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Columbus, Ohio 43266-0550

September 14, 1994

Honorable Mary K. Fenlon
Honorable Christine M. Pirik
Public Utilities Commission
of Ohio
180 East Broad Street
Columbus, Ohio 43266-0573

Re: Ohio Bell Telephone Company,
Case Nos. 93-487-TP-ALT
93-576-TP-CSS

Dear Examiners Fenlon & Pirik:

Pursuant to the Attorney Examiner's directive (see Transcript Vol. XXXXV pages 138, 149-152), the Office of the Consumers' Counsel (OCC) hereby submits late filed exhibits 26 and 27. Copies of these exhibits are herewith provided to all parties of record and the court reporters.

Sincerely,

Richard W. Pace, Sr.
Associate Consumers' Counsel
(614) 466-8574

RWP/mvw
Enclosures

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF HOWARD W. MOTLEY, JR. FOR AN INQUIRY INTO THE RATES AND CHARGES OF SOUTHWESTERN BELL TELEPHONE COMPANY.	)	CAUSE NO. PUD 000662

ORDER OF THE COMMISSION

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BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF HOWARD W. MOTLEY, JR. FOR AN INQUIRY INTO THE RATES AND CHARGES OF SOUTHWESTERN BELL TELEPHONE COMPANY.	)))))	CAUSE NO. PUD 000662 ORDER NO. 367868

ORDER OF THE COMMISSION

HEARINGS: October 7-10, 14-18, 21-25, November 4-8, 18-22, 25, 26, December 6, 16, 17, 1991 and January 15-17, 27-31, 1992 before the Administrative Law Judge.
June 24, 25, and July 30, 1992 before the Commission en banc.

APPEARANCES: Maribeth D. Snapp, Deputy General Counsel, Donna D. McLain, Lu Willis, Rick D. Chamberlain and John W. Gray, Assistant General Counsels, appeared on behalf of the Commission Staff

Robert A. Butkin and Yasodhara M. Mohanty, Assistant Attorney Generals, appeared on behalf of Attorney General Susan Loving

Eric R. King, Martin Weeks, and Nancy Pennell, Attorneys, appeared on behalf of the American Association of Retired Persons

Glen A. Glass, George M. Makohin, Nancy L. Coats, Mark P. Royer, Thad Hollie, Jr., Garry Wann, Michael C. Cavell, Lawrence G. Crahan, and Paula J. Fulks, Attorneys, appeared on behalf of Southwestern Bell Telephone Company

Lawrence M. Huffman, William M. Franz and Elizabeth S. Wood, Attorneys, appeared on behalf of the Communication Workers of America

Ronald E. Stakem and Edward J. Cadieux, Attorneys, appeared on behalf of MCI Telecommunications Corporation

Nancy M. Thompson and Rich Kowalewski, Attorneys, appeared on behalf of U.S. Sprint Communications Company

Robert D. Allen, R. Stephen Davis, II, and Mark Witcher, Attorneys, appeared on behalf of AT&T Communications of the Southwest, Inc.

J. Cody Wilbanks, Attorney, appeared on behalf of GTE Southwest

Ron Comingdeer and Bill Bullard, Attorneys, appeared on behalf of the Oklahoma Rural Telephone Coalition

Cody B. Waddell, Attorney, appeared on behalf of Alltel Oklahoma, Inc., Oklahoma Alltel, Inc., Oklahoma Communications Systems, Inc., Chickasaw Telephone Company and Pine Telephone Company

Jerry Cord Wilson, Attorney, appeared on behalf of the Cable Television Operators of Oklahoma

Maj. Kenneth C. Kitzmiller, Attorney, appeared on behalf of the Department of Defense and all Federal Agencies of the Federal Government

BY THE COMMISSION:

The Corporation Commission of the State of Oklahoma being regularly in session and the undersigned Commissioners being present and participating, the above styled Cause comes on for decision and order concerning the hearing on the merits, the Administrative Law Judge's report issued herein on May 20, 1992, and the appeals thereto.

I. PROCEDURAL HISTORY

On January 29, 1986 the Oklahoma Corporation Commission (Commission) issued Order No. 292337 in General Cause No. 29321, which directed the Commission Staff (Staff) to review and/or continue to monitor certain factors which affect the proper level of rates for Southwestern Bell Telephone Company (SWBT or the Company). The Attorney General of the State of Oklahoma (AG) and SWBT appealed Order No. 292337 to the Oklahoma Supreme Court and thereafter, on November 8, 1988, the Oklahoma Supreme Court issued its opinion in the case of Turpen v. Oklahoma Corporation Commission, 769 P.2d 1309. Rehearing of this decision was granted in part and denied in part on January 17, 1989. On October 23, 1986, Staff filed Cause No. PUD 000260, which sought to review the effect of the 1986 Tax Reform Act on 11 utilities operating in Oklahoma. The hearing regarding SWBT in Cause No. PUD 000260 commenced January 26, 1989 before the Administrative Law Judge (ALJ). On January 25, 1989, in recognition of the need to address certain issues which the Commission had previously indicated in General Cause No. 29321 needed to be reviewed, as well as other issues the parties were not prepared to address in Cause No. PUD 000260, Staff filed the above entitled Cause of action seeking to review the rates and charges of SWBT.

Motions to Intervene were filed by AT&T Communications of the Southwest, Inc. (AT&T), MCI Telecommunications Corporation (MCI), American Association of Retired Persons (AARP), U.S. Sprint, Cable Television Operators of Oklahoma (CTOO), GTE Southwest (GTE), Oklahoma Rural Telephone Coalition (ORTC), Attorney General of the State of

Oklahoma, Communication Workers of America (CWA) and the Department of Defense and all Federal Agencies of the Federal Government. The Commission granted intervenor status to all parties requesting intervention.

