DISSENT TO:

DECISION NO. 86103
Dated December 20, 1974

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

IN THE MATTER OF THE PROPOSED INCREASED RATES AND CHARGES CONTAINED IN TARIFF REVISIONS FILED BY THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY UNDER ADVICE LETTER NO. 987.	)	INVESTIGATION AND SUSPENSION DOCKET NO. 867

\- - - - - - - - - -

January 3, 1975

\- - - - - - - - - -

COMMISSIONER HENRY E. ZARLENGO DISSENTING AND CONCURRING IN PART.

I respectfully dissent for the following reasons.

Under the facts and law no increase in charges or increase in the rate of return on equity, or rate base, may be authorized.

I.

EFFICIENT AND ECONOMICAL OPERATION

No one questions the right of a utility to a fair rate of return on its investment provided certain conditions required by law are first met. One of these conditions upon which such right is fundamentally based is that the utility's operation must be efficient and economical, for unless the utility operates efficiently and economically any charges, or increases in charges, authorized to provide a fair rate of return on investment are not "just and reasonable" charges as charges are required by law to be. Before authorizing any increase in charges to achieve a fair rate of return on investment, the Commission must first find as fact based on sufficient evidence that the utility is operating efficiently and economically. Inefficiency cannot be disregarded, nor can the Commission establish rates in a factual vacuum, or in doubt. Otherwise, it could be authorizing charges regardless of inefficiency and uneconomical operation which charges clearly would not be "just and reasonable." This risk the Commission cannot legally assume.

The expert witness of the Municipal League clearly, and unequivocally, first lays the foundation upon which the whole of his testimony is based, i.e. the condition upon, and without, which the right of a utility to a fair return on investment is fundamentally based and charges established and designed to provide revenues to produce such rate of return.

> "Q. Will you tell the Commission what, in your opinion, is the fair rate of return for Colorado intrastate operations of Mountain Bell?
>
> A. The analyses I propose to present indicate that a fair rate of return for the Colorado intrastate operations of Mountain Bell is in the range of 9.1 percent to 9.2 percent to be applied to an original cost rate base." [1]
>
> "Q. Will you briefly describe the function of the fair rate of return in utility rate making?
>
> A. Fair rate of return is a basic element in utility rate making, and its role is as follows: the fair rate of return times the rate base equals the fair return; the sum of all operating expenses (including taxes and depreciation) and the fair return equals the utility's revenue requirement. Rates for the various types of service and various groups of customers, are then designed so as to collect from customers, in the aggregate, a sum equal to the above revenue requirement. It is thus evident that the fair rate of return and the rate base is one of the costs that make up the total cost of the service." [2]
>
> "A. The principles involved in determining a fair rate of return are rather straightforward. What is complex is the application and the quantification of those principles.
>
> The utility has the responsibility of providing good service to all who demand it, at reasonable and nondiscriminatory rates. If operating efficiently and economically, and fulfilling its public utility responsibility, the utility is entitled to every reasonable opportunity of earning a fair return. That in turn then means that regulation should so set rates that the utility can obtain a sufficient amount of revenue to cover all expenses and have enough left over to cover the cost of capital. If the utility earns its cost of capital, it can attract the required additional capital in reasonable amounts and at reasonable terms. This is the basic principle." [3]

1. Transcript Volume XXXII, page 7
2. Transcript Volume XXXII, page 8
3. Transcript Volume XXXII, page 11

"Q. What part then would efficiency of operations play?

A. In my book, in my philosophy of utility regulation this is the picture, this is the scenario, to use a current term: a utility, if operating efficiently and economically and fulfilling its public utility responsibility, should get rates which will give it a reasonable opportunity of earning a fair rate of return. This means that there is a burden of demonstrating efficient and economical operation. And if it doesn't, then I think that there is a question in my mind whether allowing a fair rate of return under those circumstances isn't underwriting inefficiency. So the specific answer to your question is it should be demonstrated that it operates efficiently or economically as a starting point before you even being (begin) to talk of rate of return."

Q. So the way to maintain a certain rate of return is by efficient operations and by the revenue allowed by the Commission, right?

A. Yes. . ."[1] (Emphasis supplied.)

ARE THE OPERATIONS OF MOUNTAIN BELL EFFICIENT AND ECONOMICAL?

IS THE COMMISSION UNDERWRITING INEFFICIENCY?

A.

Capital Structure

Is its capital structure prudent, efficient and economical insofar as the right of its customers to satisfactory service at the least possible cost is concerned?

