicant's property used to provide intrastate telephone service in Colorado during 1967, or rate base, is accordingly computed as follows: 1/

Average plant in service	$364,579,041
Average plant held for future use	225,927
Average materials and supplies	1,722,288
Average plant under construction	10,089,155
Subtotal	$376,616,411
Less: Average allocated Depreciation Reserve	66,854,035
Less: Separations Adjustment (net)	2,037,572
Total rate base	$307,724,804

1/ Average plant under construction from Applicant's Exhibit #100, Tab A, Worksheet A-2, line 19. Other figures - Staff Exhibit #5

Revenues and Expenses

There is no controversy in this record as to the actual 1967 revenues and expenses of the Applicant with respect to its Colorado intrastate operations, except for income taxes and interest charged construction. (Applicant's Exhibit 23, Column A and Staff Exhibit No. 4, Column A.) Since we have included plant under construction in the rate base, we will likewise credit net operating earnings with the interest charged construction during the year 1967 as discussed above. We have, however, not included interest during construction as a revenue item because it is not truly revenue, but simply an adjustment of net operating earnings. With respect to income taxes, the Staff advocates the flowing through of the investment tax credit in the year in which it is realized instead of following Applicant's procedure of amortizing the realized credits over the service life of the property to which such credits are applicable. After careful consideration, this Commission would place greater weight on the intent of Congress with respect to the treatment of investment tax credit that the Federal regulatory agencies are directed to follow. Therefore, it is out opinion, that the benefits of this tax credit are more appropriately flowed through to the benefit of ratepayers over the service life of the property which will give full effect to the intent of Congress to stimulate new investment by the allowance of this credit. As a separate adjustment, Staff Exhibits Nos. 4 and 7 show the pro forma effect on net operating earnings if Applicant had taken accelerated depreciation deductions for tax purposes under Section 167 of the Internal Revenue Code. Applicant has, however, not used accelerated depreciation for tax purposes, and consequently, we do not deem it proper to impute the estimated benefits to operating earnings without considering the far reaching effects that this might have. The record, of course, fully discloses that the use of accelerated depreciation for tax purposes would have decreased the income taxes payable by Applicant for the test year 1967. On the other hand, it appears that there might be the added risk to the common equity holder that an increase may occur in the federal income tax sometime in the future, even though a possibility of an increase may be based on several contingencies that cannot even be foreseen at this time. Since our rate of return determination will be based on the actual cost of capital to the Applicant under existing conditions, it would be improper to impute any tax benefits that might impose additional risk to Applicant's business without making adjustments in the capital costs. There is no evidence in the record that would permit us to make such an adjustment in the cost of capital.

In-Period Adjustments

Again there is no controversy in this record as to the propriety of several adjustments to revenues and expenses because of changes that have occurred during the test year. There is no question that proper adjustments must be made to annualize such changes; therefore, we have made adjustments to net operating earnings of Applicant derived from its intrastate Colorado operations for:

1. Column B, Exhibit 23 -- This refers to a book entry in 1967 of investment tax credit that is applicable to prior years.

2. Column C, Exhibit 23 -- This is an adjustment in property taxes booked in 1967 but referring to prior years.

3. Column D, Exhibit 23 -- Separations adjustments discussed before, affecting expenses.

4. Column G, Exhibit 23 -- Reflects annualization of increases during 1967 in franchise and license taxes paid by Applicant.

5. Column H, Exhibit 23 -- This reflects an annualization of increases in directory advertising rates during 1967.

6. Staff adjustment on Exhibit No. 4 for $4,518 of income taxes applicable to prior years.

Out-of-Period Adjustments

The best and most proper matching of revenues and expenses with investment during the test year precludes the use of out-of-period adjustments that occur in the normal course of business. The use of all possible out-of-period adjustments creates enormous difficulties. The test year concept would be abandoned unless proper out-of-period adjustments should be made to all the items that enter into the rate-making process including revenues, all expenses, taxes and utility plant; and, in effect, a new and future test year would be created by doing so. For this reason, we will not allow the selected adjustments contained in Columns I and J of Applicant's Exhibit 23 which reflect wage increases under collective bargaining contracts. We must observe that wage increases for the Applicant's employees are not unique for the years 1968 and 1969, but that wage increases have occurred on a more or less regular basis in the past as demonstrated in

Applicant's Exhibit No. 5. There is no evidence in the record that would lead us to believe that 1968 and 1969 wage increases are extraordinary and not related to the increase in productivity of the Applicant's employees.

We have also disallowed an adjustment for price level depreciation. After considering the evidence it is our opinion that depreciation charges should be based on the original cost of the property. Furthermore, for the same reasons that we will not impute tax benefits resulting from the use of accelerated depreciation methods, we should not impute price level depreciation for rate-making purposes as it would certainly affect the cost of capital and the required rate of return.

Column L, Applicant's Exhibit 23, proposes an adjustment of allowance for attrition. Attrition is defined as erosion in the rate of return. This erosion occurs when inflation or other economic forces cause the expenses or investment or both to increase at a faster rate than revenues. The evidence in this record clearly demonstrates that this has not been the case with respect to Applicant's Colorado intrastate operations. The rate of return since the 1953 rate case before this Commission, Decision No. 41363, Application No. 12292, has almost every year since 1955 been in excess of the 6.69% rate of return that was used by the Commission in 1953 to determine the revenue requirements of the Applicant and the rates necessitated thereby. There has been some testimony by Applicant's witnesses that attrition may take place in the future. With the record before us, however, which illustrates a perfect lack of attrition in terms of erosion in the rate of return since the last rate case, in spite of several rate <u>reductions</u> in the interim period, it is inconceivable to us how an allowance for attrition either in a dollar amount or in the rate of return could be supported at this time. This does not mean that we do not recognize the inflationary economic forces that have taken place in the economy and that affect telephone utilities, but rather that the normal forces of inflation have been effectively and completely offset by good management, efficient operations and increased usage of telephone services.