On January 9, 1991, the AG filed a Motion and Brief requesting that the rates of SWBT be placed subject to refund and that SWBT be compelled to answer the data requests of the AG. On January 10, 1991, the AG filed a Motion to Advance, requesting that the hearing on their Motion to Place Rates Subject to Refund and to Compel Discovery be heard by the Commission en banc. On January 15, 1991, SWBT filed a pleading entitled "Response to Motion and Update of Attorney General to Compel Discovery and Motion to Establish Discovery and Procedural Schedules." On January 16, 1991, the Commission's ALJ conducted a hearing concerning the AG's motion to advance the hearing on the Motion to Place Rates Subject to Refund to the Commission en banc. The Commission issued Order No. 353465 on January 18, 1991 which established a procedural schedule in the above styled Cause, as well as Cause No. PUD 000837, for (1) a hearing on the Motion to Place Rates Subject to Refund, (2) discovery, and (3) a hearing on the merits of Cause Nos. PUD 000837 and PUD 000662. The AG gave oral notice of his intent to appeal the ALJ's denial of the Motion to Advance and the Commission en banc heard arguments concerning said appeal on January 30, 1991.

The ALJ conducted a hearing February 4, 1991 concerning the issues which should be the subject of the hearing on the Motion to Place Rates Subject to Refund and orally advised the parties of his ruling on February 6, 1991. The oral ruling of the ALJ, which is fully set forth at page two of the ALJ's report filed March 14, 1991, found that the only issue which should be addressed at the hearing on the Motion to Place Rates Subject to Refund was the appropriate return on equity (ROE) for SWBT. The ALJ further advised the parties that the hearing on the Motion to Place Rates Subject to Refund would be February 22, 1991. SWBT orally advised the parties of its intent to appeal the oral ruling

of the ALJ and on February 11, 1991, filed an appeal to the ALJ's oral decision.

SWBT agreed to present its appeal to the February 6, 1991 oral decision of the ALJ after the ALJ conducted a hearing on the merits of the Motion to Place Rates Subject to Refund and issued a written report thereon.

The Commission issued Order No. 354075 on February 8, 1991 which denied the Motion to Advance and directed that the ALJ conduct a hearing concerning the Motion to Place Rates Subject to Refund on March 7, 14, and 15, 1991. On February 12, 1991, the AG filed "Attorney General's Request that Commission Issue an Order Nunc Pro Tunc so that the Previously Set Hearing on Motion to Place Bell's Rates Subject to Refund can proceed on February 22 as scheduled by the Administrative Law Judge." In response to this pleading, the Commission issued Order No. 354531 on February 21, 1991 which denied the AG's request for an Order Nunc Pro Tunc and directed that the hearing on the Motion to Place Rates Subject to Refund be changed from March 7, 14, and 15, 1991 to March 7 and 8, 1991.

On February 28, 1991, the AG filed prefiled testimony for witnesses Michael J. Ileo and Michael Brosch, as well as a Motion requesting that the proprietary testimony of these two witnesses be filed in the Office of General Counsel, Oklahoma Corporation Commission.

On March 4, 1991, SWBT filed a Motion to Strike Testimony and Motion in Limine or, In the Alternative, Motion for Continuance (Motion to Strike). In SWBT's Motion to Strike, SWBT requested that any testimony which was not directly related to the appropriate ROE be stricken to the extent such testimony was related to issues other than ROE, which would be beyond the scope of the ALJ's ruling for issues to be addressed at the time of the hearing on the Motion to Place Rates Subject to Refund. SWBT further requested that, if the Motion to Strike were denied, it be

granted a continuance of the hearing on the Motion to Place Rates Subject to Refund, in order to allow it the opportunity to present testimony on issues other than ROE, in response to the testimony of the AG's witnesses. SWBT's Motion to Strike was argued to the ALJ on March 7, 1991, prior to the hearing on the Motion to Place Rates Subject to Refund.

The ALJ conducted a hearing on the merits of the Motion to Place Rates Subject to Refund on March 7 and 8, 1991 and issued his report concerning said hearing March 14, 1991. SWBT timely filed its appeal to the ALJ's report on March 25, 1991 and the AG and Commission Staff filed their responses to said appeal on April 1, 1991.

On April 12, 1991, the Commission en banc heard the arguments of Counsel concerning SWBT's appeal and the responses thereto. On April 19, 1991 the Commission issued an Interim Order, Order No. 356271 which adopted the Report of the ALJ. On May 16, 1991, SWBT filed a Petition in Error with the Supreme Court of Oklahoma (Case No. 77,563). Specifically, SWBT was appealing the Commission placing its currently approved rates subject to refund. Further, SWBT filed another petition with the Oklahoma Supreme Court (Case No. 77,521) requesting that the Court assume original jurisdiction. On June 20, 1991, the Court denied SWBT's request to assume original jurisdiction. On September 9, 1991, the Oklahoma Supreme Court dismissed Case No. 77,563, indicating that the appeal was premature because it was an appeal to an Interim Order. On September 20, 1991, Staff filed a Motion to Consolidate Cause No. PUD 000662 and Cause No. PUD 000837. Staff's Motion was granted by the Commission in Order No. 360521, however, SWBT subsequently filed a motion requesting that it be permitted to voluntarily withdraw Cause No. PUD 000837.

Said Motion was granted as to SWBT's relief requested in Cause No. PUD 000837, but the cause was not dismissed to the extent that it concerned any affirmative relief which might have been requested by any

other party. On October 7, 1991, a hearing on the merits of the above styled Cause began before the ALJ and continued through January 31, 1992, at which time the presentation of the evidence was completed by all parties and the record was closed by the ALJ. The ALJ issued his recommendations in a Report dated May 20, 1992.

On May 28, 1992, the ALJ heard arguments relating to the Motion to Clarify Report filed by Staff. Thereafter all parties filed their respective appeals to the Commission en banc and the Commission heard oral arguments relating to these appeals on June 24 and 25, 1992.

In deliberating this Cause, the Commission heard oral arguments of Counsel, reviewed the transcripts of testimony and exhibits thereto, read the summaries of testimony and findings of fact prepared by the parties and considered the recommendations of the ALJ. In lieu of repeating the summaries of evidence provided by the parties, the Commission has recited the evidence it considered within the discussion of each issue herein. In adopting the following findings of fact and conclusions of law, the Commission determined the findings set forth herein to be credible, persuasive and supported by substantial evidence.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. JURISDICTION

This Commission has jurisdiction in this Cause pursuant to Art. IX, Section 18 of the Oklahoma Constitution, Title 17, Section 131, et seq. of the Oklahoma Statutes, and its Rules and Regulations Governing and Regulating the Operation of Telephone Companies and Telecommunications in Oklahoma (Telephone Rules). This Commission further finds that it has jurisdiction over SWBT and the subject matter of the application herein and that due and proper notice was given and made as required by law and the Orders of this Commission.