Mountain Bell in the past has maintained, and it continues to maintain, and insists upon, a debt ratio so low that its policy of financing cannot be held to be efficient and economical. The factual, and proven, difference of the excess cost of equity over debt capital to the ratepayers is so great, and the reasons given in justification so lacking in factual basis, and illogical, that its method of financing cannot be held to be prudent, efficient and economical.

The capital structure of a utility is of utmost importance to the ratepayers as it is the ratepayers who must pay for the cost of capital, and the cost of equity capital is so much greater than the cost of debt capital that the issue demands the closest scrutiny by the Commission.

1. Transcript Volume XXXII, pages 163, 164.

Management seems to have lost sight of the fundamental principle that a utility must provide satisfactory service at the least cost to the ratepayers rather than investment opportunity for investors.

The taxable income of a corporation is taxed under the federal law at 48%[1] and under the state law at 5%.[2] Because of the reciprocal inter se deductions allowed by said laws the composite tax is at least 50%. As money used to pay the cost of equity financing comes from income which is taxed at such composite rate of at least 50%, for every dollar required to pay such cost Mountain Bell must collect from the ratepayers $1 to pay the cost and $1 to pay the income taxes. The heretofore authorized minimum rate of return on equity is 11.4%.[3] Because of this doubling effect of income taxes Mountain Bell for every $100 of embedded equity capital must collect $22.80; or at the rate of 22.8%. Actual figures show the factor to be 2.1993[4] rather than double, which (lower factor) will be used conservatively and for purposes of simplification. The true factor would show even greater savings.

Interest, on the other hand, works in the opposite direction.

Interest is a deductible expense in computing income tax when the tax is paid. For every $100 of interest paid, $100 is deducted from the taxable income which being taxed at 50% results in a savings of $50 in the amount of taxes to be paid, or a 50% reduction of the ostensible rate of interest. This is true, of course, if the company has sufficient taxable income against which this offset can be applied; -- an assumption hardly disputable. When this <u>true</u> cost rate of interest, i.e. 3.38% (6.77%[5] interest rate on embedded debt less 50% for income tax savings) is deducted from 22.8%, the true, not ostensible, cost of Mountain Bell's embedded equity capital is 19.42% more than the true cost (i.e. interest on) of embedded debt capital. This excess cost of financing must be borne by the ratepayers.

---

1. Section 11 of the Internal Revenue Code (1971)
2. Section 138-1-3 (2), CRS 1963
3. Authorized heretofore by Decisions Nos. 77230 and 81320.
4. Page 18 of Majority Decision herein.
5. Commission records. Interest rate on Company's embedded debt.

As of December 31, 1973, Mountain Bell had the following amount of common equity, long term debt and debt ratio.[1]

	Amount	%
Equity	$1,340,413,463	54.22
Long Term Debt	1,131,808,045	45.78
	$2,472,221,508	100.00

Making the following substitutions of long term debt capital for equity capital, the following annual savings and debt ratios would have resulted.

Substituted Amount	Annual Savings	Annual Savings	Resulting Debt Ratio
$100,000,000	($100,000,000 X 19.42%)	$19,420,000	49.83
$200,000,000	($200,000,000 X 19.42%)	38,840,000	53.87
$300,000,000	($300,000,000 X 19.42%)	58,260,000	57.92
$400,000,000	($400,000,000 X 19.42%)	77,680,000	61.96

As allocation is prorated for the Colorado operation on a basis of 34.39%,[2] at the 61.96% debt ratio the Colorado customers would be saved $77,680,000 X 34.39%, or $26,714,152 annually; -- almost the total increase being authorized.

There is no competent evidence that such a debt ratio would be detrimental; no factual evidence; none from the market place.

The foregoing is an indication of the enormous detrimental impact of equity rather than debt capital on the cost of capital.

Had the amount of embedded equity been kept at lower levels and the amount of embedded debt capital correspondingly higher, the Company for many years would have had the same amount of capital at millions in savings, and with continued savings in the future.

This policy of financing is not "efficient and economical" operation.