The Applicant has presented evidence suggesting that the offsetting factors to the economic forces causing attrition that have been present in the past are exhausted and will not be present in the future. In this regard we point out that in addition to the factors already mentioned, the Applicant has at its disposal two major means of offsetting increased costs. Both of these refer to income tax expense that will be borne by the Applicant in the future. First, an increased debt ratio will tend to reduce federal and state income taxes because of the fact that interest expense is deductible for both federal and state income tax purposes. As discussed later, the debt ratio suggested by the Applicant's expert witness would result in an additional decrease of federal income taxes equal to approximately .30% of the composite rate of return. On a three hundred million dollar rate base this is an additional $900,000 applicable to the net operating earnings derived from intrastate Colorado operations. Applicant's witnesses indicated, however, that such benefits may, in fact, not devolve upon Applicant and its immediate stockholders, but may rather be taken by the parent company and its stockholders.

It is, of course, the prerogative of Applicant to incur long term debt at either the operating subsidiary or the parent company level, but the benefits of such debt in the form of the interest deduction for tax purposes should be applied at the point where such benefit arises, namely the plant and assets of the operating company.

Second, there is no doubt in the minds of this Commission, from the record herein, that using accelerated depreciation methods under Section 167 of the Internal Revenue Code would be of benefit to the Applicant and its ratepayers alike. The rebuttal testimony presented by Applicant in no way indicated that this was not so. Mr. Kesselman, independent expert witness, testified mainly on the relative merits of flow-through or normalization accounting. It is undisputed, however, that the aggregate tax benefits continue to increase under the conditions where new plant is added by a utility every year at a relatively high rate. Certainly in the case of the Applicant and its Colorado operations there is every expectation that new plant will be constructed at a high rate in the future. Applicant's Exhibit No. 61 indicates that invested capital is expected to grow at a minimum compound rate of 6.9% per year. By the use of accelerated depreciation methods for tax purposes, which are optional under the Internal Revenue Code, Applicant could, therefore, not only offset the effects of inflation, but probably reduce its costs far beyond any allowance for attrition that might be suggested. As a comparison, Protestant's Exhibit A shows that if accelerated depreciation had been used since 1954, income taxes attributable to Applicant's intrastate Colorado operations would have been reduced in 1967 by more than 3 million dollars; whereas the Applicant suggested an allowance for attrition of less than one-half million dollars a year. Even if Applicant's estimates of the impact of 1968 and 1969 wage increases should be included, which we would not consider proper in any event, the total possible attrition is less than the total possible tax benefits mentioned. Protestant's Exhibit A, which was prepared by Applicant, further shows that if accelerated depreciation would have been taken in 1967 only on those assets which were acquired and qualified during 1967, the tax benefits would amount to $446,572. This benefit could be derived without the necessity of obtaining permission from the Internal Revenue Service to change accounting procedures. Furthermore, it should be noted that this figure arises from taking only one-half year depreciation on the assets acquired during the current year, and this figure would necessarily be approximately three times larger in the following year, as tax benefits are derived from assets added in two separate years, and would continue to grow in subsequent years as the process is continued.

Our discussion regarding attrition or erosion of earnings, however, refers only to a more "normal" rate of inflation such as has taken place over the period of years since 1953. On the average, the Gross National Product deflator index during this period 1953-1967 has grown at a compound rate of 2.1% a year, while the increase since 1965 has been at a rate of

3.1% a year. It takes approximately a year to complete a major rate case such as the instant proceeding and put new rates into effect. On this basis, it is the finding of the Commission that while inflation at an average rate of about 2.1% annually has not and will not result in a gradual attrition of Applicant's earnings, the recent abnormal price inflation at a rate of 1% higher than the fourteen year average necessitates an adjustment of revenue requirements in the magnitude of 1% to do no less than compensate for the unavoidable lag in putting new rates in effect.

Nor is the abnormal inflation reflected solely in the so-called Gross National Product deflator index. Similar unusual increases are reflected in other indices, which lend sufficient credence to our conclusion. For instance, the Consumer Price Index in the period 1953 to 1967 changed by 27.6 points from 111.2 in 1953 to 138.8 in 1967; 7.7 points, or 28% of this increase occurred in the last 2 years (1965-1967). Similarly, the Wholesale Price Index increased from 92.7 in 1953 to 106.1 in 1967, an increase of 13.4 points in 14 years, while the increase from 1965 to 1967 was 3.6 points, or 27% of the total 14-year increase. It is common knowledge that the recent accelerated inflationary trend has not yet been reversed.

Accordingly, we have found that a special adjustment is necessary under the particular circumstances at this time. This adjustment which at this time should no more than counteract the necessary "regulatory lag" of approximately one year before new rates can become effective, is necessary so that the relationships of rate base, revenues and expenses for the 1967 test year, as adjusted herein, would continue for the foreseeable future, barring a recurrence or continuance of an inflationary trend of recent magnitude.