This Commission entered Interim Order No. 355271 on April 19, 1991, and stated that SWBT's authorized return on equity (ROE) would be reduced to 11.41 percent, effective the date of said Order, and that said ROE would remain in effect and the revenues of SWBT would be subject to refund to the extent they exceed 11.41 percent ROE until December 31, 1991. Thereafter, on December 27, 1991, this Commission entered Order No. 362281 which extended the previous Interim Order until April 10, 1992. On April 10, 1992, this Commission entered Order No. 364631 which extended the previous Interim Order until August 7, 1992. On August 6, 1992, this Commission entered Order No. 367460 which extended the previous Interim Order until September 4, 1992 or until a final order issues, whichever is earlier.

B. CAPITAL STRUCTURE AND RETURN ON EQUITY

1. Capitalization

The Oklahoma Supreme Court in Turpen v. Oklahoma Corporation Commission, 769 P.2d 1309 (Okla. 1988) mandated that the Commission closely monitor SWBT's capital structure. The Court stated at p. 1331:

> "In handling future requests for rate relief, the Commission must continue to monitor SWBT's capital structure closely." (emphasis added)

In order to establish the overall rate of return (ROR) for SWBT's utility operations, we must first determine the appropriate capitalization component ratios. The process of determining a utility's capital structure for ratemaking purposes requires a balancing of ratepayer and investor interests while considering expected economic and financial conditions. In adopting a capital structure for ratemaking purposes, the Commission must determine whether the utility's actual capital structure properly reflects a prudent and economically efficient combination of debt and common equity based upon the risks of providing the utility service. If the capital structure is found not to be representative of a mix of financing consistent with the implicit risk

of the utility, then the Commission has the responsibility to establish a hypothetical capital structure which accomplishes this objective.

When establishing a capital structure of SWBT for ratemaking purposes, the Commission must examine the total corporate capital structure of SWBT and the affiliated corporate entities of Southwestern Bell Corporation (SBC) in order to determine: (1) whether the capital structure assigned and retained in the financial statements of SWBT by SBC properly reflects the financial and business risk of the regulated utility; and (2) whether the capital structure assigned and retained in the financial statements of SWBT is being materially influenced by the financial and business risk of the unregulated affiliates of SBC. SWBT, in this case, is a regulated utility which is a subsidiary of SBC. The equity capital for SWBT and the unregulated affiliates of SBC is issued and retained by SBC. Thus, the cost of equity and the percentage of equity in the total corporate capital structure of which SWBT is part, reflects the combined risks of all affiliated companies of SBC.

In this case, SWBT proposed that its actual capital structure at test year end, December 31, 1989, be utilized, and represented that, as reflected on its books and records, the Company's capital structure was 40.99 percent debt and 59.01 percent common equity. AG witness Matthew Kahal recommended that a hypothetical capital structure be utilized and indicated that an appropriate hypothetical capital structure would be 47 percent debt and 53 percent equity. Mr. Kahal recommended that the embedded cost of debt be deemed to be 9.07 percent, based upon the Company's estimate contained in its Minimum Standard Filing Requirements (MSFR) with minor adjustments for the cost of short-term debt. Staff witness Dr. Kennedy also recommended a hypothetical capital structure and indicated that his recommendation utilized 44 percent debt, with an embedded cost of debt of 9.15 percent, and an equity level of 56 percent of total capital. The record in this Cause reflects that Dr. Kennedy developed a hypothetical capital structure for SWBT for ratemaking purposes, by removing the nonregulated capitalization from its parent

SBC's total capitalization. Dr. Kennedy utilized Standard & Poor's (S&P's) Industrial Firms Index and S&P's capital structure to delineate the unregulated portion of SBC's capitalization. He stated that the remainder should be the capital structure for the regulated portion, which in this particular case resulted in his recommended hypothetical capital structure of 44 percent debt and 56 percent equity. (Tr. 11/4/91 pp. 83, 84.)

Dr. Kennedy patterned his proposed hypothetical capital structure after a methodology practiced by the New York State Public Service Commission which he stated represents a sound approach to deriving a hypothetical capital structure for a public utility. Dr. Kennedy testified that his proposed analysis was straight forward and intuitively valid.

Dr. Kennedy testified that it was appropriate for a regulatory commission to adopt a hypothetical capital structure for a regulated utility if a regulatory commission believed that ratepayers are being requested to pay a higher revenue requirement as a result of the higher equity ratio maintained in the actual capital structure. Dr. Kennedy stated that the expectations of the regulatory commission are based upon lower revenue requirements related to a hypothetical capital structure, which more correctly reflects the capital employed to finance the regulated telephone investment of SWBT. Dr. Kennedy recognized that the capitalization necessary to fund nonregulated ventures of SBC should not be borne by the utility ratepayers. Dr. Kennedy testified that a hypothetical capital structure was appropriate in this case because the regulated intrastate markets of SWBT's Oklahoma operations exhibit less business risk than those of its consolidated parent, SBC, as demonstrated by the aggressive posture of SWBT's parent in pursuing investment in Telemex and three cable television companies at a substantial cost. Dr. Kennedy contrasted SBC's actions with that of SWBT's Oklahoma operations. He testified that the favorable regulatory treatment SWBT has received from the Commission contributes to the lower business risk experienced in its regulatory operations.

The record reflects that Mr. Kahal opposed the inclusion of 59 percent common equity in SWBT's capital structure, indicating that this level of common equity was excessive and unnecessary for a low-risk utility company such as SWBT. He indicated that using an unnecessarily high common equity ratio for setting rates leads to excessive costs to ratepayers. This result derives from the fact that the cost of equity is generally higher than the cost for debt and that the equity return dollars carry an income tax obligation. Mr. Kahal recommended a hypothetical capital structure stating that his hypothetical 47 percent debt and 53 percent equity capital structure, which reflects the average capital structure of the seven (7) Regional Holding Companies (RHC). He further stated that his hypothetical capital structure contains a higher equity level than is employed by the "high risk" independent telephone companies. It was his belief that his proposed hypothetical capital structure resolved the financial cross-subsidization problem which would otherwise arise as a result of SBC providing regulated telephone utility service through SWBT, as well as being the parent company for unregulated subsidiaries with much more risk than SWBT.