Again, during 1972 Mountain Bell sold 9,186,093 shares of common stock acquiring $180,506,727, and in 1974 Mountain Bell sold

---

1. Company Annual Report for 1973.
2. Figures supplied by the Company.

9,151,534 shares of common stock and acquired $164,727,612. By these sales of common stock it acquired an additional total amount of equity capital in the sum of $345,234,339 on which the Company was then authorized a rate of return of 11.4%, at a cost to the ratepayers of 22.8%[1] X $345,234,339 or $78,713,429 annually. If the same amount of capital had been acquired by long term debt, even at an assumed interest rate of 10%[2] the cost would be 5%[3] X $345,234,339 or $17,261,717 annually, a savings in cost of capital of $61,451,712; -- or to the Colorado ratepayers on the Colorado prorated basis of 34.39%[4] would be $61,451,712 X 34.39% = $21,133,244 annually.

Moreover, when the stock was sold in 1972 its book value was $21.68 and the stock was sold for $19.65 or $2.03 below book value, and in 1974 the book value was $23.25 and the stock was sold for $18 or $5.25 below book value.[4] Having sold 9,186,093 shares at $2.03 or $18,647,769 below book value and 9,151,534 shares at $5.25 or $48,045,554 below book value; the two stock sales were made $66,693,323 below book value. This diluted the value of the stock of the existing stockholders; another disadvantage avoidable if debt capital had been acquired.

Still another disadvantage of equity capital is the exorbitant cost imposed on the ratepayers without tangible benefit whenever, a reasonable prospect, the rate of return on equity is increased. When, in this instance, the Commission to make the Company's equity "more attractive", inter alia, increases the rate of return on equity from 11.4% to 12.04%, or by .64%, by so doing it increases the cost to the ratepayers on the already acquired equity without acquistion of any additional capital at all by the following amount, to wit:

Embedded equity 12-31-73 $1,340,413,463 X .64% = $8,578,646 annual increase. This means an additional cost to the Colorado customers of:

$8,578,646 X 34.39% or $2,950,196 -- almost three million dollars annually.

---

1. Due to the impact of income taxes (Supra, page 4.)
2. Higher than any interest rate ever paid by Mountain Bell on its bonds.
3. Due to the impact of income taxes. (Supra, page 4.)
4. Figures and percent supplied by Company.

If, and when, however, to attract new debt capital, the rate of interest is increased, the ratepayers are not made to pay any more for the cost of the already acquired debt capital as the rate of interest thereon remains fixed.

Thus, every fact relevant to the issue of the merits of low, or high, debt ratio points to the disadvantage of maintaining low debt ratios and the great disadvantage of adding new equity capital.

Admittedly, the Company from time to time has needed, and will need, additional capital for growth. However, it takes it for granted that without more, and more, equity capital sufficient debt capital is not available, or if available, its acquisition is detrimental to it and the ratepayers; that with higher debt ratios a level will be reached where additional debt capital will be unavailable, or cost more than the cost of additional equity capital. This position it bases on opinions, not fact, or facts readily and feasibly available; and, cannot be reasonably sustained. The Company has not beforehand fully explored, and ascertained, in the market place, as prudent managerial judgment would dictate, the level of debt ratio at which additional debt capital would exceed the true cost of equity capital, or otherwise, be detrimental to it and the ratepayers. Prudent managerial discretion requires that its guidelines and course of action be based not on the opinions of experts which are lacking in objectivity, no two of whom may agree, and, the probative value of whose opinions, although admissible, cannot reasonably be compared with evidence of factual experience; but guidelines based on facts obtainable in the market place which are readily and feasibly available, and which will provide factual evidence not evidence consisting of a pyramid of self-serving conjectures, prophecies, and opinion, each leaning on the others. The market place when probed will provide the answers.

Even if with progressively increasing debt ratios the rate of interest on new debt will increase, there is no evidence in the record that it will ever increase to a point where the cost of debt capital will exceed the true cost of equity capital to the ratepayers. It is for the present, and for a long period of time in the foreseeable future, inconceivable that with increases in debt ratios the rate of interest will ever remotely approach the cost of equity capital (22.8%) when it is realized that with assumed and unrealistic rates of 14%, or 16%, or 18%, etc., the cost of debt would actually be only increased to 7%, 8%, or 9%,[1] etc., to the customers. Where does this point lie? The Company itself does not dare speculate. The market place will provide the answer when such point, if ever, will be reached.

Upon consideration of its contentions that at some point, with progressively increasing debt, it cannot acquire debt capital; we find no evidence adduced where that point lies and the fact to be that in the past it has never failed to obtain whatever amount of debt capital it sought[2] at rates extremely lower than the cost of equity.

