(Decision No. 87582)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

IN THE MATTER OF PROPOSED INCREASED RATES AND CHARGES CONTAINED IN TARIFF REVISIONS FILED BY MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY UNDER ADVICE LETTER NO. 1073.	)	INVESTIGATION AND SUSPENSION DOCKET NO. 930 - PHASE I DECISION AND ORDER OF THE COMMISSION ESTABLISHING REVENUE REQUIREMENTS

October 7, 1975

Appearances: Denis G. Stack, Esq.,
Coleman M. Connolly, Esq., and
Laurence W. DeMuth, Jr., Esq.,
Denver, Colorado, for
Mountain States Telephone
and Telegraph Company,
Respondent;

Messrs. Gorsuch, Kirgis, Campbell,
Walker & Grover, by
Leonard M. Campbell, Esq., and
William H. McEwan, Esq., Denver,
Colorado, for the Colorado
Municipal League;

Lou Bluestein, Esq., Denver,
Colorado, pro se;

George A. Hacker, Esq.,
Robert A. Lubowitz, Esq., and
Kenneth R. Fish, Esq., of the
Senior Citizens Law Center
of the Legal Aid Society of
Metropolitan Denver, Inc.,
Denver, Colorado, for
Frances Allen, on behalf of
herself and all others
similarly situated;

Harold S. Trimmer, Jr., Esq.,
General Counsel,
Maurice J. Street, Esq.,
Assistant General Counsel,
Clinton P. Swift, Esq.,
General Attorney,
Washington, D. C., and
John L. Mathews, Esq., Counsel, and
John M. Hewins, Esq., Assistant
Regional Counsel, Region 8,
Denver, Colorado, for the
Administrator of General Services,
on behalf of the executive agencies
of the United States Government;

Velma Beck, President,
Denver, Colorado, for
Metro-Denver Chapter,
Colorado Motel Association;

George Falconer Wilson,
Denver, Colorado, pro se;

John P. Thompson, Esq., and
James M. Lyons, Esq., Denver,
Colorado, for Colorado
Retail Council;

John W. McKendree, Esq.,
Denver, Colorado, for
Communication Workers of
America;

Homer Ball, Assistant Vice-
Chancellor, Boulder, Colorado,
of the Regents of the
University of Colorado;

James M. Lyons, Esq., Denver,
Colorado, for Denver Burglar
and Fire Alarm Co. and American
District Telegraph Co., d/b/a
ADT Security Systems;

Eugene C. Cavaliere, Esq., and
Tucker K. Trautman, Esq.,
Denver, Colorado, for the
Commission.

BY THE COMMISSION:

I

S T A T E M E N T

A

HISTORY OF PROCEEDINGS

On March 7, 1975, Mountain States Telephone and Telegraph Company (hereinafter referred to as either "Mountain Bell," "Company" or "Respondent") filed with the Commission Advice Letter No. 1073 and tariff revisions that would have resulted in increased rates on most of Respondent's Colorado intrastate telecommunications services. According to Advice Letter No. 1073, the effect of the tariff revisions would be to produce additional gross revenues of $40,323,000, based on actual business volumes experienced by Respondent during the calendar year 1974; or, as expressed in percentage, an increase in rates of approximately 13.89% on most of Respondent's Colorado intrastate telecommunications services.

On March 25, 1975, by Decision No. 86545, the Commission ordered that a hearing be held concerning the propriety of the tariff revisions filed by Respondent under Advice Letter No. 1073, and further ordered that any person, firm, or corporation desiring to intervene as a party in the hearing (I&S Docket No. 930) must file a petition for leave to intervene on or before April 14, 1975. No dates for hearing were set in Decision No. 86545.

On April 1, 1975, by Decision No. 86581, the Commission rescinded Ordering Paragraph No. 2 of Decision No. 86545 (which set April 14, 1975, as the last day to intervene in I&S Docket No. 930) and ordered that any person, firm or corporation desiring to intervene in I&S Docket No. 930 must file a petition for leave to intervene at least five days prior to the first date set for hearing.

On April 15, 1975, by Decision No. 86646, the Commission ordered that testimony of public witnesses would be taken by the Commission (1) in Denver, Colorado, on June 16, 1975, commencing at 10:00 a.m., 2:00 p.m., and 7:00 p.m.; on June 18, 1975, commencing at 10:00 a.m., 2:00 p.m., and 7:00 p.m.; and on June 19, 1975, commencing at 10:00 a.m. and 2:00 p.m.; (2) in Greeley, Colorado, on July 14, 1975, commencing at 10:00 a.m.; (3) in Grand Junction, Colorado, on July 16, 1975, commencing at 9:00 a.m.; and (4) in Pueblo, Colorado, on July 18, 1975, commencing at 10:00 a.m. The taking of testimony from public witnesses was held by the Commission as provided in Decision No. 86646.

On April 15, 1975, by Decision No. 86645, the Commission ordered Respondent to file on or before May 30, 1975, written direct testimony and supporting exhibits directed solely to issues associated with operating expenses and rate base, upon the basis of a calendar-year-1974 test period, and further ordered Respondent to file monthly income statements and rate base summaries for the months of January, February, March, April and May, 1975, on or before June 30, 1975, and an income statement and rate base summary for the month of June, 1975, on or before July 31, 1975. In Decision No. 86645, the Commission (1) also set June 30, 1975, as the date which Respondent was to produce each of its witnesses who had filed written direct testimony and exhibits for purposes of making corrections in said written testimony and exhibits and for summarizing said written direct testimony; and (2) set the date of July 7, 1975, as the date on which cross-examination would commence of Respondent's witnesses who had filed written direct testimony and exhibits on issues associated with operating expenses and rate base, and reserved the dates of July 9, 10 and 11 for further cross-examination. In response to Decision No. 86645, Respondent filed written direct testimony and exhibits of Lloyd L. Leger and Norman W. Leake on May 30, 1975. On June 30, 1975, Respondent produced witnesses Lloyd L. Leger and Norman W. Leake, at which time said witnesses made corrections in their prepared testimony and exhibits and summarized said testimony. On July 7, 9, 10 and 11, 1975, Respondent witnesses Lloyd L. Leger and Norman W. Leake were cross-examined by all parties present and desiring to cross-examine said witnesses.

On April 15, 1975, the Commission entered a third procedural decision in this docket, i.e., Decision No. 86644. This decision will hereinafter be discussed.

On June 24, 1975, by Decision No. 87063, the Commission (1) ordered intervenors and Staff to file on or before July 25, 1975, written direct testimony and exhibits directed solely to issues associated with operating expenses and rate base on the basis of a 1974-calendar-year test period; (2) set the dates of August 6, 7 and 8, 1975, for intervenors and Staff to produce each of its witnesses who had filed written direct testimony and exhibits for purposes of making any corrections in said written testimony and exhibits and for cross-examination; and (3) also ordered intervenors and Staff of the Commission to file testimony on a single issue involving return on equity. The equity issue of Decision No. 87063 will hereinafter be discussed. By Decision No. 87063, the Commission also (1) ordered Respondent to file on or before August 22, 1975, written rebuttal testimony and supporting exhibits directed solely to issues associated with operating expenses and rate base; and (2) set September 10 and 11, 1975, as the dates on which Respondent was to produce each of its witnesses who had filed written rebuttal testimony and exhibits for purposes of making any corrections in said testimony and for cross-examination of said witnesses.

On July 25, 1975, Intervenor, Colorado Municipal League, filed written direct testimony and supporting exhibits of Thomas B. Cross and Stephen A. Duree and the Staff of the Commission filed written direct testimony and supporting exhibits of Craig Merrell and James A. Richards.

On August 6 and 7, 1975, cross-examination was had of Colorado Municipal League witnesses Thomas B. Cross and Stephen A. Duree, and Staff witnesses Craig Merrell and James A. Richards.

On August 22, 1975, Respondent filed written rebuttal testimony and supporting exhibits of Norman W. Leake, William F. Neathammer, John W. Kendrick, Rolland E. Hoffman, Michael G. Clinton, Henry S. Pino and James W. Heckman.

On September 10, 11 and 12, 1975, cross-examination was had of each of Respondent's witnesses who had filed written rebuttal testimony and supporting exhibits, with the exception of James W. Heckman.

B

PARTIES

As of September 12, 1975, the conclusion of cross-examination in Phase I, the following persons, firms or corporations had petitioned the Commission for leave to intervene in this proceeding and had been granted leave to intervene: (1) Colorado Municipal League on April 1, 1975, by Decision No. 86562; (2) Lou Bluestein, pro se, on April 22, 1975, by Decision No. 86666; (3) Frances Allen, on behalf of herself and all others similarly situated, on April 22, 1975, by Decision No. 86665; (4) J. C. Penney Company, Inc., on April 29, 1975, by Decision No. 86707; (5) General Services Administration, on behalf of the executive agencies of the United States, on May 6, 1975, by Decision No. 86784;

(6) Metro-Denver Motel Association, on May 6, 1975, by Decision No. 86788; (7) Colorado Workers Unity Organization, on May 13, 1975, by Decision No. 86820; (8) George Falconer Wilson, pro se, on May 20, 1975, by Decision No. 86860; (9) Sears, Roebuck and Co., on June 3, 1975, by Decision No. 86936; (10) The Colorado Retail Council, on June 13, 1975, by Decision No. 86993; (11) Communication Workers of America, on June 13, 1975, by Decision No. 86993; (12) The Regents of the University of Colorado, on June 13, 1975, by Decision No. 86993; and (13) Denver Burglar and Fire Alarm Co. and American District Telegraph Co., d/b/a ADT Security Systems, on July 29, 1975, by Decision No. 87219. The Commission permitted intervention of Denver Burglar and Fire Alarm Co. and American District Telegraph Co., d/b/a ADT Security Systems upon a late-filed petition for leave to intervene.

On June 12, 1975, the Colorado Workers Unity Organization filed with the Commission a motion for leave to withdraw as a party in this proceeding, and was granted leave to withdraw as a party on June 13, 1975, by Decision No. 86998. On June 24, 1975, Sears, Roebuck and Co. filed a similar motion for leave to withdraw and was granted leave to withdraw as a party on June 24, 1975, by Decision No. 87064. On June 27, 1975, J. C. Penney Company, Inc., also filed a petition for leave to withdraw and was granted leave to withdraw as a party on July 8, 1975, by Decision No. 87102.

C

TESTIMONY AND EXHIBITS

The Commission in this rate proceeding has utilized certain procedural methods designed to reduce (1) the hearing time of the Commission, the time of the parties involved, and (2) the hearing costs to the parties and the ratepayers. These procedures were also designed to afford all parties testimony and exhibits in advance so that they could participate more meaningfully in the hearing process and in only those portions of the hearing in which they had a particular interest.

First of all, the Commission in this proceeding has required all direct testimony to be in writing and pre-filed in advance of cross-examination. All hearing time was reserved solely for cross-examination of witnesses filing written direct testimony. By requiring the pre-filing of written direct testimony, the Commission was able to dispense with that phase of oral hearings called "clarification," which usually was a combination of clarification and "pre-season" cross-examination. The pre-filing of written direct testimony afforded all attorneys involved the opportunity to study the testimony and go over the same with their clients and expert witnesses -- all of which reduced hearing time and made cross-examination more to the point. All pre-filed written direct testimony was marked as an exhibit, offered and received into evidence,[1] instead of being orally read into the record. This reduced hearing time, and transcript size which reduces the cost

---

1. Except the written rebuttal testimony of James W. Heckman, which was marked as "Exhibit P," but not ruled upon by the Commission.

which the ratepayers ultimately must bear in the cost of their telephone service. Finally, the Commission has phased this rate proceeding -- a procedural method employed by certain regulatory commissions -- into two phases, i.e., Phase I to determine the Company's revenue requirement; and Phase II to determine the spread of the rates. In past rate proceedings before the Commission, there have been many more intervenors interested solely in the spread of the rates than in revenue requirement. However, having intermingled the two, attorneys were required to attend hearings solely to protect the interest of their client. This intermingling has been costly to the parties, has effectively eliminated participation by some, and has been wasteful of attorneys' time.