In regard to Columns E and F of Applicant's Exhibit 23, these reflect increases in the social security taxes and postage rates effective as of January 1, 1968. While technically out of period, they still reflect increased costs that are beyond the control of Applicant. Therefore, we have made an adjustment in net operating earnings of the amounts stated in the respective columns of Applicant's Exhibit 23.

Applicant's Exhibit 23A contains another adjustment in Column AA which reflects the increase in federal income tax because of the 10% federal surcharge effective in 1968 and scheduled by law to expire in mid-year 1969. While this adjustment again reflects an increase in the costs of doing business beyond the control of Applicant, it nevertheless requires somewhat special treatment because of the possibility that the tax surcharge, unless the law is changed, may expire shortly after the rates we shall allow in this proceeding become effective. Therefore, it is most proper that this additional cost of doing business as reflected in Column AA of Applicant's Exhibit 23A together with adjustments included in Columns C, D, E, F, G, and H of Exhibit 23A that relate to the tax surcharge effect should be allowed in the form of a special adjustment in addition to the regular rates. By this method, Applicant will be able to recover this additional cost of doing business during the period such tax is actually in effect and such additional cost will automatically expire if and when this tax surcharge expires, so that ratepayers will not be burdened with rates reflecting costs no longer applicable.

The total of the 10% federal income tax surcharge applicable to the net operating earnings, as adjusted for the test year 1967, has been computed as follows:

Tax surcharge on actual taxes for 1967	$1,592,699
Effect of the tax surcharge because of adjustments, Ad Valorem tax adjustment - Column C Applicant's Exhibit 23A	(5,297)
Separations adjustment - Column D, Applicant's Exhibit 23A	10,110
Social Security Tax increase - Column E, Applicant's Exhibit 23A	(3,620)
Postage increase - Column F, Applicant's Exhibit 23A	(2,709)
Franchise and license tax increase - Column G, Applicant's Exhibit 23A	(1,587)
Directory advertising rate increase - Column H, Applicant's Exhibit 23A	2,323
TOTAL	$1,591,919

These totals do not include the effect of the tax surcharge on the increases in net operating earnings that we shall allow and such effects will be discussed under "Revenue Requirement" later in this Order.

Rate of Return

Rate of return testimony was presented by three witnesses. One of the Applicant's witnesses, Dr. Burton A. Kolb, testified on comparable rates of return on the present value of net assets of a group of industrial companies and recommended a return of 7.5 to 8.5 percent on present value. Since we are not using the present value of telephone property in rate base, we have not considered this recommended rate of return any further, except to note (as was done above) that different rates of return would apply to a net investment rate base and a rate base based on original cost. With respect to original cost rate base, Applicant's witness, Mr. Heckman, testified that comparing earnings with a group of industrial companies the rate of return on common equity should be 13%, which after applying a hypothetical debt ratio of 40% resulted in a computation (Exhibit No. 55) as follows:

	Capital Structure	Cost of Capital	Proportional Cost
Debt			
Present	29%	4.59%	1.33%
Additional	11%	5.42%	.60%
Equity	60%	13.0%	7.80%

Recommended overall rate of return (By Heckman) - 9.73% or 9% to 10%

Mr. David A. Kosh, independent expert witness, testified on behalf of the Staff and recommended a rate of return of 7% based upon a hypothetical debt ratio of 50% and a cost of equity of 9%. Upon reviewing the evidence, we find little comparability between a telephone utility, such as the Applicant herein, which is a part of the nationwide Bell System, to a group of industrial companies./1 Neither the capital intensity,

/1 See also Re American Telephone and Telegraph Company, et al, 71 PUR 3d 273, 280, 281 (FCC Docket 16258).

markets, capitalization structures, nor fluctuations of earnings appear to be similar. It may be said that "regulation is a substitute for competition," be we interpret this in terms of regulation of prices. Certainly neither this Commission, nor any other similar commission, can regulate interest rates or costs of equity capital. These capital costs must be considered in terms of what they actually are. To simply substitute therefor rates of return earned by any group of other companies is, in our view, not appropriate. The price of the utility service or the utility rates may then be set at the level that is fair and reasonable, considering all of the costs of doing business of the utility including capital costs. It should be emphasized that this does not eliminate any comparison with other sectors of the economy; market prices of common stock are an integral part of the discounted cash flow formula used by Mr. Kosh in his analysis. Market prices in turn are determined by investor expectations and evaluations of the comparability on the investments. We have therefore concluded the proper way to determine a fair and reasonable rate of return is to determine as closely as possible the actual cost of debt and equity capital.

In this regard the effect of various debt equity ratios may be considered. It is obvious that increasing the debt ratio will increase the leverage effect and therefore the earnings of the common equity will increase, as Staff Exhibits 1, 2 and 3 demonstrate. It is also true that increasing the debt ratio may increase both the cost of debt and the cost of equity because of additional risks to investors. We have found, therefore, that it is more realistic to evaluate the return on equity capital in terms of the actual capital structure as it existed during the test year, and test such results against the higher debt ratios suggested by both Applicant's and Staff witnesses. The record herein clearly indicates that the Bell System policy is to increase the existing debt ratio. In terms of the actual test year 1967, we found from the evidence that the fair rate of return applicable to the average rate base on original cost basis to be 7.5%. In view of the United States Supreme Court mandate in the Hope case [1] we then tested this rate of return against the end result. The fixed charges applicable to the Applicant's Colorado intrastate operations in the test year 1967 were $3,680,589. It should be noted at this point that these are the actual fixed charges including interest and the related charges to all of the debt, including advances from the parent company which were not apparently considered by either expert witness.