Past, and present, disregard of the availability, and the use of, debt capital at enormous savings to the ratepayers is not <u>efficient</u> and <u>economical</u> operation. <u>Failure</u>, itself, to fully probe the market place for this great economic advantage is not <u>efficient</u> and <u>economical</u> operation.

To justify its policy of use of so much equity capital, despite its exorbitant cost, the Company also argues that the bond <u>ratings</u> of a utility affect the rate of interest of its bonds, i.e. cost of its debt; that higher debt ratios will lower its bond rating from Aaa to Aa and that the lower bond rating will increase the interest rate on its bonds. Aside from the effect of the <u>bond rating</u> itself on the interest rate, it also argues that the higher the debt ratio, the higher the interest rate. If these contentions of Mountain Bell were sound, its cost of debt would be lower than that of Public Service Company of Colorado (Public Service), the second largest, and only comparable, utility in Colorado. The <u>facts demonstrate the contrary</u>.

For many years Mountain Bell has had the highest possible bond rating, i.e. <u>Aaa</u>; whereas Public Service has had a lower bond rating, i.e.

---

1. Due to the impact of income taxes. (Supra, page 4.)
2. Example supra re substitution of debt for equity equity capital (page 5).

Aa. As of June 30, 1974, Mountain Bell had a total debt ratio of 50.52%[1] whereas Public Service had a total debt ratio of 55.64%,[2] or 5.12% lower. Thus, Mountain Bell had a higher bond rating and a substantially lower debt ratio, but contrary to its contentions, the fact is it had a higher cost rate for total debt. As of June 30, 1974, the cost of total debt of Mountain Bell was 7.82%,[3] and of Public Service was 6.38%;[2] or 1.44% higher. And, what does this mean in terms of dollars? As of June 30, 1974,[1] the total debt of Mountain Bell Colorado intrastate was $339,103,000 and of Public Service was $550,835,792.[2] Despite the fact that Mountain Bell has a higher bond rating and a lower debt ratio than Public Service, it costs the Colorado customers of Mountain Bell $4,883,083 ($339,103,000 X 1.44%) more annually than it costs the customers of Public Service for the same amount of debt.

The Commission to make equity capital "more attractive" has raised the rate of return on equity of Mountain Bell to 12.04%. Again, it misjudges reality. The Commission cannot "buck" the market. This should be obvious. Too many other factors in the market place by far outweigh the evaluation of stock by investors, and dictate its desirability, other than the rate of return authorized by the Commission.

By Decision No. 85724 of September 24, 1974, the Commission majority authorized an increase in revenues of Public Service Company in the sum of $29,695,000, and increased the rate of return on equity from 12.43% to 15%, a 20.68% increase (very substantial), inter alia, in order to "attract" equity capital. The stock market quotations of Public Service Company stock indicate the following, to wit:

	High	Low	Close
September 24, 1974	11-3/4	11-1/8	11-3/4
December 30, 1974	12-1/8	11-5/8	11-7/8

---

1. Mountain Bell Exhibit 1 (Leake) Page 14.
2. Figures supplied by Public Service Company.
3. Figures supplied by Mountain Bell.

On September 24, 1974, the date of increase, the net book value of its stock was $17.91.[1] With an increase of only one-eighth in the market value of the stock, and with the stock still <u>selling at $5.91 below book</u>, more than 3 months after the increase, effectively demonstrates "rate of return" to have insignificant impact on "attraction" of stock to investors.

B.

Usage Sensitive Pricing

Usage sensitive pricing has a twofold advantage (a) it substantially reduces the need for capital investment which in turn reduces the cost of operation and consequently reduces the charges to the customers; and (b) avoids discriminatory rates.

(a)

There is no question that when service is paid for by the amount the public will make less use of the service than if the service may be used without limit without additional charge. This is acknowledged by the Company itself, yet, instead of reducing its flat rate service which, with some insignificant exception, allows use without limit and without additional charge, it has pursued, and continues to pursue, a course in the opposite direction creating need for additional capital and additional revenue from the ratepayers.

As of March 31, 1974, the end of the test year, there were 582,511 single party residential subscribers who had flat rate service whereby they could use the service without limit, and there were 82,015 2-party residential subscribers who could use the service without limit.[2] If the service of these 664,526 subscribers was on the basis of usage sensitive pricing, i.e. rather than flat rate, their use of service would be very greatly reduced, which would have the effect of improving the quality of service and substantially reduce the amount of equipment

---

1. Figures from Commission records (Closest figures as of 9-30-74) (Supplied by Company).
2. Figures supplied by Company.

required to meet the need to provide satisfactory service. This would, in turn, reduce capitalization and expenses and thereby the overall cost of service to the customers. Experience bears this out.