In this proceeding, all pre-filed written direct testimony was marked as an exhibit using letters of the alphabet. All exhibits filed with and in support of the written direct testimony, or offered during cross-examination, were marked using Arabic numerals. The following is a list of all the pre-filed written direct testimony in Phase I of this proceeding which was marked as an exhibit:

Exhibit	Description
A	Testimony of James W. Heckman
B	Testimony of Ezra Solomon
C	Testimony of Norman W. Leake
D	Testimony of Lloyd L. Leger
E	Testimony of David A. Kosh
F	Testimony of Thomas B. Cross
G	Testimony and Schedules of Stephen A. Duree
H	Testimony of Craig Merrell
I	Testimony of James A. Richards
J	Rebuttal testimony of Rolland E. Hoffman
K	Rebuttal testimony of John W. Kendrick
L	Rebuttal testimony of William F. Neathammer
M	Rebuttal testimony of Michael G. Clinton
N	Rebuttal testimony of Henry S. Pino
O	Rebuttal testimony of Norman W. Leake
P	Rebuttal testimony of James W. Heckman

Fifty exhibits were filed with and in support of the written testimony or offered during cross-examination that were marked using Arabic numerals. Exhibit 51 was filed with the Commission following the conclusion of cross-examination in Phase I. The following is a list of these exhibits:

Exhibit No.	Description
1	Exhibit to testimony of James W. Heckman
2	Exhibit to testimony of Ezra Solomon
3	Exhibit and errata sheets 1 and 2 to testimony of Norman W. Leake
4	Exhibit to testimony of Lloyd L. Leger
5	Mountain Bell Colorado Intrastate Operations Income Statement and Rate Base - January-May, 1975
6	Mountain Bell Answer to Information Request from P.U.C. Staff
7	Mountain Bell Employees Appearing Before or Working With General Assembly of the State of Colorado During 1975 Session
8	Mountain Bell Employees Appearing Before or Working With the Colorado Public Utilities Commission Year 1975
9	Mountain Bell Contacts of Municipal Employees
10	Mountain Bell Summary of Contributions (Colorado) Year 1974
11	Mountain Bell Colorado Detail of Membership Fees and Dues, Year 1974
12	Advertising Expense Account 642 Year Ended December 31, 1974 (Mountain Bell)
13	Mountain Bell Executive Salaries, Year 1974
14	Mountain Bell Intrastate Rates for Short-Term Loans and Long-Term Debt From 1971 to 1975
15	Mountain Bell Summary State Returns on Investment and Equity
16	Mountain Bell Comparison of Rate Base for Individual States in Mountain Bell System
17	Mountain Bell Real Estate Holdings Colorado - As of 12/31/74
18	Revenue Per Man-Hour, Colorado; and Productivity, Colorado - 1969-1974
19	Main Stations (end of year) for Mountain Bell Colorado and Percent Change
20	Ratio of Residence Main Telephones to Bell Served Households - End of Year - 1971-1975
21	Non-Management Employees Colorado (Mountain Bell)
22	Percentage of Telephones in Colorado Served By ESS, TSPS, AOIS
23	Annual Report of The Mountain States Telephone and Telegraph Company, Denver, Colorado, to the Federal Communications Commission for the Year Ended December 31, 1973
24	Annual Report of The Mountain States Telephone and Telegraph Company to the Federal Communications Commission for the Year Ended December 31, 1974
25	1974 Noneffective Wages (Mountain Bell)
26	1974 Value of Estimated 1975 Expected Wages - Including 1st and 2nd Management Increase (Mountain Bell)

Exhibit No.	Description
27	Productivity Data from Mountain Bell Colorado 1974-1975
28	Mountain Bell Capital Structure
29	Forecast of Operations Data
30	Dissent, dated January 3, 1975, of Commissioner Henry E. Zarlengo to Decision No. 86103, dated December 20, 1974
31	Exhibit to testimony of Craig Merrell
32	Exhibit to testimony of Craig Merrell
33	Exhibit to testimony of James A. Richards
34	National Association of Regulatory Utility Commissioners Allocation of American Telephone and Telegraph Company Federal Income Taxes 1974
35	Mountain Bell Colorado Intrastate Operations Adjustment to State Interest Expense at Current Rates - Year ended 1974 (Exhibit withdrawn)
36	Mountain Bell Colorado Intrastate Operations Income Statement and Rate Base, June 1975
37	1971 and 1972 Estimated Federal Income Tax Deficiency
38	R. G. Rothmeier and J. E. Christiansen Lobbying Expense January through June, 1975
39	Comparison of Job Development Investment Credit ITC Options 1 and 2
40	Station Investment - end of period December 31, 1974.
41	Mountain Bell Colorado Year - 1974 - Mass Media Advertising
42	Overtime Rates for 1974 Wage Adjustment
43	Exhibit to rebuttal testimony of John W. Kendrick
44	Exhibit to rebuttal testimony of William F. Neathammer
45	Exhibit to rebuttal testimony of Michael G. Clinton
46	Exhibit to rebuttal testmony of Henry S. Pino
47	Exhibit to rebuttal testimony of Norman W. Leake
48	Exhibit to rebuttal testimony of James W. Heckman
49	Service Order Processing Flow Chart
50	Consent Decree in Peter J. Brennan, et al., v. American Telephone and Telegraph Company, et al., Civil Action No. 74-1342 - In the United States District Court for the Eastern District of Pennsylvania
51	House Report No. 92-533, Senate Report No. 92-437, and Conference Report No. 92-708 -- to Revenue Act of 1971

II

EFFICIENCY

There was much testimony in this proceeding concerning the efficiency, or lack thereof, of the Company in its day-to-day operations. It should be emphasized that the Commission feels such evidence by the Company is essential and required for the Company to prove that its proposed rates are just and reasonable. For, unless the Company is doing everything within its power to hold down its costs through efficient management, any rates, which will reflect those costs, will not be just and reasonable.

Despite the importance of this aspect of ratemaking, the Commission is aware that not every issue of a particular company's efficiency can practically be investigated by the Commission Staff and subjected to regulatory scrutiny within a ratemaking proceeding because of the limited statutory time frame and the abundance of financial and accounting issues which must be addressed. However, several such issues have been raised by the parties in this proceeding which must be considered.

A

1. General Services and License Agreement.

On October 1, 1974, American Telephone and Telegraph Company (AT&T) changed the method by which it charges Bell System operating companies under the General Services and License Agreement, dated August 5, 1930. Under the General Services and License Agreement (GS&L), AT&T agreed to provide a wide range of services to Mountain Bell and other operating companies to assist them in providing telecommunications service in their respective service areas. Under the GS&L, Mountain Bell has agreed to pay a fee which cannot exceed 2½% of its local and total revenues, less uncollectibles. In return AT&T has agreed to provide Mountain Bell with services and privilege, such as use of patents, research and fundamental development, advice and assistance in general, including advice and assistance in such specific areas as engineering, plant, traffic, operating, commercial, accounting, legal, and administration pertaining to the conduct of Mountain Bell's business.

From 1948 to October 1, 1974, payment from Mountain Bell to AT&T was equal to one percent of total local and toll service revenues, less total uncollectible revenues. Effective October 1, 1974, payment is an allocation of the actual cost of providing the service, not to exceed 2½%. However, since the new method of payment was only in effect for a fraction of the year for purposes of the instant rate proceeding, the Commission will allow these expenses subject to the exceptions noted in section III, C, 6, infra. Inasmuch as payment now is on an actual cost basis, Mountain Bell will be required in future rate proceedings to submit evidence both explaining and justifying the allocation formulas or methodologies used by AT&T in assigning Mountain Bell's share of the costs under the GS&L. Mountain Bell will also be required to delineate the nature and costs of the services received during the test year in return for the payment made to AT&T under the GS&L.

2. Business Information Systems.

In 1967, Mountain Bell, along with other Bell System operating companies, entered into an agreement with AT&T whereby Bell Laboratories (which is 50% owned by AT&T and 50% owned by Western Electric) develops business information systems (BIS) and programs to be used in the operation of the communications business as conducted by the Bell System operating telephone companies utilizing computer based methodology. Under the agreement, the costs of development of these systems are apportioned among the operating companies with Mountain Bell's share being approximately 4% of the total. By virtue of centralization, mechanized systems are made available and continually maintained for Mountain Bell at a fraction of what it would cost Mountain Bell to do itself. Operational benefits include reduction of operating costs, reduction in capital requirements, improved customer services, better work force utilization and more accurate and timely information for management control. The Commission finds that the BIS agreement, in fact, benefits the ratepayers of Mountain Bell through the advantages of centralization and decreased operating costs. We further find that the allocation procedures are fair and reasonable and that the payments are a necessary and proper business expense of Mountain Bell. As with the General Services and License Agreement, the Company in any future rate proceeding will be required to justify payment for the BIS services in terms of the allocation formula and the extent of actual use of the BIS agreement during the test year.

3. Purchases from the Western Electric Company (Western).

Mountain Bell purchases a significant amount of its materials, supplies and equipment from Western Electric Company. Inasmuch as Western Electric is wholly owned by AT&T (which is the owner of approximately 88% of Mountain Bell's common stock), the Commission must examine the transactions between Mountain Bell and Western Electric in order to determine their fairness and the ultimate effect upon Mountain Bell's ratepayers.

The Commission will not ordinarily delve into the free-market transactions between a utility and its suppliers without a clear indication of abuse of managerial discretion. However, in the case of associated companies, not only must the price paid be at least as favorable as would be available in an arm's-length transaction, but the profit to the associated company must also be reasonable. Without such a showing, excess profits could be readily funneled into a nonregulated associated company at the expense of the ratepayers of the regulated utility.

As was the case in Investigation and Suspension Dockets No. 717 and No. 867, Mountain Bell presented extensive evidence in this proceeding which indicated that Western Electric's prices to the operating companies of the Bell System are generally lower than prices which would be available by the general trade suppliers. Thus, we find on the basis of the evidence in this proceeding that the prices paid by Mountain Bell to Western Electric for its purchases are at least as favorable as would be available in an arm's-length transaction.

The most important and difficult question that must be answered is whether the prices paid by Mountain Bell result in unreasonable or excess profits to Western Electric. The reasonableness of Western's profits from sales to Bell operating companies should be evaluated by considering the actual business risks faced by Western Electric. Mountain Bell's witness, Henry S. Pino, testified that sales volatility for Western Electric, i.e., the variability of sales over time, is greater than that for a utility because the stability of a manufacturing company's revenue is dependent to a large extent on the continued growth of its customers and their commensurate demand for equipment. Further, Mr. Pino compared

Western's volatility of business (in terms of average annual percent deviation from the trend) with that of the 50 largest manufacturers listed in the May 1975 issue of Fortune magazine (exclusive of Western Electric and excluding petroleum and mining companies) and Moody's 125 Industrials (Exhibit 46, page 5 of 46). Mr. Pino's study shows Moody's average annual percentage deviation from trend, 1946-1974, for 125 Industrials at 12.6%, the 50 largest manufacturers at 12.5%, Western Total Company at 11.0%, Western Bell Business at 10.8% and Bell System Total Operating Revenues at 4.6%. The evidence also shows that Western Electric enjoys certain advantages not similarly enjoyed by other manufacturing companies which tend to reduce its risk. Western, because of its relationship with the Bell System, has a budgeted market for its products reducing the uncertainties in long-range planning and allowing it to conform its manufacturing equipment and labor force to the requirements of its assured customers. Because 98% of its sales are made to the Bell operating companies, Western incurs lower marketing expenses than other manufacturers. Finally, its large size and its specialization in telecommunciations equipment and cable sets it apart from other manufacturers.

The Commission is fully aware of the decisions in other jurisdictions in which those portions of a utility's payments to Western which represent a return to the manufacturer greater than that allowed the utility itself have been disallowed from the utility's rate base and operating expenses. City of Los Angeles v. California Utilities Commission (1972) 7 Cal.3d 331, 94 P.U.R.3d 226, 497 P.2d 785; Illinois Bell Telephone Co. v. Illinois Commerce Commission (1973) 55 Ill.2d 461, 3 P.U.R.4th 36, 303 N.E.2d 364; Re New York Telephone Co. (Conn. P.U.C. 1974) 7 P.U.R.3d 496; Pacific Northwest Bell Telephone Co. v. Sabin (Ore. Ct. App. 1975) 8 P.U.R.4th 159. These decisions are based on a conclusion that the risks of Western Electric are far less than most, if not all, other manufacturing companies in essence requiring the reasonableness of its profits to be viewed from the perspective of the regulated utility. This Commission need not decide that issue in this proceeding since Mr. Pino's testimony indicates that Western's return on equity and return on net investment for the Bell business is currently comparable to that allowed Mountain Bell.(Exhibit 46, page 9 of 16). Thus, even if one measures the reasonableness of Western's profits with those of Mountain Bell, Western's profits are reasonable, at least at this time, and we so find. For future proceedings, the Commission will require evidence from Mountain Bell on Western's costs of manufacturing its products and the markup on sales to Bell operating companies.

B

SYSTEM MOVEMENT EXPENSES

System movement includes the number of connections, disconnections and changes of telephone equipment on the system. Such movement results in costs since there is a significant amount of work tasks involving personnel in the Business Office, Traffic Department, Plant Department and Accounting Department (Exhibit 49). The labor intensity of these tasks has caused associated costs to increase over the last several years. The extent of system movement has remained high over the last several years, even as the Company's growth has lessened. For example, the percentage of connections and disconnections to total telephones for the years 1971 through 1974 has averaged around 63% (Exhibit 6, Tab 6). During these same years, the "movement-to-gain one" ratios (i.e., the total number of connections and disconnections necessary to gain one telephone on the system) have increased as follows: 1971 - 9.8; 1972 - 9.2; 1973 - 11.4; 1974 - 13.9.(Exhibit 6, Tab 6). Mountain Bell witnesses Lloyd L. Leger and Robert Heath both testified that revenue derived from installation and change charges (there is no charge for termination of service) is insufficient to cover the costs incurred, resulting in the general body of ratepayers paying part of system movement costs. In short, the less mobile ratepayers, who may often be the disabled and elderly, and least able to pay, are subsidizing the more mobile and perhaps more affluent ratepayers.

Until recently, the Company has done little to hold down such system movement costs. In July 1975, Mountain Bell submitted a tariff to begin a systemwide conversion of nonkey telephones to modular telephones. A modular telephone is one in which the base and handset contain jacks, and the mounting and handset cords are plug-ended so that the telephone can be installed merely by plugging in the cords. As the Company readily admits, there will be substantial savings in labor costs resulting from simpler and quicker means of installing and repairing telephones. In the tariff filed and approved earlier this year, Mountain Bell proposed to convert to modular <u>only</u> in connection with station activity. That is, orders involving new installations, reinstallations, moves or set changes will be converted at the time of the station work. However, on reconnection activity, or repair activity if it is not necessary to change the set or any of its components, there will be no conversion (Exhibit 6, Tab 2). After hearing the evidence in this proceeding, we believe that in light of the continuing, substantial system movement costs and the large future labor saving to be derived from modular conversion, Mountain Bell should convert to modular telephones whenever an installer or repairman is, for whatever reason, required to travel to the ratepayer's residence. The additional time and labor required to convert once the installer or repairman is already at the residence for some other reason is small by comparison to future labor savings derived from modular telephones. In order to avoid the necessity of formal Commission action at this time, we strongly urge Mountain Bell to refile, within thirty (30) days of the effective date of this decision, its Modular Telephone tariff which includes a plan for immediate conversion to modular telephones, as discussed above.

Finally, Mountain Bell has just recently filed a tariff to implement a pilot project of "take and save" to be carried out in Boulder, Colorado. The purpose of this program is to offer to customers in the Boulder area the opportunity to disconnect their own telephone and reconnect it at their new residence, thereby alleviating the need for the Company to send out an installer to perform these tasks. The potential labor savings of such a project are obvious and substantial. The only potential hazard of this project would be loss of the telephone set itself, although Mountain Bell witness Lloyd L. Leger testified that Colorado was generally a low-set-loss state. Again, based on the continuing substantial system movement costs and the potential labor savings of "take and save" which will be facilitated once modular telephones become predominant, we believe that "take and save" should be implemented statewide as soon as possible. Thus, in order to avoid the necessity of formal Commission action at this time, we strongly urge Mountain Bell to report the results of its Boulder project to the Commission Staff periodically and file tariffs, within six months of the effective date of this decision, implementing "take and save" statewide.