Mr. Kahal rebutted SWBT witness Avera's claim that comparison with the capital structure of other Bell operating companies, rather than the regional holding companies, was the appropriate comparison. Mr. Kahal testified that such a test would be circular, because all the Bell holding companies had the same incentive as SBC to load excessive equity into the utility subsidiaries, whose equities are not publicly traded, thus forcing captive ratepayers to subsidize nonregulated activities. He testified that the proper standard to use is the RHC average, not the operating company average, because, as noted by the Federal Communication Commission (FCC), the RHCs are publicly traded and cannot engage in leverage shifting financial manipulations. (Exhibit 193, Kahal rebuttal, p. 6.)

SWBT recommended the use of 40.99 percent debt and 59.01 percent equity indicating that this level represented the actual capital

structure at test year end (TYE). SWBT argued that a higher debt ratio would jeopardize its bond ratings and threaten its ability to raise capital on reasonable terms, thus resulting in increased costs of both debt and equity capital.

However, Dr. Kennedy testified that although much discussion was offered over the necessity to maintain a strong bond rating, it was likely that the higher revenues required to satisfy the financial benchmarks of the rating agencies (i.e. coverage ratios) and the credit rating desired by management would not produce the lowest revenue requirements for the benefit of ratepayers. Dr. Kennedy stated that the relationships among higher debt ratios, bond ratings, and revenue requirements should be targeted to achieve an equilibrium where revenue requirements are minimized and the Company has access to the capital markets at reasonable terms. Dr. Kennedy pointed out that the Company had not conducted any analyses that measured the impact on the revenue requirements of SWBT's Oklahoma operations at a bond rating ranging from AAA to BBB.

AG witness Kahal argued that the Commission should not provide SWBT in Oklahoma an inflated rate of return merely to satisfy external bond rating agencies. In fact, he pointed out that Dr. Avera had been unable to identify any specific benefits that ratepayers would receive through a higher SWBT bond rating. Mr. Kahal further pointed out that any benefit from a favorable bond rating occurs only when new debt is issued. Because SWBT was able to fund virtually all of its utility capital needs from internally-generated cash, and only a small percentage of the Company's outstanding debt is scheduled to mature over the next ten years, he indicated that concern with SWBT's bond rating should not be given undue consideration.

SWBT asserted through Dr. Brigham that the use of an imputed capital structure was inappropriate. The record reflects that this assertion was sharply disputed. In particular, AG witness Kahal pointed out that

the model by which Brigham attempted to make this point was flawed, because; (1) The model did not identify the type of companies relied upon (utility or non-utility); (2) The model did not specify the time frame which was studied; and (3) The model ignored the results of Brigham's own econometric study in favor of some vague, unsubstantiated rule of thumb. (Tr. 11/4/91, pp. 70-72; Exhibit 193, Kahal rebuttal, pp. 16-19.)

Mr. Kahal performed his own regression analysis, confined to the RHCs, which demonstrated that there was a coefficient of a three basis point increase in the cost of equity for every one percentage increase in the debt ratio. (Tr. 11/4/91, p. 71.) To provide even greater conservatism to his analysis, Mr. Kahal employed a much larger coefficient of six. Even with this larger coefficient, Mr. Kahal demonstrated that the use of the hypothetical capital structure would result in overall cost savings to the ratepayers.

This Commission, in Order No. 292337, issued in General Cause No. 29321, (the last major rate case for SWBT), considered the adoption of a hypothetical capital structure and determined that, because there had been no showing that: (1) the actual capital structure was manifestly unsound; (2) the actual capital structure constituted imprudent management policy; or, (3) that the actual capital structure worked to the ultimate detriment of the ratepayer, then the actual capital structure would be adopted for the purposes of Cause No. 29321. However, the Commission indicated that it would continue to closely monitor SWBT's capital structure.

The Oklahoma Supreme Court, in the Turpen decision which resulted from the appeal of Order No. 292337 in Cause No. 29321, at p 1331, found:

> "While the Commission's decision to allow SWBT to use its actual capital structure is upheld, the Commission is instructed that in its handling of future requests for rate relief it is to investigate and address the impact of the above two factors [the

> increased business risk of the unregulated SBC subsidiaries and the increased competition facing the basic telephone operations of states other than Oklahoma] on SWBT's capital structure and to impute a hypothetical capital structure if the investigation should indicate that the capital structure chosen by SWBT is more equity-laden than necessitated by basic telephone operations in Oklahoma."

The Commission finds that in the present Cause, there is substantial evidence as presented through the testimony of Dr. Kennedy and Mr. Kahal, that the actual capital structure of SWBT is more equity-laden relative to the level required for business risks related to SWBT's regulated utility operations in Oklahoma, and that this additional equity retained in SWBT's actual capital structure results from financing decisions at the SBC corporate level with regard to business risk related to SBC equity, generally. The Commission further finds that because the appropriate capital structure for use in establishing rates for SWBT's Oklahoma customers should only reflect that level of equity which is necessary to provide utility service, a hypothetical capital structure shall be adopted in this Cause.

We find ample legal authority in ordering this hypothetical capital structure. The Supreme Court in Turpen, supra, clearly directed the Commission to impute a hypothetical capital structure once it determined that the Company's actual capital structure is more equity-laden than necessitated by basic telephone operations in Oklahoma. Specifically, the Court stated:

> "In its treatment of future rate relief requests the Commission must impute a hypothetical capital structure if the one chosen by SWBT is more equity-laden than necessitated by basic telephone operations in Oklahoma."
>
> . . . .
>
> "The practice of imputing a hypothetical debt-equity ratio for purposes of rate setting is accepted throughout the United States. The reason for doing so is to protect ratepayers from excessive capital charges. The ratepayers of a regional holding company that raises funds jointly for both its competitive ventures and its regulated services are especially in need of protection from having to pay for excessive capital charges." Id. at page 1329.

We are not persuaded by SWBT's assertion that the Commission must find that the Company's actual capital structure is unreasonable before we can determine a rate of return on the basis of a hypothetical capital structure. The Commission has a duty to insure that ratepayers are not penalized by SBC's decision to maintain a low debt ratio on a total SBC basis below that ratio required by the business risks related to SWBT's telephone utility operations, for purposes related to the higher risks incurred from unregulated subsidiaries of SWBT's parent SBC.