When Metropac was first initiated in 1969 the service was rendered within a 30-mile radius on a flat rate basis rather than on usage sensitive pricing. This resulted in so great an overload of equipment that the quality of service deteriorated to the point of being unsatisfactory. In 1971 by Commission Decision No. 76215 the Company was ordered to change its method of charging to reduce usage. Usage sensitive pricing was established which reduced the level of usage to the point where satisfactory service could be rendered and additional investment in equipment avoided.

Prior to 1972 intrastate Wide Area Telephone Service (WATS) was provided on a flat rate basis. The unlimited use of the toll network at a fixed charge resulted in such abuse, and the service became so unsatisfactory, that without very substantial additional investment in equipment and facilities the service could not be improved. By Comission Decision No. 80092, dated April 25, 1972, the Company was ordered to convert WATS to usage sensitive pricing which was done within a few months. Additional investment was avoided and the service did improve.

Company witness, Robert W. Heath testifying:

"Q. Is the trend away from measured service to flat service, flat rate service?

A. No, I would say that the trend is more in the other direction.

Q. Has this been a steady trend over the last five or six years?

A. In my opinion, I believe it is as far as the system is concerned, yes.

Q. Would you say that there was more flat rate service in 1973 than there was in 1970?

A. Oh, yes.

Q. There was more flat rate service?

A. Well, I want to make sure that I respond properly. Simply by virtue of the growth, there was more flat rate service.

Q. Was there more flat rate service in 1973 than in 1970?

A. Yes, sir.

Q. Was there more flat rate service in 1972 than in 1970?

A. Yes, sir.

Q. Then the trend is toward flat rate service, isn't it?

A. Well, I think I need to clarify that, and I started to just a moment ago. I am not sure of the context that you are taking it in, but when you asked me the direct question, is there more flat rate service now as opposed to 1973 or '72 or any other year, simply by the nature of the growth I would have to answer that question yes.

Q. There is?

A. Oh, yes, but it's just a mathematical thing. If we grow, there is naturally more.

Q. What attempts is the company making to go to measured service on the new installation?

A. As far as new installations, no. As a segment, no, we are not taking any steps along that line. I think not only in this case, but in previous proceedings before this Commission there has been a great deal of evidence and discussion that the plans are certainly being laid in that direction in the mid-eighties." [1]

Company witness, Lloyd Leger, testifying:

"Q. . . . Do you think that measured service would tend to decrease the use of telephone facilities?

A. Measured service meaning --

Q. You pay by the call or by the call and the length of the call?

A. Yes, I do.

Q. What attempt is the company making to go to this type of service in order to avoid further capital requirements to provide more service?

A. Well, as I stated in my direct testimony, we have been through a complete round of very careful examination of the question and arrived at the conclusion that general usage sensitive pricing, as we call it, rather than measured service is in the public interest, will be beneficial to the company, beneficial to the public ultimately in Denver.

1. Transcript Volume XXI, pages 53 and 54.

At the same time we have concluded that if it were introduced prematurely it would not be beneficial, would cost the company more, and would cost the customers more. Our plans are to crank in, as we have done in our long-range planning, the schedules and the consideration for equipping first the Denver network with the capability of measuring all of the elements of usage, and to bring that on line as we convert the Denver metro network to complete common control technology.

At an appropriate time when the schedule is more precise, which we now see as being the early 1980s, our plan would be to come before this Commission and propose a shift, and to inform the public and to provide for a participation by the public in the deliberation of the Commission.

Q. Are you saying --

A. If that can be accomplished. Then we would set out on a schedule to equip the network with the measuring technology and convert the pricing system to usage service.

Q. Are you saying that the change has to be made all at once and cannot be made in stages?

A. Yes. It can be made in stages over a reasonably short period of time, probably a year. But to make it in stages between now and the early 1980s, in my view, my considered conclusion is that that is not a good answer.

Q. Now, when I came on the Commission about 15 or 16 years ago I heard testimony that the company was making attempts to go to more measured service. Is there more measured service today in the company than there was 15 years ago?

A. Less.

Q. There is less?

A. Right, I am sure of that.

Q. Well, doesn't that mean that the trend is in the wrong direction?

A. Well, it simply means that more and more customers have favored flat rate rather than measured rate service and have made the choice.