III

DISCUSSION AND FINDINGS OF FACT

A

CAPITAL

1. Equity.

a. Dividend Accrued, But Not Paid.

On Exhibit 3, page 8, column B, the Company submitted evidence with respect to average-year 1974 equity (as booked) as follows:

Line 5, Common Stock	$191,359,000
Line 6, Premium on Stock	45,670,000
Line 7, Retained Earnings	113,536,000
Line 8, Dividends Accrued, But Not Paid	3,843,000
Line 9, Total Equity (L. 5 + 6 + 7 + 8)	$354,408,000

The Company made pro forma adjustments to its average-year equity by adding $975,000 to Common Stock, increasing Common Stock to $192,334,000; by adding $233,000 to Premium on Stock, increasing Premium on Stock to $45,903,000; and, by adding $578,000 to Retained Earnings, increasing Retained Earnings to $114,114,000, resulting in total equity, as adjusted for the test year, of $356,194,000.

As listed above, the Company has included $3,843,000 in Dividends Accrued, But Not Paid as part of its equity capital in this proceeding. Mountain Bell witness Leake on page 5 of his direct testimony acknowledged that the inclusion of Dividends Accrued, But Not Paid was not consistent with the findings made by the Commission in Decision No. 86103, Investigation and Suspension Docket No. 867. Mr. Leake stated that Dividends Accrued, But Not Paid represent stockholder funds invested in the business for the customers' benefit. Both Colorado Municipal League witness Stephen A. Duree and Staff witness Craig Merrell recommended that the Commission remove from the total equity capital of the Company for this proceeding Dividends Accrued, But Not Paid. Witness Duree stated that once a dividend is declared, it is a liability to be paid out. A declared dividend is simply a liability like accounts payable. Witness Merrell also contended that Dividends Accrued, But Not Paid are a current liability of the Company and not part of the permanent capital of the Company. The Commission agrees with witnesses Duree and Merrell, and so finds that Dividends Accrued, But Not Paid are current liabilities of the Company and do not form part of the permanent capital of the Company. Accordingly, the Commission hereby removes from the average-year equity of the Company for the test year, as adjusted by the Company in column D on page 8 of Exhibit 3, the $3,843,000 representing Dividends Accrued, But Not Paid.

b. Colorado Sales and Use Tax Adjustment.

When Western Electric filed its sales tax return and Mountain Bell filed its use tax return for the month of October 1971, purchases of telephone instruments, station apparatus, cable, wire, conduit, telephone poles, cross-arms, directories, switching equipment and other related telecommunications apparatus used directly in providing telephone service were not reported to the Colorado Department of Revenue, upon the grounds that purchases of these items were exempt under the so-called processing clause of the state's sales and use tax statutes. When the Executive Director of the Department of Revenue made a tax deficiency assessment against the companies for failure to collect and to pay sales and use taxes, and assessed a penalty and interest thereon for nonpayment, the companies commenced proceeding in the District Court for judicial review of the assessment. During the period from October 1971 to September 1974, Mountain Bell did not pay to the State of Colorado sales or use taxes on its purchases of telecommunications equipment from Western Electric. On August 6, 1974, the Colorado Supreme Court in Western Electric Company, Inc. and Mountain States Telephone and Telegraph Company v. Hugh H. C. Weed, ____ Colo. ____, 524 P.2d 1369, upheld the Director's deficiency assessment for unpaid sales and use taxes, and the Director's assessment of penalty and interest for nonpayment. As a result of the Supreme Court's decision, Mountain Bell paid to the State of Colorado in 1974, $6,924,837 in back unpaid sales and use taxes, and paid to the state $630,160 as penalty and $952,973 as interest on the unpaid sales and use taxes.

The Company in its evidence to the Commission made several accounting and pro forma adjustments to the Company's test-year capital summary and operating expenses as a result of this payment to the State of Colorado. A total amount of $3,401,000 was added to capital, of which 52.52% was allocated to equity ($1,786,000) and 47.48% to debt ($1,615,000). Staff witness Merrell recommended that the Commission delete from the Company's total equity the $1,786,000 adjustment on the basis that the Company acknowledged that it did not issue $975,000 in common stock from which to pay part of the Colorado intrastate sales and use tax deficiency assessed by the Director of Revenue. Thus, as Mr. Merrell testified, there would have been neither $233,000 in premium on the stock nor $578,000 in retained earnings associated with this stock. Mr. Merrell stated that the Company hypothecated the common stock and also hypothecated both premium and retained earnings on the hypothetical stock. Mr. Merrell further stated, and the Company admitted, that the sales and use taxes when paid were paid from cash. Thus, as the Company admitted, at the time of payment, it would have credited cash and debited either a plant or an expense account; but that under no circumstances would the capital accounts of the Company have been affected by this transaction since no special stock issue was made in order to raise the cash with which to pay the tax deficiency. The Company asserted, however, that unless an adjustment of $3,401,000 is made to the capital of the Company, as proposed by the Company, an imbalance will occur between the rate base and the capital of the Company. As demonstrated at the hearing, since the sales and use taxes were paid from cash, there would have been no necessity for an adjustment to the capital account of the Company and that no imbalance would have occcurred when the sales and use taxes were booked. Furthermore, if the sales and use taxes were paid from cash and the source of that cash were debt of equity, the debt or equity would have already been accounted for in the Company's capitalization when the sales and use taxes were paid and booked. Accordingly, the Commission hereby disallows all of the adjustments listed under column C, from line 1 through line 10, on page 8 of Exhibit 3.

2. Return on Equity.

The Commission last determined a fair rate of return on common equity for Mountain Bell on December 20, 1974, in Decision No. 86103, in

Investigation and Suspension Docket No. 867. In Decision No. 86103, the Commission found 12.04% to be a fair rate of return on common equity for Mountain Bell. In Decision No. 86103, the Commission stated at page 13 that 12.04% was:

> . . . fair and reasonable, sufficient to attract equity capital in today's market, and commensurate with rates of return on investments in other enterprises having corresponding risks.

After applications for reconsideration, reargument or rehearing of Decision No. 86103 were filed, the Commission reaffirmed its finding of 12.04% as a fair rate of return on common equity for Mountain Bell by denying all applications for reconsideration, reargument or rehearing, the last on January 13, 1975. Only 53 days later -- on March 7, 1975 -- Mountain Bell filed Advice Letter No. 1073 and the tariff revisions which are the subject hearing in this I&S Docket No. 930. On pages 11 and 12 of Advice Letter No. 1073, Mountain Bell writes of the 12.04% rate of return on common equity and the 4.25 pre-tax interest ratio:

> Those conclusions were reached after weeks of testimony and lengthy deliberation in an economic climate substantially identical to the climate which exists today. . . . Since there has been no major changes in the economy since the last order which is less than three months old, the standards enunciated in that decision are at least prima facie controlling.

In view of the above statement made by Mountain Bell in its Advice Letter, and, in view of the fact that only 53 days had elapsed between the conclusion of I&S Docket No. 867 and the filing of Advice Letter No. 1073, the Commission entered Decision No. 86644 on April 15, 1975, which ordered Mountain Bell to file on or before May 12, 1975, written direct testimony and supporting exhibits directed solely to the following issue:

> What changes, if any, in economic conditions with respect to the national economy or the Colorado economy or in the bond market, stock market, or other money markets have occurred between December 20, 1974, and March 7, 1975, that would warrant an <u>upward revision</u> in the rate of return on common equity <u>from that which</u> is presently authorized, namely 12.04%. (Emphasis added.)

In response to Decision No. 86644, the Company filed written testimony of James W. Heckman (Exhibit A) and a supporting exhibit (Exhibit 1) on May 12, 1975, and written testimony of Ezra Solomon (Exhibit B) and a supporting exhibit (Exhibit 2) on May 14, 1975. On May 19, 1975, the Commission heard oral argument by Company counsel with respect to the written direct testimony and supporting exhibits filed by the Company.

On June 24, 1975, by Decision No. 87063, the Commission provided to all intervenors and to the Staff of the Commission the same opportunity to file written testimony and exhibits that the Commission had previously afforded the Company with respect to the issue of rate of return on common equity. In Decision No. 87063, the Commission ordered intervenors and Staff of the Commission to file on or before July 25, 1975, written direct testimony and supporting exhibits directed solely to the following issue:

> What changes, if any, in economic conditions with respect to the national economy or the Colorado economy or in the bond market, stock market, or other money markets have occurred between December 20, 1974, and March 7, 1975, that would warrant a downward revision in the 12.04% rate of return on common equity for Mountain Bell's Colorado instrastate business. (Emphasis added.)

On July 1, 1975, by Decision No. 87087, the Commission determined that the evidence submitted by Mountain Bell, in response to the Commission's Order in Decision No. 86644, did not support a finding that the 12.04% rate of return on common equity (found to be just and reasonable in Decision No. 86103) had become too low prior to the filing of Advice Letter No. 1073 on March 7, 1975. In Decision No. 87087, the Commission stated that it would adhere to the 12.04% rate of return on common equity found to be fair and reasonable in I&S Docket No. 867, unless thereinafter ordered to the contrary after consideration of testimony and exhibits submitted by intervenors or Staff pursuant to Decision No. 87063.

In response to Decision No. 87063, Intervenor Colorado Municipal League, on July 25, 1975, filed written testimony of David A. Kosh (Exhibit E). On July 29, 1975, the Commission heard oral argument by counsel for Intervenor Colorado Municipal League with respect to the written direct testimony of David A. Kosh.

Mr. Kosh, in his written testimony, considered several factors in reaching his conclusion that the "conditions which prevailed in the economy and money markets in December, 1974, which caused the Commission to increase my recommended cost of equity of 11.5% to 12.04% no longer prevail and did not prevail on March 7, 1975." (Exhibit E, page 2) Mr. Kosh stated that, in his opinion, the basic cause of the "unsettled conditions" in the capital markets in 1974 was the combination of rapid inflation and recession, and it was these two factors that caused significant instability in the money markets in general and the utility markets in particular. We agree with Mr. Kosh that the unsettled conditions in the capital markets in 1974, and particularly in December 1974 when the Commission entered Decision No. 86103, were the result of a combination of rapid inflation and recession. We disagree with Mr. Kosh, however, that the unsettled conditions in the capital markets had lessened so appreciably by the time Mountain Bell filed Advice Letter No. 1073, instituting this rate proceeding, to warrant the Commission's rehearing the issue of rate of return on common equity. According to Bureau of Labor statistics, of which the Commission hereby takes administrative notice, the rate of inflation on an annual basis was 8.4% for December 1974; 6.0% for January 1975; and 8.4% for February 1975. In Decision No. 87087, entered in this docket, we stated with respect to the testimony filed by Mountain Bell witness James W. Heckman:

> Page 2 of Exhibit 1 lists seven selected economic indicators. The first three indicators (Real Gross National Product, Industrial Production and Unemployment) indicate that the economic recession that deepened dramatically during the fourth quarter, deepens slightly more during the first quarter of 1975, i.e., during the period under consideration herein.

(At page 4.) The long-term debt market during the period under consideration herein showed varying changes from the high rates reached in December 1974. However, AAA rated utility bonds (Mountain Bell's bonds are AAA rated) dropped only .3% between December 20, 1974, and March 7, 1975 -- from 9% to 8.7%. One improvement, however, was in Dow Jones Utility Average, which rose from 66.43 on December 20, 1974, to 80.39 on March 7, 1975, a rise of 21%. The market price of Mountain Bell's common stock also rose by approximately 20% during the same period. Even with this increase in market price, Mountain Bell's market-to-book ratio rose from .75 to only .85. This is substantially below a 1.20 market-to-book ratio Commission Staff witnesses and other expert witnesses have recommended to the Commission in prior rate proceedings as desirable in order to prevent dilution of the Company's book equity in the event that the Company resorts to the money markets to raise equity capital.

For the reasons as stated above, the Commission finds that the 12.04% rate of return on common equity found to be just and reasonable in I&S Docket No. 867 on December 20, 1974, had not become too high prior to commencement of the present I&S Docket No. 930 on March 7, 1975. Accordingly, the Commission adheres to the 12.04% rate of return on common equity for this rate proceeding.

3. Debt/Equity Ratio.

The reasonableness of Mountain Bell's debt/equity ratio in its capital structure was not made an issue in this proceeding by any of the parties, but has been made an issue by the introduction into evidence of Exhibit No. 30. As raised in this proceeding, it is maintained that if necessary capital were raised by a larger percentage of debt financing over equity financing, thereby increasing the debt/equity ratio, the savings in costs including income tax would be substantial and the need for rate increases would be correspondingly reduced. As for any possible adverse effects flowing from a high debt/equity ratio, it is contended these consequences are based on opinion only and, even if true, would not outweigh the tax savings just mentioned.

The issue of what is the proper debt/equity ratio for a utility is an issue that has been raised previously before the Commission. In Mountain States Telephone and Telegraph Company v. Public Utilities Commission, 182 Colo. 269, 281-282, 513 P.2d 721 (1973), the Colorado Supreme Court stated:

> . . . (M)ethods of raising capital should be left to the discretion of management unless there is a substantial showing that rate payers are being prejudiced materially by the managerial options in the area of capital financing. . . .

One aspect of interest with regard to the above quotation is that the remarks were directed at the theory, which, similar to that raised in this proceeding, is a theoretical discussion premised upon an arithmetical analysis that fails to weigh all the factors influencing the highly complex subjects of capital financing in general and debt/equity ratios in particular.

Since no concrete evidence was introduced in this proceeding in support of the assertions in Exhibit 30, one could conclude that the above-quoted remarks of the Colorado Supreme Court are sufficient to dispose of the matter. However, rather than leave the impression that the issue of a proper debt/equity ratio is not complex, and rather than mislead the public into thinking the Commission has not given it serious thought, the following is a deeper analysis of the subject.