Accordingly, the Commission finds that the capital structure recommended by Staff witness Dr. Kennedy, consisting of 44 percent debt and 56 percent equity, shall be adopted by the Commission in this Cause. By approving the above-referenced hypothetical capital structure, the Commission is availing itself of its authority to regulate the industry as an efficient enterprise, rather than a luxurious one, while ensuring that SWBT's customers receive quality service at the lowest reasonable rates. In adopting this hypothetical capital structure, the Commission notes that the analyses and conclusions of Dr. Kennedy and Mr. Kahal were substantially similar and support the appropriateness of imputing a hypothetical capital structure for SWBT. In making this determination, the Commission is convinced that it has appropriately balanced the interests of the ratepayers in receiving quality utility service at the lowest reasonable rates with the interests of the stockholders in obtaining a fair return on their equity investment which is consistent with the risk business of an investment in SWBT only.

2. Cost of Capital - Embedded Cost of Debt

The determination of a utility's embedded cost of debt is generally accomplished from reviewing and analyzing its cost of debt related to the individual debt instruments in the capital structure used to finance investment. The evidence reflects that as of December 31, 1989, SWBT's weighted average embedded cost of debt was 9.15 percent. The record reflects that Dr. Kennedy argued that adopting a hypothetical capital

structure with an equity ratio of 56 percent as compared to SWBT's actual 59.01 percent equity level would not necessarily require use of a hypothetical cost of debt because the Company's debt coverage ratios would remain adequate to maintain an acceptable bond rating.

The record further reflects that the ALJ recommended the adoption of 9.07 percent as the cost of debt for SWBT's capital structure. The Commission notes that this finding reflects two adjustments to SWBT's 9.15 percent debt cost reflected at TYE. The first adjustment is the use of a twelve-month average for short-term debt rather than year-end levels. This adjustment recognizes and accounts for the fluctuation of short-term debt during the test year by normalizing to a monthly average. The second adjustment is the application of a 6.5 percent cost rate to the short-term debt component of capital structure, slightly higher than SWBT's current cost of debt.

The Commission finds that the ALJ's recommendation concerning the embedded cost of debt is based upon substantial evidence and, therefore, adopts 9.07 percent as the cost of debt.

3. Cost of Common Equity and Overall Rate of Return

In determining the Company's cost of common equity, the Commission must establish a return on equity (ROE). A proper ROE is one which is:

> . . ." 'commensurate with returns on investments in other enterprises having corresponding risks' and which is 'sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital'. . . ."

Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 603 (1944).

While theoretically straightforward, application of these standards require, as a practical matter, the careful analysis of financial data

from companies in the telephone industry, the assessment of expected market conditions, the examination of investor expectations, and ultimately, the exercise of informed judgment.

The range of recommended ROEs in this Cause was from 11.9 percent to 14.0 percent. SWBT's witness, Dr. Avera, recommended a ROE of 14.0 percent, as being the midpoint of his 13.75-14.25 percent cost of equity range. He performed several analyses, including the constant growth discounted cash flow (DCF) model, two applications of the general form of the DCF model, and the risk premium method. Mr. Kahal, the AG's witness, recommended an 11.9 percent ROE based upon his use of the DCF model, which he applied to the seven RHCs as a proxy for SWBT. Mr. Kahal also rebutted Dr. Avera's claim that the use of the DCF method produced unreliable results. He pointed out that the high degree of earnings stability and the large number of analysts following the RHCs made it especially suitable for the DCF methodology. He further explained that assumptions which underlay the constant growth DCF model do not significantly reduce the usefulness of the DCF model, because (1) certain assumptions proceed directly from the assumption that the stock market is an efficient market; and (2) other assumptions simplify the mathematics without distorting the final results. Further, as a reasonableness check, Mr. Kahal performed a two-stage growth rate analysis using both a short-term growth rate and a sustained or long-term growth rate. He found that for the seven RHCs, the growth rates were about the same.

Mr. Kahal rejected Bell witness Avera's attempt to determine ROE through the risk premium method which attempts to determine cost of equity by reference to cost of debt. Mr. Kahal suggested that in assessing investor expectations, that Dr. Avera relied upon studies which were oriented towards the electric utility industry, <u>not</u> the telephone industry. Finally, Mr. Kahal testified that other studies were discredited because they reflected outdated investor surveys conducted by a professional expert witness for utilities.

Dr. Kennedy, Staff's expert witness, recommended an ROE of 12.20 percent based upon the average of the results of his analyses utilizing the DCF model, which calculated an equity return requirement of 12.0 percent and a risk premium analysis which calculated a 12.4 percent equity return requirement.

Although each of the witnesses used a DCF model, the data selected for use in their respective calculations and the sample companies used for evaluation purposes varied among the witnesses, thus resulting in variations among their respective recommended ROEs.

The Commission is mindful that it must consider the fact that our evaluation of an appropriate ROE only relates to SWBT's influence on the riskiness of an investment in the corporate equity of SBC since SWBT does not issue stock itself, and that SBC has other subsidiaries whose activities will contribute greater risks to an investment in SBC equity than those of SWBT. Also, the other subsidiaries influence the perception of the strengths or weaknesses of the corporation, its anticipated growth, and the value of the stock. The Commission, after thoroughly reviewing the record, including the testimony of these witnesses, their calculations and their reasoning, as well as their choices of data for use in their calculations, finds that the appropriate ROE to be adopted in this Cause is 12.20 percent. This 12.20 percent ROE level is compatible with the hypothetical capital structure mix previously determined to be appropriate for the Company.