Q. Well, does the desire of the customers control the efficiency of the operations of the company or does management?

A. Well, the desire of the customer where you have an option between measured service and flat service is the controlling factor on which one grows and on which one goes down." [1] (Emphasis supplied.)

---

1. Transcript Volume XVIII, pages 53,54,55 and 56.

The witness speaks of an "option". Actually the customers have no realistic "option". As of March 31, 1974 there were 582,511[1] single party flat rate residential customers who were offered no service but flat rate service unless they went to 2-party service, a very much less desirable and unacceptable type of service, as privacy is lost and availability of service is doubtful. To have an "option" the "option" should be available to the single party customer retaining single party service.

(b)

Only flat rate single party residential service is provided. No explanation is made, nor can any justification be supplied, to show why such method of charge for service is not discriminatory. Why should the customer who needs the service infrequently, and makes use of it sparingly, pay the same as the customer who uses the service frequently, or makes use of it prodigally or recklessly?

So, the Company imposes upon the public,and asks the Commission to accept, a system of charging which increases the cost of service, increases the charges, and is discriminatory; and, offers no sign of improvement except to state that plans are being laid to correct this inefficiency of operation, and inequity, as far off as some ten years hence. Such operation is not efficient and economical.

C.

Purchasing Practices

AT&T owning 88% (rounded) of the common stock controls absolutely Mountain Bell, the Purchaser, and totally controls its wholly-owned subsidiary Western Electric (Western), the Seller. As Western is not subject to regulation its charges may be whatever the traffic will bear. The more money Western makes the more AT&T makes, and the more it costs the customers of Mountain Bell for service. No more favorable, and feasible, set of circumstances can be imagined to siphon money from the customers of Mountain Bell to AT&T. What incentive could AT&T have, or Mountain Bell

1. Figures from Commission records (Supplied by Company).

its alter ego, to deal "at arm's length", and to seek for the most favorable competitive prices, when both the Seller and the Purchaser are in reality one and those who pay are captive? Under these circumstances the Commission is bound to exercise extreme caution and strict scrutiny, and require hard and convincing evidence to establish that Mountain Bell's purchases are efficient and economical; and, the Company is bound to provide such evidence. This evidence, however, is totally lacking in the record notwithstanding the fact that such evidence is definitely, and pecurliarly, within the resources of Mountain Bell and not of the Commission Staff, or of the Protestants. Having such evidence, and failing to adduce it, poses a presumption which feebly rebutted under circumstances requiring strict accountability is conclusive. A Company witness[1] testified on this issue. The testimony consists of bare statements, opinions and conclusions (nothing tangible), that the purchases from Western are at the best available prices. This witness admits without explanation that Mountain Bell <u>does not</u> follow the widespread, and well recognized, practice for making purchases at the most economical prices, i.e. by solicitation of sealed bids with equal opportunity to all bidders and with the assurance that the lowest qualified bidder gets the bid.

Some evidence to indicate efficient purchasing practices from Western Electric is adduced by making a comparison of purchases made by an independent telephone company, to wit: The Independent Telephone Company[2] showing that company to have made purchases totaling $8,052,180 within a 12 month period; however, purchases of $2,321,528[3] were not included in the price comparisons leaving the total amount of purchases made by the Independent Telephone Company used for comparison of $5,730,662. The total purchases of Colorado Mountain Bell from Western was $99,632,297.

$$\frac{5,730,662}{99,632,297} = 5.69\%$$

1. Maureen Smith, Witness - Tr. Volume IV, pages 211, 238 and Tr. Volume XXI, page 139
2. Mountain Bell Exhibit 9 (Smith) Part J, Sheet 1
3. Mountain Bell Exhibit 9 (Smith) Part J, Sheet 2

The comparison is made of prices paid by a particular independent telephone company having a dollar volume of purchases of only 5.69% the dollar volume of purchases of Colorado Mountain Bell. It is obvious that the volume of purchases is a very dominant factor in price paid for merchandise. The comparison is not only inappropriate in this respect, but the prices paid by the particular independent telephone company used in the comparison are not shown to be the lowest prices of independent telephone companies buying in a competitive market. Furthermore, no claim is made that the prices paid by the Independent Telephone Company are within the range of the lowest prices paid by a broad spectrum of independent telephone companies making purchases in the competitive market. The comparison is indicative of something, but does not support the conclusion that Mountain Bell could not obtain in a competitive market better prices than it pays Western Electric.