First, it is appropriate to present in more detail the theory presented for a high debt ratio. The approximate composite tax applicable to Mountain Bell is 50%. Since income is taxed at 50%, for every dollar required to pay a return on equity, an additional dollar is required to pay the tax. Exhibit 30 uses Mountain Bell's previously authorized return on equity of 11.4%. Because of the doubling effect of taxes, Mountain Bell must collect $22.80 for every $100 of equity capital. Therefore, every $100 of equity capital costs the ratepayers at the rate of $22.80.

On the other hand, the theory continues, for every $100 of long-term debt acquired at an assumed rate of 6.77%, the interest of $6.77 is deducted from taxable income, and, using the tax rate of 50%, results in a savings in taxes of $3.38 or 3.38%. As a result of this deduction, the actual cost of long-term debt is not the ostensible rate of 6.77%; its true cost is 3.38%. Deducting the true cost of long-term debt from the actual cost of equity, the result is a cost of equity that is 19.42 percentage points higher than the cost of debt.

The Commission's discussion of this theory will be set forth in two parts. The first part will attempt to place into perspective the relative costs, as affected by taxes, of debt versus equity. The second part will discuss the other factors affecting the reasonableness of a debt/equity ratio.

Advocates of a high debt ratio set forth the relative costs of long-term debt and equity by comparing a utility financed by 100% debt to a utility financed by 100% equity. In comparing these two extremes in a vacuum, the mathematics are correct. To be realistic, however, the relative costs of debt and equity must be analyzed under various capital structures, and the following schedule sets forth their relative costs under 11 different debt/equity ratios.

The capital structure is set forth in column A. Columns B and C contain the amounts and the ratios of debt and equity with total capital being $100. In column D are set forth the costs of debt and equity. The embedded costs of debt and equity are set forth in column E. In column F are set forth the tax savings resulting from interest costs, and column G contains the additional taxes necessary before the return on equity can be paid. Columns F and G are based on a composite tax rate of 50%. Column H is the total of the amounts in columns E and G, less the amount in column F.

(A) Capital		(B) Amount	(C) Ratio	(D) Cost	(E) Embedded Cost	(F) Tax Savings	(G) Impact of Taxes	(H) Total Revenue Needed
1)	Debt	$100	100%	6.77%	$ 6.77	$3.39		
	Equity	$ 0.00	0%	11.40%	$ 0.00		$ 0.00	$3.38
2)	Debt	90	90	6.77	6.09	3.05		
	Equity	10	10	11.40	1.14		1.14	5.32
3)	Debt	80	80	6.77	5.42	2.71		
	Equity	20	20	11.40	2.28		2.28	7.27
4)	Debt	70	70	6.77	4.74	2.37		
	Equity	30	30	11.40	3.42		3.42	9.21
5)	Debt	60	60	6.77	4.06	2.03		
	Equity	40	40	11.40	4.56		4.56	11.15
6)	Debt	50	50	6.77	3.39	1.69		
	Equity	50	50	11.40	5.70		5.70	13.10
7)	Debt	40	40	6.77	2.71	1.36		
	Equity	60	60	11.40	6.84		6.84	15.03
8)	Debt	30	30	6.77	2.03	1.02		
	Equity	70	70	11.40	7.98		7.98	16.97
9)	Debt	20	20	6.77	1.35	.68		
	Equity	80	80	11.40	9.12		9.12	18.91
10)	Debt	10	10	6.77	.68	.34		
	Equity	90	90	11.40	10.26		10.26	20.86
11)	Debt	0.00	-0-	6.77	-0-	-0-		
	Equity	100	100	11.40	11.40		11.40	22.80

Thus, as the examples above illustrate, a utility with a debt/equity ratio of 50:50 will decrease its costs if its debt/equity ratio is changed to 60:40, the savings being $1.93 or a difference of 1.93 percentage points. This is radically different from the 19.42% stated in Exhibit 30, and it demonstrates the defective reasoning in Exhibit 30. The theory therein is relevant only when comparing a utility financed by 100% debt to a utility financed 100% by equity. The Commission is not aware of any informed person who advocates that a utility such as Mountain Bell be financed by 100% debt.

The Commission agrees that there is a difference between the cost of equity and the cost of debt when only the impact of taxes is considered. As the above demonstrates, however, it is much less than has been stated. Having placed it in perspective, it is appropriate now to proceed and discuss other factors affecting the reasonableness of a debt/equity ratio. Although advocates of high debt treat these in summary fashion or avoid them entirely, they are the very factors that must be considered by any Commission if it is to perform its duties in a responsible manner.

No matter how perfect the arithmetical exercise is in which one engages, it is only as valid as the assumptions upon which it rests. As the debt ratio of a utility is increased, buyers of new bond issues will require an increase in yield to compensate for the additional risk inherent in the lessening of security to support the issue. Equity holders, in turn, will require an even higher rate of return to compensate for the greater risk imposed upon them. To allege otherwise is to ignore the economic realities of the capital market. If the debt ratio is increased continuously, the point will be reached when additional bonds cannot be sold regardless of the yield offered. Since bonds are considered more secure than equity, it is obvious that equity capital could not be sold at that point either.

Further, advocates of high debt have overlooked the legal liability associated with interest on long-term debt. One of the basic principles of regulatory philosophy is that the authorized rate of return is not guaranteed. Thus, if a utility does not realize its net operating earnings, the rate of return to equity will be less than the rate of return that was authorized. This brings into perspective another basic principle -- equity holders assume the risk that the authorized return may not be earned.

However, the interest payable on long-term debt is not flexible. It is a legal obligation that the utility is required to pay if it is to avoid default. If the high debt ratio is the result of Commission action, it becomes the Commission's responsibility to ensure sufficient rates so that default may be avoided. Thus, as the debt ratio is increased as a result of Commission decisions, the guarantee of a rate of return correspondingly comes closer to being a necessity.

Another point deserving of mention is the "Times Interest Earned Ratio." If a utility is to maintain its rating, its earnings must exceed its interest payments on long-term debt a certain number of times. Thus, as the debt ratio increases, the necessary earnings must increase by the "Times Interest Earned Ratio." If earnings do not, the point will be reached when potential investors no longer consider the utility's long-term debt a worthwhile investment, resulting in a downgrading of its rating and a probable foreclosure to all sources of capital in today's market.

The Commission does not believe that the debt/equity ratio of any utility is inviolate. However, what constitutes a reasonable debt/equity ratio involves many factors other than income tax considerations. Before intruding into the domain of management, the Commission must have substantial evidence to justify such intervention. The Commission does not believe such action is justified merely because one wishes to dismiss summarily the opinions of experts in the field without concrete evidence to the contrary.

As for the suggestion that Mountain Bell continue to increase its debt ratio until it is no longer able to sell debt, the response of David A. Kosh, previously recognized by this Commission as an expert on rate of return when he appeared on behalf of the Colorado Municipal League in I&S Docket No. 867 captures the essence of the problem:

> . . .(I)t's like saying to somebody we don't know whether a certain medicine is good or bad so we are going to let you try it, and if you die it's bad and if you don't it's good. (Investigation and Suspension Docket No. 867, Volume XXXII, pp. 224-225 of transcript.)

In summary, the Commission does not believe it should intrude into management's discretion with regard to the capital structure of Mountain Bell where there is no evidence that demonstrates ratepayers are being prejudiced by its debt/equity ratio.

B.

RATE BASE

On Exhibit 3, page 7, column B, the Company submitted evidence with respect to average-year-1974 rate base as follows:

1.	Plant in Service	$809,513,000
2.	Less - Depreciation Reserve	136,134,000
3.	Plant under Construction	49,764,000
4.	Property Held for Future Use	718,000
5.	Materials and Supplies	5,889,000
6.	Less - Deferred Income Taxes-Accelerated Depreciation	33,452,000
7.	Rate Base (L. 1 thru 6)	696,298,000

All parties accepted as the starting point, an average-year rate base for the test period of $696,298,000. The Company made pro forma adjustments to its average-year rate base by adding $3,786,000 to Plant in Service, increasing Plant in Service to $813,299,000; and by adding $238,000 to Depreciation Reserve, increasing Depreciation Reserve to $136,372,000. Both adjustments were made to reflect the addition to plant of back unpaid sales and use taxes paid to the State of Colorado in 1974 following the Colorado Supreme Court's decision in Western Electric Company, Inc., and Mountain States Telephone and Telegraph Company v. Hugh H. C. Weed, Supra. The Company's recommended average-year rate base for the test period is $699,846,000.

The Colorado Municipal League witness Stephen A. Duree recommended an average-year rate base of $686,410,000 (Exhibit G, page 14). Mr. Duree, in his testimony (Exhibit G), recommended that the Commission deduct from rate base the $5,889,000 allowance for Materials and Supplies because there were adequate tax accruals recorded on the Company's books and allocated to Colorado intrastate operations to fully offset the Company's requested allowance for Materials and Supplies. Mr. Duree also recommended that the rate base be reduced by an additional $3,999,000, which is the unamortized pre-1971 investment tax credits remaining on an average basis during 1974. Mr. Duree made no recommendation with respect to the pro forma sales and use tax adjustments made by the Company, stating that that was beyond his scope of his employment. Staff witness Craig Merrell recommended to the Commission an average-year rate base of $697,898,000 (Exhibit No. 31, column E, line 8). Mr. Merrell recommended that the Commission remove from average-year rate base $1,999,000 as representing one-half of the Colorado intrastate amount of the unamortized investment tax credit earned by the Company prior to 1971; and that the Commission add to rate base $51,000 representing a computation error made by the Company in Exhibit 3, page 7, column B in its adjustment to Deferred Income Taxes-Accelerated Depreciation. Mr. Merrell, like Mr. Duree, made no comment with respect to the Company's sales and use tax adjustment.

Inasmuch as the pre-1971 investment tax credit is a dead account, that is, no additional amounts have been added to this account since 1971, the full amount of the unamortized balance remaining in the account during 1974 will not be available to the Company in 1975, or in succeeding years. Thus, the Commission will accept as fair and reasonable the recommendation by Staff witness Merrell that the rate base should be reduced by one-half of the Colorado intrastate amount of the unamortized investment tax credit earned by the Company prior to 1971.

The Commission, in prior decisions involving general rate proceedings for the Company, has always included in the Company's average-year rate base the amount representing average Materials and Supplies of the Company for the test period.[2] The Commission's inclusion of Materials and Supplies in rate base in Decision No. 72385 in Application No. 23116 was specifically appealed to the Colorado Supreme Court. The Supreme Court affirmed the Commission's inclusion of Materials and Supplies in rate base in Colorado Municipal League v. Public Utilities Commission, 172 Colo. 188, 205-206, 473 P.2d 960 (1970). The same argument that was made in Application No. 23116 and was rejected by the Commission is being made again in this rate proceeding. For the present proceeding, the Commission adheres to its prior decisions and does not accept the recommendation that average-year Materials and Supplies of $5,889,000 be deleted from rate basis. The Commission finds that the rate base in this proceeding is an average-year rate base of $697,898,000.

Considerable testimony and cross-examination was submitted to the Commission concerning treatment for ratemaking purposes of the job development tax credit earned by the Company under Section 46(e) of the Internal Revenue Code, 26 U.S.C.A. § 46(e). With regard to the treatment of the job development investment credit for ratemaking purposes, Congress has provided three basic elective options: The first option provides that the investment credit is not to be available to a company with respect to any of its public utility property if any part of the credit to which it would otherwise be entitled is flowed through to income; however, in this option, the tax benefits derived from the credit (if the regulatory commission so requires) may be used to reduce rate base, provided that this reduction is restored over the useful life of the property. The second option provides that the investment credit is not to be available to a company with respect to any of its public utility property if the credit to which it would otherwise be entitled is flowed through to income faster than over the useful life of the property; however, in this option there may not be any adjustment to reduce the rate base, if the credit is to be available. Under the third of the elective options, the above restrictions would not apply at all. Only the first and second options were available to Mountain Bell. The Company made its election of the second option within 90 days after the enactment of the job development investment credit, as provided in the statute. Under Section 46(e), if a regulatory commission flows through a utility's investment credit at a rate faster than permitted under the applicable option, or insists upon a greater rate base adjustment than is permitted under the applicable option, then the utility will not be allowed to take any investment credit for that period and for any taxable periods that are open at the time the limitations of the applicable options are exceeded by the Commission. The second option which Mountain Bell has elected has two specific prohibitions: (1) The Commission, for ratemaking purposes, may not flow the credit through to income faster than ratably over the useful life of the property. In determining the period of time over which the investment may be ratably flowed through, reference must be made to the period of time on the basis of which depreciation expense is computed on the utility's regulated books

---

2. See Decision No. 72385 in Application No. 23116 (January 7, 1969), 75 P.U.R. 3d 481; Decision No. 77230 in I & S Docket No. 668 (March 25, 1971), 89 P.U.R. 3d 64; Decision No. 81320 in I & S Docket No. 717 (September 19, 1972), 96 P.U.R. 3d 321; and, Decision No. 86103 in I & S Docket No. 867 (December 20, 1974).

of account, and not to the useful life used for depreciation under the Internal Revenue Code. (2) The Commission, for ratemaking purposes, may make no adjustment with respect to the credit for purposes of reducing rate base.

Neither Mountain Bell, nor any of the other parties to this proceeding have recommended that the rate base of the Company be reduced by reason of the unamortized portion of the job development investment credit. The Commission in this rate proceeding is not reducing the average-year rate base of the Company nor its cost of service for the test period by reason of the unamortized portion of the job development investment credit, as enacted in the Revenue Act of 1971, Public Law 92-178.