With respect to the appropriate rate of return on SWBT rate base, the Commission notes that the ALJ's recommendation that the weighted cost of capital should be 10.858 percent, utilizing the hypothetical capital structure recommended by Staff, is not supported by the ALJ's own conclusions. On page 154 of the ALJ report, the ALJ concluded that a ROR of 10.858 percent is derived using a hypothetical capital structure for SWBT, incorporating a ROE of 12.20 percent and using the

actual cost of debt for SWBT as of December 31, 1989. However, on Page 12 of his report, the ALJ recommends a 9.07 percent cost of debt which incorporates two minor changes to SWBT's actual December 31, 1989 cost of debt. Under this analysis, the ALJ should have concluded that the ROR of SWBT is 10.823 percent utilizing a hypothetical capital structure of 44.0 percent debt and 56.0 percent equity and the 9.07 percent cost of debt adopted by the ALJ on page 12 of his Report. The proper equation for calculating the ROR is debt ratio times debt cost, plus equity ratio times equity cost, and is illustrated in the following formula:

	Ratio	Cost	Weighted Cost
Debt	44.0%	9.07%	3.991%
Equity	56.0%	12.20%	6.832%
	100.0%		10.823%

Therefore, the Commission finds that the recommendation of the ALJ shall be rejected with regard to the overall ROR on rate base and that the ROR of SWBT shall be 10.823 percent utilizing the analysis set forth above.

C. ISSUES SET FORTH IN EXHIBIT 361

Exhibit 361 contains a listing of approximately one hundred general and specific adjustments. The Commission notes that the parties did not appeal every adjustment as set forth in Exhibit 361. Those unappealed adjustments were nonetheless independently reviewed by this Commission and the evidence supporting those adjustments was examined to insure that it represented the appropriate determination concerning those issues.

As a result of that independent review, the Commission finds that all Exhibit 361 adjustments recommended by the ALJ which were not appealed by the parties hereto, shall be adopted as clarified by the Commission within this Order.

The following individual line item discussions correspond to the line item shown on Exhibit 361 and the corresponding line item contained in Schedule E attached to this Order. Schedule E summarizes the revenue, expense, and rate base impact of this Commission's decision on issues addressed in the instant Cause.

Line 1 - 1989 Actual Results

The record reflects that the ALJ concluded that the starting point for both Staff's and SWBT's analysis was SWBT's 1989 book results of revenues, expenses and rate base. The record also reflects that the AG began with SWBT's April Minimum Filing Schedule.

The Commission has reviewed the record and finds that the ALJ's recommendation to use SWBT's actual 1989 book values as the starting point for determining revenues, expenses and rate base is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

Accordingly, the actual SWBT 1989 book results of revenues, expenses, and rate base, which amount to $568,394,327, $444,830,039 and $857,678,021 respectively, are presented on Line 1 of Schedule E.

Line 2 - Year End Revenues

This line represents a general heading only and contains no issues to be determined by this Commission.

Line 3 - Year End Revenues: Local

Staff witness Mr. Crosslin proposed an adjustment to annualize recurring local revenues. He testified that he calculated SWBT's pro forma recurring revenues by multiplying SWBT's December 1989 revenues times 12. He further testified that the pro forma revenue level was

adjusted to reflect conditions or events in existence at TYE that were not fully reflected in the actual test year data.

SWBT witness Mr. Chicoine recommended annualizing recurring revenues by multiplying the last quarter of the test year times four. He argued that Mr. Crosslin's annualization of recurring revenues, which merely multiplied December 1989 revenues times 12, was not a valid adjustment since one month's data would not provide a reasonable indication of an ongoing level of revenue. He further stated that seasonal variations alone could make the use of any single month as the basis of a revenue annualization adjustment questionable. Additionally, Mr. Chicoine argued that Mr. Crosslin did not normalize the revenue booked during December 1989 to adjust for any abnormal or out-of-period amounts. He asserted that these factors distorted Mr. Crosslin's year-ending adjustment.

The record reflects that Mr. Crosslin did not recommend any adjustment to nonrecurring local revenues, therefore that amount remained at TYE book levels. Mr. Crosslin stated that nonrecurring revenues are more seasonal in nature than recurring revenues, and that it would be inappropriate to use the December revenue level times 12 method he used to annualize recurring revenues for purposes of annualizing nonrecurring revenues. He further stated that he believed that the Company could expect to at least maintain the level of nonrecurring local revenues booked during the test year because his analysis of inward movement of access lines reflected a trend of increasing nonrecurring revenues. Mr. Crosslin stated that Exhibit 313, (SWBT's Response to data request GM 64,) indicated that SWBT's 1990 actual recurring and nonrecurring local access revenues were higher than his proposed revenues.

Mr. Chicoine argued that Staff erred by refusing to make an adjustment to normalize nonrecurring local revenues. Mr. Chicoine stated that by not making an adjustment to nonrecurring local revenues,

a less representative amount of test-period revenue was used to determine future rates in this Cause. Mr. Chicoine stated that using all twelve months' data, yet not normalizing all twelve months' data, increased the opportunity for abnormal or out-of-period revenue to be erroneously included in Staff's test-period revenue. He gave the example that nonrecurring local revenue actually booked in both May and August, 1989 was considerably higher than the average monthly revenue for the other ten months. He explained that these two high months were caused by the nonrecurring charges for the emergency 911 (E911) systems installed in Oklahoma City and Tulsa. He stated that since there are no other cities in Oklahoma large enough to generate similar levels of one-time charges, these E911 nonrecurring revenues, totaling $2,143,000, should have been excluded from the test period.

Mr. Chicoine argued that Mr. Crosslin's method of annualizing Line 6 - Other Year-end Revenues such as Directory, Billing and Collection, and Miscellaneous Revenue was incorrect for the same reasons mentioned for recurring and nonrecurring local revenues.

AG witness Brosch also employed a December-times-twelve approach to annualize recurring local revenues (e.g., monthly exchange service revenues), under which recorded amounts in December 1989 were multiplied by twelve and then compared to actual calendar year 1989 revenues to derive the appropriate annualization. Mr. Brosch stated that the advantage of his proposed annualization methodology, over SWBT's fourth-quarter-times-four method, is that December amounts were more representative of year-end business volumes, and were consistent with use of a year-end rate base. Mr. Brosch testified that Staff also used a December-times-twelve methodology to annualize recurring revenues, but that Staff omitted recurring revenue amounts for certain information delivery services and other exchange business which should have been annualized. (Exhibits 137, 137a, Brosch testimony, pp. 12-14; (Exhibits 323, 323a, Schedul C-1; Exhibit 318, Brosch Summary (unexpurgated), p. 4; Exhibit 361, Lines 2-6.)

Mr. Brosch argued that SWBT's arbitrary selection of three months' revenue data to extrapolate to an annualized nonrecurring revenue level was not likely to produce meaningful results. He testified that SWBT's adjustment to annualize local nonrecurring revenues reflects a 10 percent reduction from test year levels. Mr. Brosch stated that when asked about this discrepancy, the Company could explain less than half of this decrease and acknowledged the existence of distortive data within its calculation.