The actual return on equity is computed as follows:

Net Operating Earnings (7.5% x $307,724,804)	$23,079,360
Less: fixed charges	3,680,589
Earnings available for common equity	$19,398,771
Common stock shares applicable to Colorado intrastate	11,304,429
Earnings available per common stock share	$ 1.72
Average book value per share	$ 18.65
Rate of return on equity	9.2%

The resulting 9.2% return on equity is somewhat above the bare cost of equity of 9% as computed by Mr. Kosh and in line with his recommendation that the actual rate of return on common equity should be 9.2% (based, however on a 50/50 debt-equity ratio). In view of the higher future debt ratios suggested by the two expert witnesses, we further tested the overall rate of return against the recommended capitalization ratios in this record. Using Mr. Heckman's recommendation of 40% debt, we get a rate of return on common equity of 9.28% as follows:

/1 Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281

	Capital Structure	Return	Proportional Return
Debt			
Present	29%	4.59%	1.33%
Additional	11%	5.42%	.60%
Total Debt	40%		1.93%
	Overall rate of return		7.5%
	Less: debt portion		1.93
	Available for equity		5.57%
Return on equity 5.57 ÷ 60% =			9.28%

Using Mr. Kosh's recommendation of 50% debt we get a return on common equity of 10.2%:

	Capital Structure	Return	Proportional Return
Overall rate of return	100%		7.50
Less: debt portion	50%	4.81%	2.40%
Available for equity	50%		5.10%
Return on equity 5.10% ÷ 50% =			10.20%

Since interest on debt is deductible for income tax purposes, additional earnings would be generated by the reduction in income taxes as debt is increased.

From the above we concluded that a 7.5% rate of return is a fair rate of return to be applied to the average rate base applicable to the Applicant's Colorado intrastate operations and would produce earnings on common equity that are fair and reasonable in terms of the cost of such equity capital. An increase in the debt ratio, because of additional leverage, would produce additional equity earnings that are fair, reasonable and necessary for the continued attractiveness of an equity investment in Mountain States stock in the future.

In our determination of the rate of return, we have considered all of the factors which have a bearing thereon. In doing this we necessarily observe that the financial and tax policies of the Applicant are extremely conservative, and it is our feeling that such conservative policies tend to reduce the risks to equity capital. We have already discussed the possibilities of future attrition and the two major means at Applicant's disposal to reduce income taxes to counteract any erosion in earnings due to normal inflation. We are quite aware that the California Commission has imputed to the Pacific Telephone and Telegraph Company a limited amount of income tax benefits that could have been derived from the use of accelerated depreciation, and further, that the Federal Communications Commission is still studying this matter. The reasons for not using this advantageous provision in the income tax law by the Applicant have not been sufficiently explained in this record. Neither has it been shown in this record to what extent, if any, the risks to investors would be increased under more aggressive policies with respect to increased debt ratio and the use of accelerated depreciation. We strongly believe that further study of these matters should be made by the Applicant before another proceeding involving these same issues should be instituted by Applicant before this Commission.

Revenue Requirements

The total revenue requirements based on the test year 1967 conditions are computed by adding to the actual 1967 revenues an amount that would produce after income taxes the deficiency in net operating earnings that we have computed. This deficiency has been determined as follows:

Net operating earnings required to realize a 7.5% return on rate base	$23,079,360
1967 net operating earnings as adjusted	$22,634,414
Deficiency	$ 444,946

To compute the required revenue and provide for the income taxes on such additional revenue we must first do the following calculations with respect to each revenue dollar.

Gross revenue	$1.000000
Less: uncollectible revenue	.002002
Balance	$ .997998
Less: general service and license fee (1% of .997998)	.009980
Less: taxes on local service revenue	.015565
Taxable income (State)	.972453
Less: State Income Tax @ 5% of .972453 =	.048623
Taxable income (Federal)	.923830
Less: Federal Income Tax @ 48% of .923830 =	.443439
Balance for net operating earnings	$.480391

The reciprocal of the last figure equals the amount of gross revenue required for each dollar of net operating earnings, as follows:

$$\$1.00 \div .480391 = \$2.0816$$

Therefore, in order to obtain an increase in net operating earnings of the Applicant on the basis of 1967 conditions of $444,946, the gross revenue must be increased by $444,946 x 2.0816 = $926,200.

The above computation does not include any effect of the income tax surcharge. The revenue required to compensate the utility for the income tax surcharge is not simply equal to the surcharge, as any additional revenue becomes taxable income to the utility. Consequently, the revenue increase must cover the tax surcharge plus the income taxes (including surcharge) on the additional revenue. In effect, the utility is paying a tax on tax. To measure the effect of the tax surcharge on any additional net operating earnings that we may allow to the Applicant, the calculation of revenue required for each dollar of net operating earnings must be further continued; as follows:

Federal income tax for each new revenue dollar as computed above	$ .443439
10% surcharge on federal income tax	.044344
Net operating earnings as computed above for each dollar of revenue	.480391
Less: Federal income tax surcharge	.044344
Net operating earnings after surcharge	$ .436047

Again, to find the amount of gross revenue required for each dollar of net operating earnings, the reciprocal of the above figure ($.436047) must be obtained, and it is: $1 \div .436047 = \$2.29333$. Therefore, to compensate the Applicant for the 10% tax surcharge on the additional operating earnings that we have allowed, the following calculation must be made:

Net operating earnings	$ 444,946
Gross revenue required before taxes, including the 10% surcharge (Factor = 2.29333)	$1,020,408
Gross revenue required before taxes, without the 10% surcharge (Factor = 2.0816)	926,200
Difference in gross revenue attributable to 10% surcharge	$ 94,208

To recover the federal income tax surcharge applicable to net operating earnings, as adjusted for the year 1967, the following calculation must be made:

Effect on net operating earnings multiplied by the factor of 2.29333 equals gross revenue required, or:

$1,591,919 X 2.29333 = $3,650,796

The 1% special adjustment for abnormal inflation is computed as follows:

1967 Gross revenue, including uncollectible revenue (Finding No. 8)	$119,849,530
Revenue deficiency computed on basis of 7.5% return in test year (not considering income tax surcharge) (Finding No. 21)	926,200
Total Revenue Requirement before special inflation adjustment	$120,775,730
1% of the above = special inflation adjustment	1,207,757
Total Revenue Requirement on the basis of 1967 test year (Finding No. 30) is the total of the above two figures, or	$121,983,487

The total additional gross revenue required is:

Attributable to inflation adjustment	$1,207,757
Attributable to earnings deficiency	926,200
Attributable to 10% income tax surcharge	3,745,004
Total	$5,878,961

Western Electric Prices

Applicant presented evidence to show that prices of equipment and materials furnished by Western Electric, an affiliate in the Bell System, are fair and reasonable. Needless to say, the affiliate profits are a proper subject for inquiry in regulating utility rates. Although no testimony was presented on the subject, Protestants indicated during cross examination that equipment furnished by Western Electric should be repriced to reflect the same rate of return to Western Electric as allowable to Mountain States Telephone, the utility affiliate. In any event, in line with our previous discussion, we are of the opinion that rates of return on investments in industrial companies, including Western Electric, may well need to be higher than those of a utility company such as the Applicant and no true comparability exists. The record is clear and convincing that the prices charged by Western Electric have been generally lower than those charged by other manufacturers for comparable equipment. Therefore, we conclude that no repricing of purchases from Western Electric is warranted or necessary to adjust the rate base.

General Service and License Fee

Applicant pays to American Telephone and Telegraph Company, its parent corporation, general service and license fee equal to one percent of gross revenues, not including miscellaneous and uncollectible revenue. In return the Applicant obtains a number of different services in the nature of financial, legal, engineering and operating assistance. The evidence in this record indicates that the cost of these services alone exceed the one percent fee. In addition, Applicant has the free use of all of its parent company's patents and innovations in the manner telephone service is rendered. We, therefore, conclude that such charge, again subject to review because of the affiliate relationship, is fair and reasonable and a necessary business expense.

Local Franchise and License Taxes

It is not uncommon for a municipality to levy a local franchise or license tax upon a utility, which tax is normally designed to compensate the municipality for the use of its streets and alleys by the utility. Not only is it not uncommon, it is also reasonable. A problem arises when such taxes exceed the bounds of reasonableness and become solely a method for raising revenue for general municipal purposes. If the entire franchise or license tax is then allowed as a necessary expense of the utility and, consequently, the utility rates reflect such taxes, all the customers of the utility are paying a proportionate share thereof. If such taxes are used for the purpose of raising general revenue for the municipality, a discriminatory situation may arise whereby customers outside the municipal boundary of a particular city or town are in effect paying general taxes to a municipality. We have, therefore, concluded that a franchise and license tax of not more than three percent of local revenue is a reasonable charge for the use of municipal streets and alleys, but we feel that any part of a franchise or license tax in excess of three percent of revenue should be properly surcharged to the customers located within such municipality and upon whose revenues such tax is levied. There is no question of the power of the municipality to levy this type of tax, but the incidence of the tax should be properly directed to prevent discrimination to the customers outside the municipal boundaries. There may, of course, be special circumstances where a higher percentage may be indicated. The Commission will therefore provide in its Order to follow that any portion of a municipal franchise or license tax in excess of three percent of local service revenues will be surcharged unless otherwise ordered by this Commission at the time when such higher tax may become effective.

Annual Reports by Applicant

During cross examination of the Staff witnesses, the proposition was advanced by Applicant's Counsel that neither the Commission nor its Staff were bound by the test year of 1967 in this proceeding as the Applicant had filed quarterly reports of its operations which would be more up to date. It is quite obvious, of course, from the record that such quarterly reports do not even remotely approach the detailed information that is required for a rate case, and the only basis upon which this Commission can make its findings is for the test year 1967. This line of questioning has, however, painfully reminded us that the present annual reports filed by the Applicant do not set forth in sufficient detail the breakdown between Applicant's Colorado intrastate operations and other operations. Consequently, continued surveillance of Applicant's operations is not possible without obtaining additional information. It is for this reason that we have made our Findings in this regard and will set forth in the Order to follow the type of report that this Commission will require from the Applicant in the future.

O R D E R

THE COMMISSION ORDERS THAT:

1. Applicant may file with this Commission new tariffs for its intrastate Colorado telephone service, which, when applied to the test year 1967 conditions, would produce additional gross revenue in the amount of $2,133,957, to become effective upon 30 days notice to the Commission.

2. Applicant may file with this Commission a tariff rider providing for an adjustment clause on intrastate Colorado telephone rates on its existing tariffs, such adjustment to provide for a charge of 3.07% of gross revenue in addition to all regularly filed rates. In the alternative, Applicant may file such new and separate tariffs providing for an adjustment clause, the application of which, under the conditions of the 1967 test year, would produce additional gross revenues to Applicant of $3,745,004. Under either method, such adjustment clause shall be filed to become effective upon not less than 5 days notice to the Commission, and shall remain effective only as long as the present 10% federal income tax surcharge remains in effect with respect to Applicant.