The Company in this proceeding calculated test-year 1974 additional revenue required through equity, rather than through rate base. (Exhibit 3, page 2.) The Company included $1,101,000 in its calculation as representing required earnings at 10.85% on the $10,149,000 unamortized job development investment credit. The Company maintained in this proceeding that Section 46(e) requires that it be permitted to earn on the unamortized JDIC at the debt-equity composite rate. The Commission has reviewed Section 46(e) and House Report 92-533, Senate Report 92-437, and Conference Committee Report 92-708 to the Revenue Act of 1971 (Exhibit No. 51) in light of the Company's position in this proceeding. Section 46(e), as discussed above, contains only two prohibitions, both designed to prevent regulatory commissions from flowing through all of the benefits of the credit currently to the utility's customers. The Commission finds nothing in either Section 46(e), or in the Reports, that would lead the Commission to a conclusion that the Company should earn on the unamortized balance of the JDIC other than as the balance is represented in the original investment in plant in the rate base. The Commission finds nothing in its review that would lead it to a conclusion that the Company must be permitted to earn at the composite debt/equity rate on the unamortized JDIC balance in addition to earning on the original investment that is in rate base and being earned on at the rate base rate - as any other investment in plant in rate base.

Colorado Municipal League asserted that the selection by Mountain Bell of the second option instead of the first option was an abuse of management discretion. The League, however, suggested no remedy. Congress, in the Revenue Act of 1971, gave to the Company the election of either the first option or the second option (the third option was not available to the Company). The Company elected the second option. Section 46(e) is designed to divide the benefits of the investment credit between the ratepayers of the utility and the investors of the utility and makes the credit unavailable where all of the benefits are flowed through currently to the ratepayers. If the Commission in this rate proceeding should reduce cost of service or rate base by any accounting treatment of the credit, Mountain Bell will lose the credit and, not only the investors in Mountain Bell, but also the ratepayers of Mountain Bell, will be adversely affected. In the year 1974, the job development investment credits assigned to Colorado intrastate amounted to $4,458,357. Accordingly, the Commission does not concur in the suggestion that it should reduce cost of service (or rate base) because of Mountain Bell's selection of the second option.

C

OPERATING EXPENSES

The Company has included on Exhibit 3, page 4, under column A, line 27, $120,000 in interest expense on a theory that it would have paid $120,000 in interest expense on the additional $1,615,000 in debt which the Company would have had to issue to pay the unpaid Colorado Sales and Use Tax in 1974. Staff witness Richards has recommended to the Commission that the Commission should not hypothecate long-term debt and then hypothecate an interest charge on the hypothetical long-term debt. Inasmuch as the Commission has already determined that it will not accept the Company's theory for increasing capital by $1,615,000 in long-term debt and $1,786,000 in equity, the Commission will also not accept the Company's inclusion of the $120,000 as an interest expense on the grounds stated by Staff witness Richards.

The Company has made one last adjustment with respect to the payment of the sales and use tax deficiency. The Company paid to the State of Colorado as interest on the sales and use tax deficiency the amount of $952,973. The 1974 Colorado intrastate allocated share of the sum is stated by the Company to be $170,000, which the Company has included as an item in its operating expenses. The Company has argued to the Commission that the $952,973 represents an interest payment to the State of Colorado on a loan of some $6.9 million from the State of Colorado for the period of approximately three years. The Commission does not look at either the $6.9 million-deficiency tax assessment against the Company, nor the interest paid thereon, as a business transaction with the State of Colorado, as characterized by the Company. Furthermore, the Commission does not intend, by use of its regulatory power in ratemaking proceedings, to encourage utilities subject to its regulatory jurisdiction to refuse to pay taxes to either the State or Federal government until such time as either the State or Federal government secures a court judgment against the utility Company. In addition, the Commission agrees with Staff witness Richards that the $170,000 is a nonrecurring expense and should be disallowed as an item of operating expense. The Company admitted under cross-examination that it would not be required to make a $170,000 interest payment to the State of Colorado in the years 1975, 1976, or in the future. Accordingly, the Commission disallows the $170,000 as an interest expense.

2. 1971 and 1972 Federal Income Tax Deficiency - Interest Expense.

On Exhibit 3, page 4, column D, the Company made an accounting adjustment to its income statement for the year ended December 31, 1974, to remove interest costs associated with the year 1973 on an anticipated federal income tax deficiency for the years 1971 and 1972. The Company is anticipating a $1,624,674 Federal income tax deficiency because of the United States Supreme Court Decision on June 20, 1974, in Commissioner of Internal Revenue v. Idaho Power Company, 94 S.Ct. 2757. In the Commissioner of Internal Revenue case, the U. S. Supreme Court upheld the Commissioner by reversing a decision of the Court of Appeals for the Ninth Circuit in Idaho Power Company v. Commissioner of Internal Revenue, 477 F.2d 688 (9th Cir. 1973), which, in turn, had reversed a decision of the U. S. Tax Court. Pending appeal by the Commissioner to the U. S. Supreme Court from the decision of the Ninth Circuit, Mountain Bell (as had Idaho Power Company) claimed as a deduction from gross income for federal income tax purposes, all of the year's depreciation on certain motor vehicles and tools, including that portion attributable to their use in the construction of capital facilities, thus increasing the Company's depreciation expense for the years in question, and reducing its federal income accrual. It was this deduction which the Commissioner disallowed and upon which he was ultimately upheld.

The purpose of the Company's accounting adjustment was to remove that portion of the anticipated interest cost associated with the year 1973 from that of the test year 1974. In December 1974, the Company booked $150,000 in interest expense relating to this anticipated deficiency for total State of Colorado's 1971 and 1972 federal income tax accrual. The Company in its accounting adjustment has removed the intrastate portion of the interest expense allocable to the year 1973 in the amount of $42,000, from the test year. Staff witness Richards recommended the removal of the remaining $76,000, which represents the Colorado intrastate portion allocable to the test year 1974. Mr. Richards stated as a reason that the $76,000 in interest expense is a nonrecurring expense that should not be built into the Company's operating expenses, inasmuch as the Company will not be making similar interest payments to the Internal Revenue Service because of this anticipated tax deficiency. The Company took the position that the $1,624,674-tax-deficiency assessment represents funds borrowed from the United States Government and that these borrowed funds were used in the business and had no different status than money borrowed from a bank for which interest was paid. As stated heretofore in this decision, the Commission does not accept the Company's characterization of tax deficiency assessments as business transactions with the government analpgous to business transactions with banks and other creditors. In addition, the $76,000 is a nonrecurring expense. The Commission disallows this adjustment as an interest expense for ratemaking purposes.

3. 1974 Federal Income Taxes.

Staff witness Richards recommended to the Commission in this proceeding that a portion of the net tax savings retained by American Telephone and Telegraph Company, which is derived from filing a system-wide consolidated federal income tax return, be allocated to Mountain Bell's Colorado intrastate operations. Mr. Richards recommended that the amount shown on Mountain Bell Exhibit 3, page 3, column F, line 17, be reduced by $361,000. Mountain Bell witness Leake testified that the Company was included in the consolidated return filed by AT&T for the Bell System, and that Mountain Bell did not file a separate federal income tax return with the Internal Revenue Service. Mr. Leake testified that the Company places a sum of money on deposit with the federal government and is granted credit towards the tax liability of Mountain Bell on the consolidated income tax return. The amount the Company places on deposit with the federal government is equal to the amount of taxes that the Company would pay if it filed a separate income tax return.

Witness Richards offered Exhibit No. 34 at the hearing, which exhibit was received into evidence. Exhibit No. 34 is entitled "National Association of Regulatory Utility Commissioners, Allocation of American Telephone and Telegraph Company Federal Income Taxes 1974."

Exhibit No. 34 was prepared by the Comptrollers Department of AT&T for the NARUC Committee on Accounts to show the allocation of tax savings realized through consolidating the Bell System tax returns. Mr. Richards stated that Exhibit No. 34 shows that the General Department of American Telephone and Telegraph Company realized a net tax savings of $166,319,310 applicable to 1974, as a result of the Bell System filing a consolidated federal income tax return. Mountain Bell disputes both the amount and the statement. The Commission finds that Exhibit No. 34, Appendix C thereto, Statement 1, shows a negative $166,319,310 total liability for federal income taxes for the General Department of AT&T for the year 1974, from the books of account.

In I&S Docket No. 867, Mr. Richards also recommended an allocation to Mountain Bell of the federal income tax savings resulting from the filing of a consolidated return by the Bell System, which recommendation the Commission adopted in Decision No. 86103. Mr. Richards used the same allocation methodology in this proceeding that he used in I&S Docket No. 867, except that he has not allocated any of the tax savings from Exhibit No. 34, Appendix C, Statement 1, Group (b) entitled "Federal Income taxes arising from the License Contract services rendered by the General Department." As stated heretofore, on October 1, 1974, AT&T changed the method of charging its operating companies under the General Services and License Agreement from the 1%-flat-fee basis to a cost allocated basis for services actually rendered, not to exceed 2½%. Thus, in 1975, and in future years, there should be a zero tax savings from this item. Inasmuch as the rates in this proceeding will be set, not for 1974, but for 1975 and for the future, we find this a reasonable deviation from the prior allocation methodology used in I&S Docket No. 867, which was approved in that proceeding.

Exhibit No. 34, Appendix C,Statement 1, is broken down into three tax-effect groups. Only Groups (a) and (b) pertain to Bell System operating companies, such as Mountain Bell.

The first item on Exhibit No. 34, Appendix C, Statement 1, Group (a) is captioned "Tax effect of interest paid on debt." AT&T issues a large portion of the bonds issued by the Bell System companies. Proceeds from these bonds are invested in equity capital of the subsidiary operating companies, the Long-Lines Department and other investments. The allocated tax savings to Mountain Bell total Colorado operations used by AT&T in its Report to the NARUC Committee on Accounts for the calendar year 1974 (Exhibit No. 34, Appendix A, Schedule 1 - state data for multi-state companies) is a negative $1,536,596. The Colorado intrastate share would be 69.87% of this amount,or a negative $1,073,620.

The second item found on Exhibit No. 34, Appendix C, Statement 1, Group (a) is designated "Tax effect of interest received on advances." This represents the amount of tax liability produced by interest AT&T received on loans to its subsidiaries. In computing income taxes on an individual return basis, as Mountain Bell has done in this proceeding, the amount of interest expense paid to AT&T is treated as a reduction in income tax liablity. This item is an offset to the reduction in income tax liability. The tax effect of this item applicable to Mountain Bell's total operations in Colorado, as shown on Exhibit No. 34, Appendix A, Schedule 1 (state data for multi-state companies), is a positive $1,020,466. The Colorado intrastate portion is a positive $713,000.

The third item listed on Exhibit No. 34, Appendix C, Statement 1, Group (a), is designated "Tax effect of dividends received and tax increases arising from consolidated return." This item consists of two parts in the Report to the NARUC Committee. One part relates to dividends on preferred stock paid to AT&T by Pacific Telephone and Telegraph Company, one of the subsidiary companies included in the Bell System consolidated return. In a tax return filed on an individual company basis, Pacific Telephone and Telegraph Company would receive a deduction for income tax purposes on a portion of these dividends. This deduction is not available in a consolidated return; therefore, AT&T has included the reimbursement to Pacific Telephone and Telegraph Company for this item as an added cost of filing the consolidated return. The second part in the Report to the NARUC Committee under this item is taxes paid by AT&T on dividends received from other than its principal telephone subsidiaries. These amounts are assigned to such companies on a source basis. No allocation to Mountain Bell is necessary from this item nor will any be made.

The fourth item listed on Exhibit No. 34, Appendix C, Statement 1, Group (a), is entitled "Tax effect of interest paid and income received on investments in net current assets." AT&T maintains a pool of funds for lending to its subsidiaries. AT&T invests the undrawn down amount in short-term securities to the extent possible. The Report prepared by AT&T for the NARUC Committee shows on Schedule 5, Appendix A, that AT&T received income in 1974 from these investments in the amount of $95,250,004. Also shown on Schedule 5 of Appendix A is the income tax liability for 1974 on this income in the amount of $34,579,859. The Commission finds that since AT&T keeps the income, it is only proper that the income taxes associated therewith be paid out of the income received.

Mountain Bell in this proceeding has challenged Mr. Richards' methodology with respect to the income tax effect of interest paid and income received on investment in net current assets, as being contrary to the Report prepared for the NARUC Committee on Accounts. The Company contends that the application of the Report to the NARUC Committee should include all of the parts for the sake of consistency and equity, if the study is to be used as a revenue requirement tool. It should be noted herein that had Mr. Richards used the same methodology in this proceeding that he used in I&S Docket No. 867, and, in addition thereto had included the tax effect of interest paid and income received on investments in net current assets, the amount shown by the Company for federal income taxes would be reduced over $400,000, instead of the $361,000 recommended herein. The distinction between this fourth item (the tax effect of interest paid and income received on investments in net current assets) and the first item (tax effect of interest paid on debt) and the second item (tax effect of interest received on advances), which Mr. Richards used in his allocation methodology, is that in the first and second items there is a direct tax relationship between the filing of a separate return and the filing of a consolidated return, whereas there is no such direct relationship in the fourth item. In the fourth item, the federal income taxes paid by AT&T would be the same whether or not it was filing a consolidated return or a separate return. Mountain Bell's tax liability would be the same with respect to this particular item regardless of whether it filed a separate return or filed as part of the consolidated return. In the Report prepared by AT&T for the NARUC Committee, AT&T did not allocate any of the income received from investments in net current assets to its operating subsidiaries, but did allocate the tax effect of the income received from investments in net current assets. If the Report prepared by AT&T for the NARUC Committee did allocate the income received on investments in net current assets, then it would be incumbent upon the Commission to allocate also the associated income taxes. It should also be noted that the System companies pay AT&T, as part of the General Services and License Agreement, for the maintenance of the pool of funds, which AT&T invests in short-term securities when the pool of funds has not been completely drawn down. No amount of this fourth item will be allocated by the Commission to Mountain Bell's Colorado intrastate operations.

Only the tax effect of the first and second items of Group (a) will be used in this proceeding in allocating the federal income tax saving resulting to the Bell System from filing a consolidated federal income tax return. No part of the tax effect of the third or fourth items of Group (a), the second item of Group (b), or Group (c) will be used in this proceeding. This is the methodology used by Mr. Richards in this proceeding, which the Commission hereby finds to be a fair and reasonable recommendation for the allocation to Mountain Bell's Colorado intrastate operations for the test year.

4. 1974 Wage, Salary and Benefit Adjustment.