Because of circumstances of relationship requiring the strictest type of accountability of purchasing practices, and failure to measure up to its responsibility to so account, the purchasing practices of Mountain Bell cannot, under the evidence be held to be <u>efficient</u> and <u>economical</u>, and the Commission cannot legally establish any rates as "just and reasonable".

II.

VALUE OF SERVICE

The Company's charges are based on the cost of service and on the value of service.[1] Charges are legally required to be "just and reasonable" and "nondiscriminatory". Charges based on value of service cannot possibly effectuate charges which are "just and reasonable" and are "nondiscriminatory". There are no reasonable standards, or criteria, by which the <u>value</u> of service may be measured.[2] The value of an emergency call, i.e. for a doctor, an ambulance, police, or fire assistance, etc., cannot be determined. Neither can a business call, nor

1. Transcript Volume XXVIII, Pages 119, 120
2. Transcript Volume XVIII, Pages 46, 47, 48

a call made for personal reasons. The benefit, or value, derived by the caller is not subject to measurement.

It has been suggested that if the charge made for the service is not equal to the value placed on the service by the Company, the customer need not have the service. This test may reasonably have some justification in a competitive market where alternative service is available, but where the service is a necessity, and its availability is from one source only, i.e. a monopoly, the captive customer has no option. The suggested test, therefore, is fallacious. If the value of any service cannot realistically be determined by "value of service", charges based on such a concept cannot be "just and reasonable" and "nondiscriminatory".

If, again, the value of any particular service itself cannot be measured and determined, how can different charges based on the value of service for different classes of service such as between residential and business, etc. (the rate structure) be "nondiscriminatory"?

Moreover, since some customers are charged on the basis of "value of service", an unrealistic approach; and some customers charged on the basis of "cost of service", a realistic approach, the customers are not treated equally and discrimination is unavoidable.

The law itself calls for more realistic and reasonable criteria. Courts routinely have held that a utility is entitled to sufficient revenue to cover its <u>cost</u>, not <u>value</u>, of service with a surplus to provide a fair rate of return on its investment. While perfection itself is not attainable in determining cost of service this method for achieving "just and reasonable" charges and charges which are "nondiscriminatory" is weighted with objectivity, and means, totally lacking to the concept of basing charges on the <u>value</u> of service. Other utilities, i.e. railroads, airlines, motor carriers, gas and electric utilities, do not base charges on the <u>value</u> of service; nor, are their rates authorized on such basis. By basing charges on the "value of service" concept which inevitably results in arbitrary, rather than "just and reasonable", charges and in charges which cannot feasibly be made to be "nondiscriminatory", either among customers who are charged on "value of service", or between those customers charged on the "value of service" and those customers charged on "cost of service", the Company's method of charging, and its charges, are not in compliance with the law. Nonetheless the Company makes extensive use of this illusory method of charging.

III.

RATE OF RETURN

A.

Any increase in the rate of return recommended by the Company, the League, the Commission Staff, or authorized by the Commission overlooks failure to affirmatively establish efficient and economical operation.

B.

The ratios (annual basis) of the net operating income to average net book cost of telephone plant of all 22 Bell Telephone System companies for the year 1973 indicate that there is only one company which had a higher ratio, to wit: Chesapeake & Potomac Telephone Co. (West Virginia) with a percent of 9.04, and Mountain States Telephone and Telegraph Company with a percent of 8.60.[1] A later report shows for the 12 month period ending September 30, 1974 that Mountain Bell dropped to fifth place among the 22 operating Bell System companies with a percent of 8.33 rather than 8.60, but still maintaining a higher net operating income than 17 companies of the system and higher than the Bell System Operating Companies (Excluding Long Lines) average of 7.71%.

With this record of net operating income to average net book cost of telephone plant, it is an abuse of Commission discretion to further increase rates of return on rate base, or on equity.

Moreover, there is no evidence in the record that the present rates of return are confiscatory.

---

1. Source: Monthly Reports of Mountain Bell, Commission records.

IV.

8-PARTY LINES

The history of 8-party line service should be considered as another example of the Company's inefficiency to improve service. Eight-party line service for many years has been one of the most dissatisfactory of services provided by the Company. CRS 115-1(2) provides that every public utility shall furnish, provide, and maintain service as shall in all respects be adequate, efficient, just and reasonable. Attesting to the inadequacy and insufficiency of 8-party service is the fact that as of February 25, 1971, there were 12,690 requests for a higher grade of service.[1] Regardless of the law, and the noncompliance therewith over the years, the following indicates the history of failure to improve the service.