3. On or before March 31, 1969, and every year thereafter until further order of the Commission, the Applicant shall file with the Commission a financial and operating report for the calendar year next preceding the date of the report, attested to by an officer of Applicant, and containing at least the following information:

(a) A duplicate of the information in the same form as contained in the annual report to the Federal Communications Commission.

(b) Rate base data - Investments, consisting of the following:

Telephone plant in service - Account 100.1
Telephone plant under construction - Account 100.2
Property held for future use - Account 100.3
Telephone plant acquisition adjustment - Account 100.4
Materials and supplies - Account 122
Cash working capital
Depreciation reserve - Account 171
Amortization reserve - Account 172

in a form that will include total Company and State of Colorado Division, interstate and intrastate data, and other information as shown in Operating Results Summary, Applicant's Exhibit 100, page 1, in these proceedings.

(c) Plant Accounts 100.1, 100.2, 100.3 and 100.4, Materials and Supplies Account 122, cash working capital, Depreciation Reserve Account 171 and Amortization Reserve Account 172 Summaries that will include total State of Colorado Division, interstate and intrastate data and other information as contained in Worksheets A-1 and A-2 of Applicant's Exhibit 100 in these proceedings.

(d) An income statement that will include data for total Company and State of Colorado Division, interstate and intrastate, and other information as shown in Operating Results Summary, Applicant's Exhibit 100, page 2, in these proceedings.

(e) Operating revenues that will include data for total Company and State of Colorado Division, interstate and intrastate, and other information as shown in Operating Revenue Summary, Applicant's Exhibit 100, Worksheet B, in these proceedings.

(f) Operating expenses that will include data for the State of Colorado Division, interstate and intrastate, and other information as contained in the Operating Expense Summary, Worksheet C of Applicant's Exhibit 100 in these proceedings.

(g) Income tax computations for the total Company and State of Colorado Division, interstate and intrastate, with information as shown in Federal Income Tax reconciliation, Worksheet E of Applicant's Exhibit 100, in these proceedings.

(h) Other taxes for the total Company and State of Colorado Division, interstate and intrastate, with information as shown in Worksheets F, F1, F2 and F3 of Applicant's Exhibit 100, in these proceedings.

(i) A schedule of Taxes Accrued, Account 166, as of January 1 and December 31, for the total Company and State of Colorado Division, interstate and intrastate.

(j) Accumulated deferred investment tax credit for the total Company and State of Colorado Division, interstate and intrastate, with information as shown in PUC Staff Series 1, Request 38, page 3 supplement, Applicant's Exhibit 98 in these proceedings.

(k) An explanation of any changes in separations procedures adopted during the year and the results of any separations studies completed during the year and their effect on any of the foregoing calculations.

4. Any portion of the franchise or license taxes levied by a municipality upon the local service revenues of the Applicant in excess of three percent (3%) of such revenues shall be surcharged to the customers located within the boundaries of the municipality levying such tax unless otherwise ordered by this Commission.

5. The Commission retains such further jurisdiction in this matter as is proper and necessary.

This Order shall become effective twenty-one (21) days from date.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Howard S. Bjelland

[signature]

Commissioners

CHAIRMAN HENRY E. ZARLENGO DISSENTING.

Dated at Denver, Colorado,
this 7th day of January, 1969.
ls

CHAIRMAN HENRY E. ZARLENGO DISSENTING:

I respectfully dissent to the majority decision in the following respects and insofar as these points of dissent, if followed, would affect the Findings and Conclusions therein.

The majority decision authorizes an increase in revenues, in addition to the interim increase for income surtax, in the sum of \$2,133,957. Under the law, the facts, and for the reasons hereinafter set out this increase in revenues is not warranted.

Under the law, the Commission cannot arbitrarily interfere with the utility's exercise of its managerial discretion -- neither can management arbitrarily exercise its managerial discretion. If this were not true, the rights of ownership of the Applicant would be nullified and, on the other hand, the regulatory powers of the Commission would be destroyed. There is no conflict in these principles and they can live side by side so long as sound judgment is exercised on the part of the utility and on the part of the Commission.

The law provides that "All charges made, demanded or received by any public utility,. . . for any service rendered or to be rendered, shall be just and reasonable. . ." (1963 CRS 115-3-1.) and further provides that "The power and authority is. . . vested in the public utilities commission of the state of Colorado, and it is. . . made its duty to adopt all necessary rates, charges and regulations to govern and regulate all rates, charges -- of every public utility. . ., and to generally supervise and regulate every public utility in this state and to do all things, whether specifically designated. . ., or in addition thereto, which are necessary or convenient in the exercise of such power. . ." (1963 CRS 115-3-2.).

Thus, it is clear that the Commission is not only given very broad powers but is additionally charged with the duty to exercise such powers in the adoption of rates which "shall be just and reasonable."

Emphasis must be made of the fact that the Commission is invested with not only the power, but is under the duty not to exercise its discretion in the adoption of rates in a capricious and arbitrary manner. See Consolidated Freightways Corp. et al v. PUC Colo., 158 Colo. 239, 406 P. 2d 83 (1965)

The increase in revenues authorized by the majority, as will clearly be shown, also authorizes increase in charges which will include revenues for payment of large expenses which not only can be, but should be avoided. Such charges, including as they do revenues for payment of expenses, in the stupendous magnitude here present, which can reasonably be, and should be, avoided are not "just and reasonable" and should not, nor can they be, legally authorized by the Commission.