Following negotiations with its union employees through collective bargaining, Mountain Bell entered into a new three-year wage and benefit contract which was signed and effective in July 1974 (Exhibit 3, Appendix C, page 43). According to evidence submitted by Company witness Norman W. Leake, "first year" costs of the new wage and benefit agreement, together with costs for 1974 salary increases for supervisory, technical and other management employees, when annualized to reflect the entire test year, increases the Company's employee, wage, salary and benefit expense by $7,884,000. Mr. Leake has included this pro forma adjustment on Exhibit 3, page 6, under column H.

Included in the "first year" of the wage and benefit contract are a basic wage increase for craft and clerical employees, effective July 18, 1974, which when annualized amounts to $3,451,000; pension benefit increase, effective from January 1, 1975, to January 1, 1976, of $1,574,000 when annualized for the test year; and, a shortening in Central Office Traffic Tours from eight hours to seven and one-half hours effective January 1, 1975, which when annualized amounts to $653,000. Included also, in the adjustments under the 1974 wage, salary benefit increase are salary increases granted to supervisory and technical employees, effective September 15, 1974, which when annualized amounts to $1,914,000, and salary increases for other management employees, effective December 28, 1974, which when annualized amounts to $292,000.

Built into Mr. Leake's pro forma adjustment for wage and benefit increases for the year 1974 is an amount reflective of overtime rates. Mr. Leake used overtime loading factors for the Company's various departments which were derived by adjusting factors included in a 1973 study. Staff witness Richards recommended to the Commission that the Company's pro forma adjustment of $7,884,000 be reduced by $2,531,000 in order to reflect actual overtime loading factors for the Company for the year 1974. Based upon information supplied by the Company during the Staff audit, Mr. Richards calculated the actual overtime loading factors for the first four months of 1974 and has compared these with the overtime loading factors for the same period in 1975 to derive a trend in overtime for the year 1974. According to Mr. Richards, the Company's overtime was on a downward plane in 1974, which is not reflected in Mr. Leake's overtime figures, thus causing the Company's 1974 pro forma wage and benefit adjustment to be overstated.

On rebuttal, Company witness Dr. John W. Kendrick testified that Mr. Richards' overtime adjustment was already implicit in Mr. Richards' productivity adjustment, thus resulting in a "doubling up" since "the productivity offset contemplates all savings with respect to the reduction of labor input, including reduced overtime amounts." What Dr. Kendrick failed to realize, however, is that Mr. Richards' overtime adjustment was an in-period adjustment to the test year 1974, while Mr. Richards' productivity adjustment was an out-of-period adjustment for the year 1975. Thus, there could be no such "doubling up" as Dr. Kendrick concluded.

Accordingly, we adopt and find as reasonable Mr. Richards' overtime adjustment contained on Exhibit No. 33, page 2, column F, since it is based on overtime loading factors of the Company experienced in 1974, while the Company's figures were based on overtime loading factors of the Company for the year 1973, as adjusted which do not accurately reflect the downward plane during the year 1974.

5. 1975 Wage, Salary and Benefit Adjustment.

Under columns I, J and K on page 6 of Exhibit No. 3, Company witness Leake makes a pro forma adjustment to the test-year income statement to reflect annualization of the costs associated with the "second year" of the wage and benefit agreement and to reflect annualization of a proposed salary increase to technical and supervisory employees proposed for October 1, 1975. The annual intrastate operating expense increase for the 1975 wage, salary and benefit increase, according to testimony of Company witness Leake, is $11,291,000. Included in the pro forma adjustment for the second year of the union wage and benefit contract are a basic wage increase for the 12 months effective August 3, 1975; a cost-of-living increase for the 12 months effective August 3, 1975; reclassification of Grand Junction from Zone 3 to Zone 2 and Longmont from Zone 3 to Zone 1; vacation change for the 12 months effective January 1, 1976; a dental plan for the 12 months effective January 1, 1976; and pension improvements for the 12 months effective January 1, 1976.

a. Benefits Effective January 1, 1976.

Staff witness Richards has recommended to the Commission that it disallow the costs associated with the out-of-period adjustment by the Company for vacation change, dental plan and pension improvement. Mr. Richards recommends disallowance of these out-of-period costs because of their remoteness to the test year, each being effective for the period January 1, 1976, to January 1, 1977. We agree with Mr. Richards that these out-of-period adjustments encompassing the period January 1, 1976, to January 1, 1977, are too remote in time vis-a-vis a 1974 test year, and, accordingly, disallow the costs associated with these out-of-period adjustments.

b. First and Second Level Management Salary Increases.

Mr. Richards recommended that the Commission also disallow the cost associated with the out-of-period adjustment for salary increases proposed for first and second level management, proposed effective October 1, 1975. Mr. Richards testified there is no contractual obligation on the part of the Company to pay the increase, or to pay the increase on October 1, 1975, or to pay it in the amount proposed. Thus, this is not a known and contractual out-of-period wage adjustment within the meaning of Mountain States Telephone and Telegraph Co. v. Public Utilities Commission, 182 Colo. 269, 513 P.2d 721 (1973). Company witness Leake in his rebuttal testimony testified that he has been advised by his legal counsel that under the commitments contained in "Memorandum of Agreement" signed July 18, 1973, filed in the U. S. District Court of the District of Pennsylvania, that Mountain Bell is obligated by law to adjust first and second level management salaries as a corollary to its nonmanagement wage contracts. The Commission has reviewed the consent decree marked as Exhibit No. 50 in this proceeding and is unable to find anywhere in said consent decree that Mountain Bell is obligated to adjust management salaries as a corollary to its nonmangement union wage contracts. Thus, the Commission will not include in the Company's 1975 wage and benefit out-of-period adjustment those proposed costs associated with the Company's possible future first and second level management salary increases.

c. Productivity Offset.

Company witness Leake has partially offset the annual Colorado intrastate operating expense increase for the 1975 out-of-period wage and benefit adjustment with a productivity factor of 4.9%. Prospective productivity increases must be considered to determine whether they, in fact, offset the increased wage costs. The questions in this proceeding are what methodology should be used in calculating such offset and what is the proper offset to the out-of-period 1975 wage and benefit adjustment.

The Company determined productivity by taking the ratio of output (measured in terms of revenues deflated by rate increases since 1967) and input (measured in terms of man-hours) to arrive at an index of output per man-hour. The Company then calculated the change in the output per man-hour index from one year to the next from 1970 through 1974 and arrived at an average productivity increase for that five-year period (Exhibit 18). The Commission recognizes that the most accurate measure of productivity is the ratio of physical output, i.e., volume of goods or services produced, to physical inputs, i.e., man-hours. However, it is impossible for the Company to determine its physical output, which probably should be measured in terms of message-minute units, since local exchange calling is not so measured under the Company's present technology. Thus, the Company substituted revenues deflated by rate increases for its measure of output, which the Commission finds reasonable under the circumstances.

Commission Staff witness Richards used the productivity gain of 6.3% that was associated with the test year 1974 on the grounds that "the wage expenses used by the Company were based on 1974 test-year employee counts and not a five-year average." In rebuttal to Mr. Richards' testimony, Mountain Bell witness Kendrick, a nationally known expert on productivity, testified that a productivity increase for any one year cannot be logically used to estimate the productivity for the following year because of year-to-year variations. Dr. Kendrick further testified that these variations tend to be greater for relatively small units, such as Mountain Bell's Colorado operations, compared with larger units, such as the total Mountain Bell Company. Accordingly, Dr. Kendrick testified a five-year average, which approximates the length of a business cycle, tends to minimize those yearly variations and distortions in the trend. The Commission generally agrees with the methodology proposed by Dr. Kendrick of calculating productivity by use of a five-year average. However, in this proceeding, the Commission will reject the particular five-year average utilized by the Company in arriving at its 4.9% productivity offset, inasmuch as the five-year average utilized by the Company in this proceeding is itself distorted and not accurately reflective of the productivity trend that the Company is currently experiencing. As Mr. Leake testified, productivity figures for the Mountain Bell Colorado operations were used in all of the five years except 1972 and 1973, when Mountain Bell total Company figures were substituted. Instead of using the Colorado figures of 0.2 and 0.7 for 1972 and 1973, the total Company figures of 6.1 and 4.4, respectively, were utilized because, as Mr. Leake testified, those two years were not representative of the current productivity trend in Colorado. It should be noted, however, that even the total Company figures used by Mr. Leake included the admittedly unrepresentative Colorado productivity experience, which leaves that particular five-year average distorted. According to Company testimony, during the years 1972 and 1973, the Colorado operations were faced with the situation in which their facilities were rendered inadequate as a result of Colorado's unusually rapid growth, thus necessitating massive additions of capital to catch up with that growth. The Commission cannot ignore the testimony of Mountain Bell witness Lloyd L. Leger who amply demonstrated that Colorado's rate of growth has lessened, thus allowing the Company's facilities to catch up while at the same time the Company has been and will continue to add technological advances, such as Electronic Switching Systems (ESS), Automatic Operator Intercept Systems (AOIS) and Traffic Service Position Systems (TSPS). Such technological advances have markedly improved Colorado's productivity since 1972 and 1973. Even Mr. Leger testified that this recent trend of slow growth and labor-saving technological improvements will continue through 1975 and into 1976. A 6.3% productivity figure for 1974 supports Mr. Leger's assessment. Moreover, the Company itself, based on five-months' experience in 1975, has estimated that 1975 productivity will be 7.8% (Exhibit 27). For all of the above reasons, the Commission rejects the five-year average used by the Company in this proceeding as being unrepresentative of the productivity trend of Colorado's operations since 1973.

The five-year average of Mountain Bell total Company including Colorado for 1970 to 1974 shows a 5.5% productivity trend. As Dr. Kendrick testified, the productivity trend of a larger economic unit, such as Mountain Bell Total Company, is more stable and thus more indicative of the long-run trend than that of a smaller unit, such as Mountain Bell Colorado intrastate. Because of Colorado's dominant size within the Mountain Bell System (approximately one-third of the total) that average would be appreciably larger if it were calculated without Colorado's poor experience (3% productivity increase for the five years used by the Company) (Exhibit 18). However, like Dr. Kendrick, we believe that more emphasis should be given to Colorado's experience; yet we believe that Colorado's unrepresentative experience of 1972 and 1973 should be completely eliminated. Using Mountain Bell total Company productivity figures excluding Colorado for those two years and Colorado figures for the remaining years would result in a higher five-year average than used by the Company, which would be more reflective of Colorado's recent productivity experience. Considering all of the above evidence and realizing that predicting future productivity involves judgment, we find that the Company's 1975 wage expense should be offset by a 6.3 productivity factor.

The effect of disallowing the above discussed items of the Company's proposed 1975 wage, salary and benefit adjustment is to reduce the Company's adjustment by $3,692,000.

d. <u>Employee Attrition Adjustment</u>.

Commission Staff witness Richards recommended a fourth adjustment to the Company's 1975 wage and benefit adjustment "to reflect the savings in wage dollars that will be generated by the Company in its program of employee cutbacks." In calculating the Company's 1975 wage expense, the Company used average 1974 employee levels. Mr. Richards, on the other hand, based on figures provided by the Company, calculated the average number of employees for 1975 which showed a reduction of 269 from the average 1974 employee level used by the Company. Mr. Richards then deflated the Company's 1975 wage expense to reflect that employee reduction. On rebuttal, Mountain Bell witness Kendrick testified that the productivity offset already has implicit in it a reduction in labor input reflected as employee attrition. Therefore, according to Dr. Kendrick, Mr. Richards' additional employee attrition adjustment results in "doubling up." We partially agree with Dr. Kendrick, but further note that Mr. Richards' calculation of employee attrition in 1975 is conservative when compared to the actual employee level reduction in just the first five months of 1975, which amounted to 568 for the non-management work force, although Mr. Leger testified that approximately 180 of these employees would be rehired after the summer (Exhibit 6, Tab. 6). To the extent that Mr. Richards' employee attrition figure is conservative, any "doubling up" is minimized.

The Commission, however, believes any "doubling up" mentioned by Dr. Kendrick can be eliminated while still recognizing some employee attrition from the average 1974 employee force level. The number of employees as of December 31, 1974 (13,126) was 135 less than it was on December 31, 1973 (13,261), representing a 1.02% decline in employees during the year 1974. The productivity for 1974 was right at the trend rate found by this Commission of 6.3%. Thus, included in the 6.3% productivity increase for 1974 was the 1.02% employee attrition rate. Since we have found that the Company will probably experience a similar productivity increase in 1975, the "doubling up" of Mr. Richards' adjustment can be eliminated by subtracting from his figure of 269 (average 1974 employees of 13,148 used by Mr. Leake minus average 1975 employees of 12,879 used by Mr. Richards) that portion of average 1975 employees which is already embodied in the 6.3% productivity figure (average 1975 employees of 12,879 x 1.02% = 131). When the 131 employees are subtracted from the 269 employees, we arrive at an employee attrition of 138 over and above that included in the 6.3% productivity figure. Thus, based on employee attrition of 138 from average 1974 employee levels, Mountain Bell non-management wage expense for 1975 will be reduced by $1,035,996.

6. General Services and License Agreement.

On Exhibit 3, page 6, column E, Company witness Norman W. Leake made a *pro forma* adjustment to the test-year income statement of $777,000.[3] This *pro forma* adjustment by the Company is to annualize the effect of the change in the method of computing the payment by Mountain Bell to American Telephone and Telegraph Company under the General Services and License Agreement. Effective October 1, 1974, AT&T changed the method of charging its operating companies under the General Services and License Agreement. The new basis is an allocation of the actual cost of providing the service to the operating company, not to exceed 2½% of operating revenues. Prior to October 1, 1974, payment by Mountain Bell to AT&T was on the basis of an amount equal to 1% of total local and toll service revenues, less total uncollectible revenues. Staff witness James A. Richards recommended to the Commission two adjustments to the *pro forma* adjustment made by the Company with respect to its General Services and License Agreement.

3. The original adjustment shown on Exhibit 3, page 6, column E, was $800,000. This figure was corrected prior to commencement of cross-examination.