The Commission notes that SWBT's testimony confirmed that year-end recurring levels were more representative of ongoing revenue streams than were fourth-quarter revenues. Thus, Bell witness Chicoine testified that access lines, which he acknowledged were the "driver" of recurring local revenues, had increased in years subsequent to the test year, indicating that year-end 1989 levels would be a conservative representation of ongoing revenue streams.

The Commission finds that Staff's method of calculating local revenues provides a closer approximation of SWBT's expected revenue-generating capabilities as of TYE. Although use of a single month may distort revenues in some cases, it did not do so in the instant case. Exhibit 313 is persuasive in that it indicates that the actual 1990 local recurring revenues received by SWBT were more than Staff's proposed revenues. Additionally, SWBT's request to annualize the fourth-quarter recurring revenues would result in understating revenues and result in future potential over-earning by SWBT. The Commission finds that Staff's method of calculating recurring and nonrecurring local and other revenues is appropriate and the Commission adopts Staff's adjustment at Column C, Lines 3 and 6, Exhibit 361.

The Commission notes SWBT's disagreement with Staff's local revenue adjustments but is persuaded by Staff's analysis of inward movement, and Exhibit 313 showing higher revenues in 1990 than 1989, which reflect the

appropriateness of Staff's use of December, 1989 data to annualize the amount of local revenues to determine SWBT's future earnings capability. Therefore, the Commission finds that Staff's method of calculating local and other revenues is appropriate and adopts Staff's adjustment at Column C, Line 3 and Line 6, of Exhibit 361.

These adjustments are reflected as adjustments to revenues on Lines 3 and 6 of Schedule E in the amounts of $997,777 and $1,341,984 respectively.

Line - 4 Year End Revenues: Toll

Staff witness Mr. Manning testified that the intraLATA toll revenue for SWBT results from an intrastate pooling arrangement between all local exchange carriers (LECs) in Oklahoma. Mr. Manning explained that the settlements from the toll pool are a replacement of the settlements with AT&T before divestiture and are not subsidies to independent telephone companies as Mr. Chicoine had indicated in his direct testimony. Mr. Manning agreed that these settlements represent a viable way to distribute toll revenues to participants in the toll network in Oklahoma.

Mr. Manning further explained that the matching of expenses to revenues for the pooling process is done monthly with quarterly true-ups and annual audit adjustments performed by the Toll Pool Administrator and its employees. He stated that Staff's adjustments were based upon the actual revenues calculated by the toll pool, which were completed subsequent to the audit test period, but finalized before Staff filed its testimony.

Mr. Manning disagreed with SWBT's recommendation to annualize the last quarter data of the test year for toll revenues. Mr. Manning testified that using actual revenues and expenses from reports prepared by the Toll Pool Staff was more accurate than annualizing one quarter of

the year. He explained that SWBT's annualization method did not reflect the seasonality of toll activity, such as holidays or the beginning and ending of school terms. Mr. Manning further disagreed with Mr. Chicoine's rationale that because Staff had used the fourth quarter annualization method in SWBT's last full rate case (General Cause No. 29321), it should do so again. Mr. Manning explained that during the previous rate case, the actual test year amounts were not representative of usage because it was the first year access charges were in effect. He further explained that because SWBT's books were a morass of exceptions in General Cause No. 29321, Staff had to rely upon the last quarter amounts of the test year and annualize them, believing that method to be more representative of the expected future than the historical 12 months' experience during the abnormal test year.

Mr. Manning also proposed adjusting toll revenues for an accrual of a disputed amount which may be refundable from SWBT to its interexchange customers. He stated that the potential for the refund arose from a case before the Commission regarding multijurisdictional WATS lines. He further stated that Cause No. PUD 000254 established a lower rate than previously authorized for the use of a single WATS line in the intrastate, as well as the interstate, environment. He added that the lower rate was disputed, and an appeal pending before the Oklahoma Supreme Court resulted in a stay of the order which established the lower rate. Mr. Manning indicated that SWBT is currently charging the higher authorized rate for WATS access lines and the difference between the two rates is subject to refund pending the decision of the Oklahoma Supreme Court. Because of these circumstances, he reversed the accrual for the difference between the actual amount billed and the potential lower rate.

Mr. Manning proposed adjusting the intraLATA toll revenue for the impact of other Staff adjustments that have a material impact on the settlement amounts derived from the intraLATA toll pool. (Manning - Prefiled testimony 8/12/91 p. 3). Mr. Manning stated that the

adjustments made by Staff will change the settlements provided by the pools, because these pools allow each company in the pool to recover expenses and investment used to support the toll network in Oklahoma. He further stated that any change to the reported investment or expenses of a pooling company will affect the revenue derived from settlements. He estimated the total impact of Staff's adjustments to the test year intraLATA toll revenues as shown on Section K, Schedule 3, Page 4 in Parts I, II, and III of Exhibit 363.

SWBT witness Chicoine disagreed with the method used by Staff. He testified that SWBT year-ended the toll revenues by normalizing the booked revenue for the fourth quarter of 1989, and annualizing the fourth quarter's normalizing revenue to obtain a TYE level. He explained that the fourth quarter was selected because it reflected SWBT's revenue levels at year-end and was broad enough to be representative of a full twelve-month test period. He claimed that the Commission has historically applied year-ending techniques consistent with SWBT's approach. Mr. Chicoine testified that Mr. Manning did not make year-ending adjustments to the test year revenue for intraLATA toll and carrier access revenue. He stated that not year-ending these revenue categories produced a less reasonable indication of an ongoing level of revenue.

Mr. Chicoine disagreed with Mr. Manning's adjustment to reverse the accrual for WATS access line revenues. He testified that SWBT's normalization of the fourth-quarter toll revenue included removal of the difference between the 19.2 cents and 27.6 cents per minute WATS revenues, and that by not recognizing the potential reduction SWBT would never obtain recovery for the lost revenue.