LIBERALIZED DEPRECIATION

The Commission should order the Applicant to make use of the double declining balance method of depreciation available under the income tax laws to all property depreciable for income tax computation acquired by it after January 1, 1968. No consent is required to do this and it is available and usable "for the taking." Although available for past years since 1954, Applicant's management has not in the exercise of its managerial discretion seen fit to take advantage of it to the detriment of the ratepayer and the consequences have been disastrous. Applicant's own figures (Protestants' Exhibit A) show that for the year 1967 alone, had it used such method since 1954, there would have been a savings in income taxes in the sum of $3,241,202, and consequently a savings in the charges to the ratepayer in the sum of $6,746,886 when income taxes are taken into consideration. Based upon the assumption that $38,000,000 in depreciable property will be added each year in 1968 and 1969, and this is a very conservative figure in the light of the testimony; for the year 1968 a total savings in income taxes will amount to $456,380, and a total savings to the customer in charges will amount to $950,000; and for the year 1969 these savings will amount

$1,279,785 and to $2,664,000, respectively. These figures are given for purposes of illustration. This exercise of managerial discretion which it continued to make over the past years it contemplates to continue in future years. Lessons of the past should serve as a guide for the future. During the course of the hearing, even though it was apprised of this issue as the same was raised by the protestants, the Applicant presented no good and valid reason, nor any reasonable explanation, for its refusal to take advantage of this optional method of depreciation for the benefit of the ratepayer. The excuse is given that the taking of accelerated depreciation in the present will at some indefinite time in the future have to be made up. The ratepayers of today have a present right to this relief under the tax law. They are making very substantial payments for research and development of more efficient equipment and methods of operation which will undoubtedly inure to the great benefit of the ratepayers of the future. It is unfair and unjust to deprive them of the present tax benefits and relief made available to them by the law on the mere expectation, and so it is, that at some time in the indefinite future by so doing those benefited future ratepayers may have to pay some higher rates.

This Order to make use of the double declining balance method of depreciation should be limited as to the period of time it is used and should provide that at such time in the future when the amount of depreciation as calculated by the accelerated depreciation method on the depreciable property acquired in any past calendar year shall become less than the amount of depreciation as calculated by the straight line method, the method of depreciation applied for such property shall be changed to the straight line method which shall be thereafter applied for such property.

DEBT RATIO

The Commission should order the Applicant to trend its debt to equity ratio toward at least a 40% debt to 60% equity ratio. It cannot be reasonably contended, nor is it contended by anyone in the record, that such a debt ratio would in any degree weaken the financial integrity of the Applicant or otherwise be detrimental. In fact a witness of the Applicant states that a 40% debt ratio is a proper objective. The current debt ratio, however, at the present time for intrastate operations is actually 29% debt (71% equity). Over the years, the Applicant's policy has been to maintain an unreasonably low debt ratio. This policy has been followed with total disregard for the best interests of the ratepayer and has resulted in the loss of countless millions of dollars to him. That this is obvious is apparent from a consideration of the difference in cost to the ratepayer for equity capital used over debt capital used. The Applicant expects a rate of return on equity of as much as 13%. In the majority decision, however, the Applicant is allowed 9.2%. The Applicant can reasonably and conservatively be expected to pay 6.5% on debt capital. (Kosh - page 20). It must be borne in mind that it is the ratepayer who pays for the cost of capital. Thus, capital will cost the ratepayer 2.7% more for equity capital than for debt capital. If new depreciable property acquired each year for the next 3 years is assumed to be in the sum of $38,000,000, a conservative figure supported by the evidence as contemplated, the cost to the ratepayer for equity capital, taking into consideration income taxes, will amount to $21,831,821, while the cost of debt capital will amount to $7,410,000, or a difference of $14,421,821 more. These figures have been calculated and presented to illustrate the magnitude of amounts of dollars involved. The carrying of this enormous and unnecessary burden will certainly harm the ratepayer and will in no manner benefit the Applicant itself. Should such policy continue to be used by the Applicant and tolerated by the Commission the losses to the ratepayer will continue to snowball as the years go by! In my judgment, to order, rather than to hope for, such a change of policy is not an arbitrary or abusive exercise by the Commission of its power to regulate by interfering with managerial discretion but is rather, in the light of the statutory law, hereinabove set out, the duty of, and a mandate to, the Commission to interfere with and curtail an arbitrary and abusive exercise of managerial discretion.

INFLATION FACTOR

An inflation factor of 1% is found to be necessary by the majority. (See Decision pages 27 and 28).