The first adjustment recommended by Mr. Richards was the disallowance of $9,000, which was allocated and charged to Mountain Bell by AT&T for contributions made by AT&T. The rationale stated by Mr. Richards was that in past general rate proceedings involving Mountain Bell, the Commission disallowed, as an operating expense, contributions made by the Company itself; thus, the same treatment should be accorded contributions made by AT&T and allocated and charged to Mountain Bell under the General Services and License Agreement. Mountain Bell contends that there is no basis for Staff witness Richards singling out any amount paid by Mountain Bell for services rendered to it by AT&T under the General Services and License Agreement. Commission finds that the record amply demonstrates that AT&T has allocated to Mountain Bell Colorado intrastate, the sum of $8,979 as Colorado intrastate's share of contributions made by AT&T.

The subject of disallowing charitable contributions made by AT&T and charged to Mountain Bell arose in the last rate proceeding involving Mountain Bell, that is, I&S Docket No. 867. In I&S Docket No. 867, the Commission added the following caveat at the bottom of page 20 of Decision No. 86103:

> A caveat is in order. Mountain Bell's Colorado intrastate share of charitable contributions paid by AT&T for the year 1973, amounts to $9,249.
>
> The Commission does not allow donations and contributions as expenses which are included in the cost of service payable by the ratepayers of Mountain Bell. Theoretically, the $9,249 should be disallowed as part of the license fee paid by Mountain Bell to AT&T. However, evidence in the record would indicate that the expenses incurred by AT&T for its services amount to $3,673,871 for the year 1973, compared to revenues received of $3,209,791, which would indicate that Mountain Bell receives in return from AT&T more than it would cost the latter. Accordingly, no adjustment need be made for this minimalistic amount of $9,249, to which reference has been made.

Since the circumstances no longer exist that lead the Commission not to disallow in I&S Docket No. 867 Mountain Bell's Colorado intrastate share of contributions made by AT&T, the Commission finds that $9,000 should be disallowed from the test-year operating expenses included by Mountain Bell in its General Services and License Agreement pro forma adjustment.

The second adjustment recommended by Staff witness Richards to the pro forma adjustment made by the Company was the disallowance of $65,000 allocated by American Telephone and Telegraph Company to Mountain Bell as the Colorado intrastate share of AT&T's advertising expenses for the year 1974. Staff witness Richards characterized the advertisements involved as "institutional" advertisements because they did not show either the name "Mountain States Telephone and Telegraph Company" or the name "Mountain Bell." Mr. Richards recommended this disallowance as being consistent with the Commission's treatment of institutional advertisements in several past dockets. The Company contested Mr. Richards' characterization of these advertising expenses as institutional advertisements, but did not contest Mr. Richards' assertion that the name "Mountain States Telephone and Telegraph Company" and "Mountain Bell" do not appear anywhere on the advertisements. The Company asserted that Mountain Bell participates in the national Bell System mass-media advertising for exactly the same reasons it advertises in the mass media itself, and, for the additional reason, that certain of the messages and the objective can be more effectively, efficiently and inexpensively accomplished on a national basis rather than on a local basis by the System companies advertising independently. The Company asserted that companies that advertise on a national basis feature their universally known logo, and, in the case of the Bell System, it is the Bell seal. In Decision No. 78811, in Application No. 24900, the Commission disallowed such advertising on the basis that "such advertising is done largely outside of Applicant's service territory and does not identify Public Service Company of Colorado as the sponsor. No benefit has been shown to accrue to ratepayers by this advertising program." The mere fact that advertising is done in the name of the Bell System as opposed to "Mountain States Telephone and Telegraph Company" or "Mountain Bell" should not necessarily preclude its inclusion as an expense for ratemaking purposes. The former type of advertising may be as beneficial as the latter. Obviously, questions such as the geographical location of the advertising, the media used, and the amount may be factors in determining whether to allow or disallow such advertising as an operating expense.

Following the conclusion of the hearings, Mountain Bell submitted to the Commission samples of AT&T's mass-media advertising. A review of the material indicates that, with the exception of one advertisement entitled "20 Ways to Save Money on Phone Bill," all would be classified by this Commission as promotional advertisements, and disallowed on that basis. The Company has not submitted a cost breakdown of the $65,000 included in this category. Accordingly, the Commission finds that $65,000 should be disallowed from the pro forma adjustment made by the Company under the General Services and License Agreement as representing the amount allocated by AT&T to Mountain Bell as the Colorado intrastate share of advertising expenses by AT&T.

7. Company Advertising Expenses.

Staff witness Richards recommended in his testimony and exhibits that $713,000, representing the Colorado intrastate share of advertising done by the Company itself, be disallowed, inasmuch as the Company did not submit to the Commission in this proceeding any studies or evidence justifying charging advertising expenses to the ratepayers. The thrust of Mr. Richards' recommendation was to require the Company in its rebuttal case to demonstrate what benefits, if any, are derived by the ratepayers from advertising the Company proposes to charge the ratepayers. From this showing, the Commission would be in a position to properly analyze the evidence and allow or disallow that amount of advertising expenses the Commission decided was a reasonable or unreasonable charge to operating expenses. In its rebuttal case, the Company submitted the testimony of William Neathammer (Exhibit L) and a supporting exhibit (Exhibit 44). Notably absent from this showing were any samples of the Company's advertisements included in the $713,000 the Company proposed charging the ratepayers for advertising expenses. Pursuant to a request during the hearing, samples were submitted to the Commission subsequent to the hearing.

Of the $713,000 involved in this issue, $389,659[4] is categorized by the Company as Mass-Media Advertising Expense; that is, mass-media advertising in newspapers, periodicals, radio and television. Mass-Media Advertising Expense is broken down into seven categories as follows:

Advertising Categories	Amount
1. Long Distance	$183,423
2. Directory Assistance	74,361
3. Business Services	57,553
4. Holidays	6,829
5. Informative	25,411
6. Service Ads	30,799
7. Miscellaneous	11,283

The Company has failed to provide the Commission with a cost breakdown for the individual long-distance advertisements included in the material provided the Commission. The Commission finds some of this material to be promotional and some of the material to be informational. Ordinarily, the Commission would allow, as a charge to operating expenses, those advertisements that are customer informative and would disallow those advertisements that are company or product promotional. Inasmuch as the Commission is without information as to the costs of the different advertisements, the Commission disallows the entire amount for long-distance advertising of $183,423. In future rate proceedings, the Company should provide the Commission with the necessary cost data to make this

4. Source: Exhibit 33, page 4.

allocation. The Commission finds that the Directory Assistance Mass-Media Advertising is informational and a proper charge to operating expenses, and thus will allow the full amount of $74,361. The Commission finds that the Business Services Advertisements are promotional and we disallow the full amount of $57,553. The Commission finds the advertisements in the categories entitled "Holidays," "Informative"and "Service Aids" to be informative and directed toward decreasing customer costs, and allows the full amounts of $6,824, $25,411 and $30,799, respectively, as items of operating expense. The full amount of $11,283 listed as "Miscellaneous" is disallowed because there has been no showing by the Company as to what, in fact, is included in this category.

The amount of $323,715[5] of the $713,000 for advertising expenses was characterized by the Company as "Other Than Mass-Media Advertising Expense." The categories and amounts under this portion were as follows:

Advertising Categories	Amount
1. Booklets, Pamphlets and Bill Inserts	$163,300
2. Displays, Exhibits and Posters	18,901
3. Motion Pictures	7,924
4. Other - Advertisements	51,882
5. Other Expenses	18,090
6. Salaries	63,616

The Company stated that the entire $163,300 expended by Mountain Bell in 1974 under the category "Booklets, Pamphlets and Bill Inserts" was expended upon bill inserts for such messages as customer notification of the one-minute rate for both intra- and interstate long-distance calls, local service aid notices, notification to some customers of international direct-distance dialing, aid to handicappted with hearing problems, and information on interconnection of answering sets, production of "phone kit" information packages, and expenses incident to public notices with respect to rate filing. As such, these are a proper expense for ratemaking purposes and will be allowed as an item of operating expense. However, the Company is directed in the future to make a breakdown of the expenses associated with each of the sub-categories. All remaining categories, with the exception of the category entitled "Salaries," will be disallowed on the basis that the Company has failed to make any showing as to how these expenditures benefit the ratepayers the Company proposes to charge with the advertising expenses. In the case of the "Salaries" category, the Commission allows only the portion related to advertising which was found beneficial to the ratepayers and thus allowed by the Commission. Accordingly, only the proportion of the amount of advertising allowed to the total of Mass-Media Advertising and Other Than Mass-Media Advertising (less salaries), or 46.3% of the $63,616, is allowed for salaries.

---

5. Source: Exhibit 33, page 4.

8. Membership Fees and Dues.

Mountain Bell in this proceeding included on Exhibit 3, page 3, $22,000 in membership fees and dues charged to operating expenses and $8,000 in membership fees and dues, net of taxes, charged to miscellaneous deductions. Staff witness Richards recommended disallowance of these membership fees and dues. Mr. Richards based his recommendations upon recent Commission decisions involving natural gas pass-on proceedings. The Commission takes administrative notice of Decision Nos. 86903, 87047, 87048, 87050 and 87089 as requested at the hearing. In these decisions, the Commission disallowed, as an item of operating expense, expenditures by the utility company on behalf of its executives and other employees for membership fees and dues in social or service clubs.

As stated in the foregoing decisions, expenditures for social or service club dues or fees are for the personal benefit of the utility executives and other employees, rather than for the benefit of the ratepayers, and thus, in the opinion of the Commission, it would not be in the public interest to assess such dues and fees to the ratepayers. With the exception of the payment of $1,601 (Colorado intrastate portion of the $8,850 total) as membership fees and dues to the Rocky Mountain Telephone Association, the Commission disallows all other expenditures by the Company for membership fees and dues in social and service clubs. The Rocky Mountain Telephone Association is a trade association and the Commission finds that there is a benefit to the ratepayer in Company membership in the Rocky Mountain Telephone Association.

Apart from the foregoing exception involving the Rocky Mountain Telephone Association, the Commission takes strong exception to the Company's espoused position that the ratepayers are benefited by the Company's reimbursing or initially paying for membership fees and dues of employees and executives in service clubs and social clubs. Mountain Bell did not, and undoubtedly could not, set forth a rationale whereby the Mountain Bell ratepayers are benefited by Mountain Bell paying club dues in such entities as the Brown Palace Club, City Club of Denver, Denver Athletic Club, Petroleum Club, Twenty-Six Club, University Club, or United Airlines 100,000-Mile Club.

It must not be assumed that the Commission, or any of its individual members, is opposed to a healthy interest in the international affairs of our county or in the cultural benefits to be derived from choral music. Nevertheless, we believe that Mountain Bell tiptoes into the world of fantasy and strains the tolerance level of its credulity when it claims that membership in such organizations as the Denver Committee on Foreign Relations, the American Security Council, and the National Western Choir produce a measurable benefit to a telephone user. Furthermore, Mountain Bell's "justification" for inclusion of dues in such entities as the Association of the United States Army and the Air Force Association as "to further coordination and communications between the military and the Bell System" (transcript-Volume XVI, page 150) is fanciful, but disconcerting, when one realizes that said entities are not official organizations within the United States defense establishment, but are, rather, associations principally organized to further the interests of Armed Forces reserve personnel--lobbying organizations--if you will.

Realizing the possible stresses that Mountain Bell executives and other employees might have to undergo, perhaps in some rather remote way the ratepayer may be indirectly benefited by Mountain Bell's payment of club dues to the American Society for Gastrointestinal Endoscopy. However, inasmuch as the Commission strained to find, unsuccessfully, a measurable impact benefiting the ratepayer, we are compelled to likewise disallow club dues for this entity as well as all the other social club and service club dues and fees expended by Mountain Bell. Finding, as we do, that payment of such dues and fees is for the personal benefit of the Company's executives and employees, rather than for the benefit of the ratepayers, and finding further that it would be against the public interest to assess such fees and dues to the ratepayers, the Commission disallows the $21,000 in membership fees and dues charged to operating expenses and the $8,000 in membership fees and dues, net of taxes, charged to miscellaneous deductions as an operating expense of the Company for ratemaking purposes.

9. Salaries of Lobbyists Before the General Assembly.

During the test year 1974, Mountain Bell incurred certain expenses relating to lobbying before the General Assembly of the State of Colorado. According to Mountain Bell witness Leger, R. E. Rothmeier, Assistant General Manager, and J. E. Christiansen, Public Affair Manager, both appeared before and worked with the 1974 Legislature. Although Mr. Leger was not very precise concerning the amount of time spent by Mr. Rothmeier and Mr. Christiansen on lobbying during the year, he did provide some guidance. For example, according to Mr. Leger, Mr. Christiansen worked full-time as a lobbyist during the 1975 regular session of the General Assembly, and Mr. Christiansen regularly reported to Mr. Rothmeier. Inasmuch as the General Assembly was in session almost six months in 1974, approximately 50% of Mr. Christiansen's time, on an annual basis, would have been spent as a lobbyist before the General Assembly on behalf of the Company. This does not include any time he spent preparing for the 1975 session during the year 1974. Mr. Leger testified that during the legislative session, Mr. Rothmeier spent a considerable amount of his time on lobbying although Mr. Leger had no specific percentage.

Lobbying, like payment of membership dues and fees, making contributions and promotional advertising, is a function not directly connected with providing a utility service. Thus, if expenditures in these areas are to be included as items of operating expense, the utility company must demonstrate to the Commission how the expenditures benefit the ratepayers, with whom the utility proposes to charge the expenditures. Except for characterizing lobbying as informational in nature, the Company has made no other showing in this proceeding of how the Company's lobbying before the General Assembly benefits the ratepayers. While we believe that a certain small amount of lobbying may be informational, the majority of such lobbying, as the Company admits, involves an attempt to influence the outcome of legislation in accord with the interests of Mountain Bell, as viewed by its management. Inasmuch as the Company has not shown that those interests coincide with those of the ratepayers, the Commission disallows a portion of the salaries of each Company lobbyist listed above. In the case of Mr. Christiansen, 50% of his annual salary reduced to the

Colorado intrastate portion will be disallowed on the basis that he spent approximately 50% of his time during the year before the General Assembly. The Commission disallows a conservative 25% of the salary of Mr. Rothmeier also reduced to the Colorado intrastate portion. In any future rate proceeding, the Company should provide the Commission with a detailed breakdown of its lobbying expenses.