Year	No. of 8-Party[1] Lines in Service
As of December 31, 1967	41,310
As of December 31, 1968	42,395
As of December 31, 1969	44,950
As of December 31, 1970	46,203
As of December 31, 1971	49,718
As of December 31, 1972	53,965
As of December 31, 1973	55,522
As of November 30, 1974	34,824

The Company, instead of decreasing the number of 8-party lines, progressively increased them each year from 41,310 in 1967 to 55,522 in 1973. As of November 30, 1974 the number of 8-party lines did drop to 34,824. This improvement, however, was ordered by the Commission in Decision No. 81320, September 19, 1972, which required the Company to convert from 8-party line service to a higher grade of service.

Moreover, the Commission, having found in that Decision that the rate structure therein being authorized would provide revenues in excess of the revenue requirement in the amount of $2,261,000,[2] rather than redesigning the rate structure authorized application by the Company of this excess revenue amount to the cost of making the conversion. This authorization (a) constituted an annual contribution of $2,261,000 to the utility's capital investment not provided by the stockholders but

1. Source: Commission records
2. Decision No. 81320, September 20, 1972, pages 25 and 26.

by the general customer, or (b) at best, a subsidy of a special class of customers; either of which is illegal.

Preserving this archaic type of service over many years does not indicate fulfillment of its responsibility as a public utility.

CONCURRENCE

I concur in the allowance of $19,500 for attorney fees and costs incurred by the Colorado Municipal League. I am of the opinion, however, that any allowance of any fee and expenses incurred in the future should be determined after proper hearing on the merits without commitment in this order one way or another.

C O N C L U S I O N

In this opinion an effort has been made to concentrate on only several fundamental principles of regulation leaving for consideration of others reference to the briefs of the parties. The basic principle concerned is that unless the Company operates efficiently and economically, it is not entitled to any increase in charges to provide a fair rate of return on the investment; that efficient and economical operation must first be established as a condition precedent before any consideration of what are, or are not, reasonable charges may be undertaken; that to sustain such finding of fact is the burden of Mountain Bell requiring sufficient and competent evidence that it is operating efficiently and economically; that in this instance such operation has been shown to be inefficient and uneconomical; or, not shown by competent and sufficient evidence to be efficient and economical; and, that therefore the charges authorized are illegal as not being "just and reasonble."

To authorize increased charges in the face of inefficiency, or even doubt, not only results in unjust and unreasonable charges; it also destroys incentive to operate efficiently and economically.

When a utility is not earning a fair rate of return on its investment two alternatives are open to it. It must either make its operation more efficient and economical by reducing expenses, or must request that its charges be increased, to increase its revenues. If it is already operating efficiently and economically, then it must resort to the second alternative. Likewise, two alternatives are open to the Commission. It must first ascertain whether the utility's operation is efficient and economical. If it finds by sufficient evidence that the utility is already operating efficiently and economically it then, and then only, may and must authorize increase of charges to provide a fair return on the investment.

COMMENTS

(a)

Having shown the great desirability of Usage Sensitive Pricing to effect efficiency and economy, to provide better quality service and to avoid discrimination, the Company should be ordered to file a complete and comprehensive study on, or before, April 1, 1975, indicating the cost of converting all service to Usage Sensitive Pricing service in the metropolitan areas of Denver, Colorado Springs and Pueblo, and the earliest feasible date for the conversion.

(b)

The discretion of management is very broad indeed, but it is not without limit, and when that limit is abused the Commission has not only the power but the duty to correct the abuse. (172 Colo. 188).

Chapter 115-6-15 (3), CRS 1963, provides for an even broader power of the Courts than pronounced in the Colorado Municipal League v. PUC and Mountain States Telephone and Telegraph Company 172 Colo. 188 at pages 203, 204, providing, inter alia, that upon review the Court shall determine whether the Commission has violated any constitutional rights of the petitioners and additionally "whether the decision of the Commission is just and reasonable, and whether its conclusions are in accordance with the evidence." Not only an abuse of law, but an abuse of findings of fact is clearly indicated. Under the evidence in this case the Decision of the Commission is not just and reasonable and its conclusions are not in accordance with such evidence.

(c)

This Dissent was not filed concurrently with the Decision of the majority because of insufficient time for full consideration of Transcript, Briefs and the Decision itself.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Commissioner
hbp