> "Our discussion regarding attrition or erosion of earnings, however, refers only to a more 'normal' rate of inflation such as has taken place over the period of years since 1953. On the average, the Gross National Product deflator index during this period 1953-1967 has grown at a compound rate of 2.1% a year, while the increase since 1965 has been at a rate of 3.1% a year. It takes approximately a year to complete a major rate case such as the instant proceeding and put new rates into effect. On this basis, it is the finding of the Commission that, while inflation at an average rate of about 2.1% annually has not and will not result in a gradual attrition of Applicant's earnings, the recent abnormal price inflation at a rate of 1% higher than the fourteen year average necessitates an adjustment of revenue requirements in the magnitude of 1% to do no less than compensate for the unavoidable lag in putting new rates in effect.
>
> Nor is the abnormal inflation reflected solely in the so-called Gross National Product deflator index. Similar unusual increases are reflected in other indices, which lend sufficient credence to our conclusion. For instance, the Consumer Price Index in the period 1953 to 1967 changed by 27.6 points from 111.2 in 1953 to 138.8 in 1967; 7.7 points, or 28% of this increase occurred in the last 2 years (1965-1967). Similarly, the Wholesale Price Index increased from 97.7 in 1953 to 106.1 in 1967, an increase of 13.4 points in 14 years, while the increase from 1965 to 1967 was 3.6 points, or 27% of the total 14-year increase. It is common knowledge that the recent accelerated inflationary trend has not yet been reversed.
>
> Accordingly, we have found that a special adjustment is necessary under the particular circumstances at this time. This adjustment, which at this time should no more than counteract the necessary 'regulatory lag' of approximately one year before new rates can become effective, is necessary so that the relationships of rate base, revenues, and expenses for the 1967 test year, as adjusted herein, would continue for the foreseeable future, barring a recurrence or continuance of an inflationary trend of recent magnitude."

The effect of attrition which is defined in the record as "a wearing away of the rate of return" is sought to be avoided. <u>But, there is no attrition</u>. The actual facts and the actual experience of the Applicant itself refute the expectation that attrition will play any part.

The rate of return of the Applicant has been as set by the Commission in the last rate case at <u>6.69%</u>. The actual rate of return of the Applicant for the past 11 years has been, as follows, to-wit:

Year	Rate of Return
1957	6.81%
1958	6.91%
1959	6.87%
1960	7.15%
1961	7.14%
1962	7.23%
1963	7.33%
1964	6.87%
1965	6.86%
1966	6.64%
1967	6.91%

During the 11 years, 1957 to 1967 inclusive, the rate of return has averaged <u>6.97%</u>, or .28% over the rate of return of 6.69% set by the Commission. In dollar amount this means an average annual excess earnings over the authorized earnings in the estimated sum of $622,454. These figures conclusively show that in spite of the mentioned steady inflationary trend, "normal" <u>or</u> "abnormal," in the economy there actually was no attrition of the rate of return during these years, and to the contrary, with the exception of the year 1966 where an insignificant difference is present, the rate of return has been constantly higher and in many instances very substantially higher. It is stated "On the average, the Gross National Product deflator index during this period 1953-1967 has grown at a compound rate of 2.1% a year, while the increase since 1965 has been at the rate of 3.1% a year." Their conclusion must be that during the years of so-called "abnormal inflation" (whatever that really means) to-wit: 1965, 1966, 1967, attrition <u>must</u> have played its role.

But the facts are to the contrary. The rate of return for 1965 was 6.86% and the rate of return for 1966 was 6.64%. The decision itself is concerned with the test year 1967 and the rate of return for that very year is in excess of each of the consecutive preceding three years, to-wit: 6.91%. Undeniably inflation does have a bearing on the rate of return -- yet, nevertheless, due to other ever present factors which also have a bearing on the rate of return, such as more efficient operation, new technological advances, use of newer and more efficient equipment, acquisition of more customers, increase in the volume of business, etc., it is seen as a matter of fact that there was no "wearing away, or erosion, of the rate of return." This, then, appears to be a method of making use of additional revenues in the sum of $1,207,757 for the test year 1967, which is baseless in fact and without any justification, and therefore arbitrary.

With regard to Findings of Fact 18, there is insufficient competent evidence in the record to make a finding one way or another that the prices charged by Western Electric are fair and reasonable.

RATES OF RETURN FOR COMPANY AND STOCKHOLDER

With regard to a reasonable rate of return for the Company and a reasonable rate of return for the stockholders on their investment, we find the following evidence in the record. To clarify, "cost rate of equity" is the same as "rate of return on stockholders investment." Witness Kosh states (page 45 direct testimony) that 9% is a "reasonable cost rate of equity," which also means is a "reasonable rate of return on stockholders investment." He further states (page 54) that "The 9% allowance for common equity is substantially above the bare equity capitalization rate." These statements are logically supported by him. Further evidence of sufficiency of the 9% rate is given under cross examination.

If a 9% cost of equity, which is shown to be reasonable, and a 40% debt ratio is used, which is shown to be reasonable (it is the debt ratio used in the decision and is the debt ratio acceptable as the desired objective by the Applicant), is to be achieved the rate of return must be 7.33% as is shown by the following calculations, to-wit:

<u>Equity Capital</u>	60% x 9.00% = 5.40%
<u>Debt Capital</u>	
Present	29% x 4.59% = 1.33%
Additional	11% x 5.42% = .60%
Rate of Return	7.33%

When the 7.33% rate of return is applied to the rate base of $307,724,804 a net operating income of $22,556,228 will be produced. While this operating income is $78,186 more than the net operating income actually realized by the Applicant in the test year, 1967, it is within reasonable bounds and therefore should not be made the basis for a reduction in revenues at this time. The rate of return of 7.33% and the 9% rate of return on stockholders investment are both fair to the Applicant and to the stockholders.

NECESSARY ORDER

The Commission should also enter an Order for the Applicant to show cause whether or not the method of accelerated depreciation should be applied in computing depreciation for income tax purposes on its depreciable property still subject to depreciation and acquired from 1954 to 1967; and, if a determination should be made that it should so do, to show cause why it should not apply to the Internal Revenue Service for consent to change its method of depreciation to the accelerated depreciation method.

Chairman

Dated at Denver, Colorado,
this 7th day of January, 1969.