D

REVENUE REQUIREMENT CALCULATION

The separation of revenues, expenses, plant and investment of Mountain Bell 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 purposes of this proceeding, is approved by the Commission as the method of determining the proportionate share of intrastate revenue, expenses, plant and investment.

The revenue requirement of the Company in this rate proceeding, including uncollectible revenues and excluding interest charged construction, for its Colorado intrastate telephone business, on the basis of test-year conditions, is $299,335,000. The Company's revenue requirement is based upon the following findings of fact:

1. The test year in this rate proceeding for determining Mountain Bell's Colorado intrastate revenue requirement is the calendar year 1974, as heretofore determined in Decision No. 86645, entered April 15, 1975, in this docket.

2. The rate base of Respondent for the test year, for the purposes of this proceeding, consists of:

a.	Average Plant in Service	$813,299,000[6]
b.	Average Property Held for Future Use	$ 718,000[7]
c.	Average Materials and Supplies	5,889,000[8]
d.	Average Plant Under Construction	49,764,000[9]
e.	Deduction of the Average Accumulated Reserve Depreciation	136,372,000[10]

---

6. Source: Exhibit 3, page 7, column D, line 1.
7. Source: Exhibit 3, page 7, column D, line 4.
8. Source: Exhibit 3, page 7, column D, line 5.
9. Source: Exhibit 3, page 7, column D, line 3.
10. Source: Exhibit 3, page 7, column D, line 2.

f.	Deduction of the Average Accumulated Deferred Income Taxes	$ 33,401,000[11]
g.	Deduction of 1/2 Unamortized Pre-1971 Investment Tax Credit	1,999,000[12]
	Total Rate Base	$697,898,000

3. The total value, for the purposes of this proceeding, of Mountain Bell's property devoted to intrastate telephone service in the State of Colorado consists of all the rate base items found in paragraph No. 2 above, and is $697,898,000.

4. Revenue of Mountain Bell derived from its intrastate telephone operations in the State of Colorado during the test year is $262,266,000,[13] less uncollectible revenue of $2,279,000,[14] for a net total of $259,987,000.[15] Expenses, including taxes, of Mountain Bell applicable to its intrastate telephone operations in the State of Colorado for the same period are $212,107,000.[16] After deducting expenses, including taxes, from total operating revenues, Mountain Bell's net operating income derived from its intrastate telephone operations in the State of Colorado for the test year is $47,880,000.[17]

5. Interest charged to construction during the test year and applicable to Mountain Bell's Colorado instrastate operation is $4,125,000,[18] which must be added to its net operating income, if telephone plant under construction is included in the rate base. Miscellaneous deductions, as calculated by Mountain Bell for the test year, are $196,000. Net operating earnings applicable to the rate base found above in paragraph No. 3 are $51,809,000.[19]

6. Net operating earnings of the Company derived from its Colorado intrastate operations for the test year is adjusted as follows:

		Add	Subtract
a.	Colorado sales and use tax accounting adjustment		$2,010,000[20]
b.	Income tax accrual accounting adjustment	$1,206,000[21]	
c.	Interest expense accounting adjustment		60,000[22]

---

11. Source: Exhibit 31, column E, line 7.
12. Source: Exhibit 31, column E, line 6.
13. Source: Exhibit 3, page 3, column B, lines 1, 2 and 3.
14. Source: Exhibit 3, page 3, column B, line 4.
15. Source: Exhibit 3, page 3, column B, line 5.
16. Source: Exhibit 3, page 3, column B, lines 15 and 21.
17. Source: Exhibit 3, page 3, column B, line 22.
18. Source: Exhibit 3, page 3, column B, line 23.
19. Source: Exhibit 3, page 3, column B, line 25.
20. Source: Exhibit 3, page 4, column A, as adjusted by Exhibit 33, page 2, column C.
21. Source: Exhibit 3, page 4, column B.
22. Source: Exhibit 3, page 4, column D, as adjusted by Exhibit 33, page 2, column J.

	Add	Subtract
d. Annualization of 1974 directory advertising price increase	199,000[23]	
e. *Pro forma* adjustment for exchange reclassification, effective 9/74	15,000[24]	
f. Annualization of general rate increase, effective 1/14/75	12,590,000[25]	
g. Annualization of change in interest charged construction, effective 7/74	230,000[26]	
h. Annualization of postage increase, effective 3/74		15,000[27]
i. Disallowance of donations, charitable contributions and certain club dues, for ratemaking purposes	79,000[28]	
j. Normalizations of special expenses in connection with regulatory cases		5,000[29]
k. Annualization of general service and license increase, effective 10/1/74		347,000[30]
l. Annualization of cost of funded debt	389,000[31]	
m. Annualization of social security tax increase, effective 1/1/75		55,000[32]
n. Annualization of 1974 wage and benefit increase		2,799,000[33]
o. *Pro forma* costs of out-of-period 1975 wage and benefit increase		1,052,000[34]
p. Disallowance of certain advertising expense that were Company-generated for ratemaking purposes	189,000[35]	

---

23. Source: Exhibit 3, page 5, column A.
24. Source: Exhibit 3, page 5, column B.
25. Source: Exhibit 3, page 5, column C.
26. Source: Exhibit 3, page 6, column A.
27. Source: Exhibit 3, page 6, column B.
28. Source: Exhibit 3, page 6, column C.
29. Source: Exhibit 3, page 6, column D.
30. Source: Exhibit 3, page 6, column E, as adjusted by Exhibit 33, page 2, column A.
31. Source: Exhibit 3, page 6, column F.
32. Source: Exhibit 3, page 6, column G.
33. Source: Exhibit 3, page 6, column H, as adjusted by Exhibit 33, page 2, column F.
34. Source: Exhibit 3, page 6, columns I, J and K, as adjusted by Exhibit 33, page 2, columns D and G.
35. See Part III, C, 7 of this Decision.

		Add	Subtract
q.	Disallowance of membership fees and dues charged to operating expense, for ratemaking purposes	10,000[36]	
r.	Disallowance of membership fees and dues charged miscellaneous deductions, for ratemaking purposes	8,000[37]	
s.	Adjustment of 1974 Federal Income Taxes to actual, for ratemaking purposes	361,000[38]	
t.	Disallowance of lobbyists' salaries, for ratemaking purposes	8,000[39]	
	Totals	$15,284,000	$6,343,000

7. Adjusted net operating earnings of the Company derived from its Colorado intrastate operations on the test-year-basis, after making the adjustments listed in paragraph No. 6 above, are $60,750,000.[40]

8. Net fixed charges, i.e., interest on debt and related expenses of issuance, applicable to Company's Colorado intrastate operations for the test year are $23,706,000.[41]

9. Other charges - Net, applicable to the Company's Colorado intrastate operations for the test year are $73,000.[42]

10. The average common equity of the Company applicable to its Colorado intrastate operations for the test year is $350,565,000.[43]

11. Income available for common equity (applicable to the Company's Colorado intrastate operations for the test year of $42,207,000[44] is necessary to provide a rate of return on common equity of 12.04%, found to be a fair, just and reasonable return in Decision No. 86103 in I&S Docket No. 867, and adhered to in this docket.

12. Net operating earnings, on the test-year-basis, of $65,986,000[45] is necessary to cover the costs of debt capital of the Company and to provide a 12.04% return on the equity capital of the Company.

---

36. See Part III, C, 8 of this Decision.
37. Source: Exhibit 33, page 2, column I.
38. Source: Exhibit 33, page 2, column E.
39. See Part III, C, 9 of this Decision.
40. $51,809,000 (paragraph 5) + $15,284,000 (total from "add" column of paragraph 6) - $6,343,000 (total from "subtract" column of paragraph 6) = $60,750,000.
41. Source: Exhibit 33, page 1, line 30.
42. Source: Exhibit 33, page 1, line 29.
43. Source: Exhibit 31, column E, fifth line.
44. $350,565,000 x .1204 = $42,207,000.
45. $23,706,000 (paragraph 8) + $73,000 (paragraph 9) + $42,207,000 (paragraph 11) = $65,986,000.

13. Net operating earnings, on the test-year-basis, of $65,986,000 results in a rate of return to the rate base and valuation of the property of the Company devoted to intrastate telephone service in the State of Colorado of 9.455%, which rate of return, when applied to such rate base, is adequate to cover the costs of debt capital of the Company and to provide a 12.04% rate of return on the equity capital of the Company.

14. The difference between the required net operating earnings for the Company's Colorado intrastate telephone operations for the test year of $65,986,000 (from paragraph 12) and the actual net operating earnings, as adjusted for the same period of $60,750,000 (from paragraph 7) amounts to an earnings deficiency of $5,236,000. In order to produce $1 of net operating earnings, a revenue increase of $2.1898 is required considering the applicable franchise and corporate income tax rates. Therefore, an increase in revenue in the amount of $11,466,000 is required to offset the net operating earnings deficiency.

15. The total revenue requirement, excluding interest charged construction and including uncollectible revenue, of the Company to be derived from its Colorado intrastate telephone operations, on the basis of test-year conditions, is $299,335,000.

16. The rates and charges as proposed by the Company and under investigation herein (proposed rates) would, under the test-year conditions, produce additional revenue of $40,323,000, or a total annual revenue (including uncollectible revenue) of $328,192,000. To the extent that revenue produced by such rates and charges would, therefore, exceed the Company's revenue requirements, as found in paragraphs No. 14 and No. 15 respectively, such proposed rates and charges are not just and reasonable, and will be disallowed.

IV

CONCLUSIONS ON FINDINGS OF FACT

Based upon the foregoing discussion and findings of fact, the Commission concludes that:

1. The Public Utilities Commission of the State of Colorado has jurisdiction over the Colorado intrastate telephone rates of Mountain Bell, and has jurisdiction over the subject matter of this proceeding.

2. The proper test period for determining the reasonableness of the proposed increase in Colorado intrastate telephone rates is the 12-month period ended December 31, 1974.

3. It is proper to use an average-year rate base for Mountain Bell Colorado intrastate for the test year.

4. The amount of $697,898,000 is proper and reasonable for the average-year rate base of Mountain Bell Colorado intrastate.

5. A fair and reasonable rate of return on the average-year rate base for Mountain Bell Colorado intrastate is 9.455%.

6. A 12.04% return on common equity is fair and reasonable, sufficient to attract equity capital in today's market, and commensurate with rates of return on investments in other industries having comparable risks.

7. The existing telephone rates of Mountain Bell Colorado intrastate do not, and will not in the foreseeable future, produce a fair and reasonable rate of return.

8. The rates that are presently in effect, in the aggregate, are not just and reasonable or adequate, and, based upon the test year ended December 31, 1974, result in a net operating earnings deficiency, on the test-year basis, of $5,236,000.

9. A total revenue increase of $11,466,000 is required in Mountain Bell's Colorado intrastate telephone rates to offset the $5,236,000 net operating earnings deficiency.

10. The revenue requirement of Mountain Bell, including uncollectible revenues and excluding interest charged construction, for its Colorado intrastate telephone business, on the basis of test-year 1974 conditions, is $299,335,000.

11. All motions presently pending and not disposed of heretofore should be denied.

An appropriate Order will be entered.

O R D E R

THE COMMISSION ORDERS THAT:

1. The revenue requirement of Mountain Bell in this rate proceeding, including uncollectible revenues and excluding interest charged construction, for its Colorado intrastate telephone business, on the basis of test-year 1974 conditions, is $299,335,000.

2. The difference between the required net operating earnings for Mountain Bell's Colorado intrastate telephone operations for the test year, of $65,986,000 and the actual net operating earnings, as adjusted for the same period, of $60,750,000 results in an earnings deficiency of $5,236,000.

3. An increase in revenue in the amount of $11,466,000 is required to offset the $5,236,000 net operating earnings deficiency.

4. The rates and charges as proposed by Mountain Bell in Advice Letter No. 1073, and under investigation herein, would, under the test-year conditions produce additional revenue of $40,323,000, or a total annual revenue (including uncollectible revenue) of $328,192,000. To the extent that revenue produced by such proposed rates and charges would exceed the $11,466,000 gross increase in revenue required to offset the net operating earnings deficiency and exceed the $299,335,000 total revenue requirement respectively, such proposed rates and charges are not just and reasonable and are hereby rejected.

5. Hearings with regard to the "spread of the rates" in Phase II of this proceeding shall commence on October 23, 1975, in the manner previously set forth in Decision No. 87492 in this proceeding.

6. Subsequent to the "spread of the rates" phase of the hearings, the Commission shall enter a decision authorizing Mountain Bell to increase its Colorado intrastate telephone revenues, based upon the test year ended December 31, 1974, in the amount of $11,466,000.

7. This decision is interim in nature.

8. All motions presently pending and not disposed of heretofore are denied.

9. All parties requesting that the Commission take official or administrative notice of decisions, rules, reports or other documents or materials, which motion was granted by the Commission during the hearings, shall file with the Secretary of the Commission three copies of such material no later than 20 days following the conclusion of Phase II of this proceeding.

This Order shall be effective forthwith.

DONE IN OPEN MEETING the 7th day of October, 1975.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

EDWIN R. LUNDBORG

EDYTHE S. MILLER

Commissioners
jsk

COMMISSIONER HENRY E. ZARLENGO
DISSENTING.

COMMISSIONER HENRY E. ZARLENGO DISSENTING:

I respectfully dissent to any increase in charges and to some of the finding and orders of the Majority.

I concur, however, in some of the findings and orders entered.

The Decision does not appear to be a final decision.

Due to other pressing matters at hand, and to the complexity of the issues, and of the findings and orders entered, I will submit in detail a dissenting and concurring opinion when the final decision is issued.

(S E A L)

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

HENRY E. ZARLENGO

Commissioner
hbp/jsk

ATTEST: A TRUE COPY

Harry A. Galligan, Jr.

Harry A. Galligan, Jr., Secretary