Mr. Chicoine further disagreed with Staff's toll pool settlement effect of year-ending adjustments, to billed intraLATA toll carrier access, and billing and collection revenue. He testified that adjustment for toll pool settlement effects are required only for

year-ending adjustments to billed amounts, not year-ending adjustments to test year toll pool settlements themselves. He stated that Staff did not determine the toll pool settlements effects of its adjustments to these types of billed revenues.

Staff, SWBT and AG all sponsored varying adjustments to year-end toll revenues. Staff determined actual test year toll pool revenues and made normalizing adjustments. SWBT normalized the fourth-quarter booked revenues and then annualized that amount to obtain a TYE level. The AG normalized test year toll revenue and annualized that amount based upon growth in access lines occurring through December 31, 1989.

Further, Staff argued that using SWBT's proposed method for calculating toll revenues, which is based soley upon the fourth quarter multiplied by four methodology, does not incorporate all known and measurable information. For example, the last quarter of the calendar year does not reflect the seasonal nature of toll usage.

Staff urged the Commission to reject the ALJ's recommendation and stated that the Commission has consistently utilized the finalized toll settlements method to calculate toll revenues in previous rate cases. Staff argued that its proposed methodology represents the actual test year level of toll usage which affects SWBT's revenues and has been used both before divestiture and since divestiture for toll revenues.

The Commission agrees with Staff's and AG's arguments that the use of the fourth quarter to normalize and annualize toll pool revenues is not as reliable a method for calculating anticipated revenues as utilizing the actual revenues as annualized. The use of the fourth quarter to determine test year revenues in SWBT's last rate case, General Cause No. 29321, was necessitated by the fact that it was the first year access charges had occurred and SWBT's booked revenue levels reflected many abnormal factors. The use of the fourth-quarter revenues in that particular rate proceeding does not constitute a mandatory

Commission approach to ratemaking. Therefore, the Commission finds that Staff's use of actual finalized toll revenues, as adjusted for known and measurable changes which impacted 1990 revenues, is reasonable, supported by substantial evidence and the Commission hereby adopts Staff's adjustment at Column C, Line 4, Exhibit 361.

This adjustment is reflected as an adjustment to revenues on Line 4 of Schedule E in the amount of $2,829,707.

Line 5 - Year End Revenues: Access

Staff witness Mr. Manning recommended that the test year jurisdictional access revenues be adjusted for a decrease of approximately $1 million caused by out-of-period items. He stated that the three adjustments which were responsible for this change in access revenues were: (1) reversal of a 1988 accrual not applicable to 1989; (2) recognition of a settlement concerning disputed billing which was settled out-of-period; and, (3) reversal of out-of-period Surcharge Pool revenues. Mr. Manning adjusted out-of-period activity by reversing a SWBT adjustment of a 1988 accrual made in July 1989. He stated that SWBT's adjustment had the effect of reducing the current-year revenues for the unrealized accrual from 1988. He further testified that Staff recognized the revenue, which would apply to 1989, from a four year disputed billing with AT&T, which was settled after the test year. The amount which applied to 1989 was one-fourth of the total amount. Additionally, he adjusted access revenues for Surcharge Pool revenues earned prior to 1989 in the amount of $816,785 as an out-of-period adjustment.

SWBT's witness Mr. Chicoine testified that Mr. Manning did not make year-ending adjustments to the test year access revenue. He further testified that Mr. Manning incorrectly made adjustments to the test year toll pool settlement amounts, instead of making adjustments to the billed amounts.

AG witness Brosch agreed that Staff did adjust access revenues for out-of-period accounting adjustments but noted Staff did not adjust for growth in volume of business, which was recognized by SWBT in its access revenue methodology.

Staff opposed use of the fourth-quarter multiplied by four methodology for access revenues, as recommended by the ALJ, even though using the ALJ's recommendation for calculating access revenues resulted in an increase of $197,000 to access revenue over Staff's method. Staff argued that the use of the fourth-quarter multiplied by four methodology did not incorporate all known and measurable data and that the last quarter of a year did not reflect the seasonal nature of access usage by the interexchange carriers.

The Commission has reviewed the record and finds that Staff's adjustments to access revenues are appropriate because they eliminate out-of-period activity which should be removed. Therefore, the Commission finds that Staff's adjustments shall be adopted as shown at Column C, Line 5, of Exhibit 361.

This adjustment is reflected as a reduction to revenues on Line 5 of Schedule E in the amount of $1,047,135.

Line 6 - Year End Revenues: Other

The record reflects that Staff witness Crosslin adjusted other year-end revenues, both recurring and nonrecurring, in a manner consistent with the adjustments he proposed for local year-end revenues. Having accepted Staff's rationale for its proposed adjustments to local revenues, the Commission finds that Staff's proposed adjustments to other year-end revenues are also reasonable, proper, supported by substantial evidence and shall be adopted for the reasons set forth in the discussion above at Line 3 - Year-end Revenues: Local.

This adjustment is reflected as an adjustment to revenues on Line 3 of Schedule E in the amount of $997,777.

Line 7 - Year End Wage & Nonwage

This line represents a general heading only and contains no issues to be determined by this Commission.

Line 8 - Management Survey

Staff and the AG appealed the ALJ's recommendations relating to Line 8 of Exhibit 361 - Management Survey.

Staff and the AG requested that the Commission reject the ALJ's recommendation to deny Staff's disallowance of management salaries which exceed the 75th percentile of the market. The record reflects that the ALJ recommended rejection of Staff's proposed management cash compensation adjustment, indicating that there was no basis for finding that SWBT's management compensation was excessive, imprudent or inefficient. The ALJ further found that SWBT has structured its management compensation in a manner which is consistent with the practices of the United States' largest corporations. The ALJ further stated it was inappropriate to evaluate the reasonableness of compensation on the basis of a single year's data or to accord greater weight to multi-industry rankings than to industry-specific rankings when both are available. Staff also took exception to the ALJ's use of imprudency and inefficiency as foundations for his recommendation to reject Staff's proposed adjustments. In its appeal, Staff notes that imprudency and inefficiency were not presented by the Staff as being the basis for Staff's proposed adjustment. Staff further argues that these terms do not appear in the record in this Cause and therefore cannot form the basis for the ALJ's recommendations concerning this adjustment.

Staff witness Ms. Krug testified that she made an adjustment to the salaries of management employees of SWBT based upon her review of a number of salary surveys conducted at the request of SWBT. She indicated that because SWBT is a monopoly which operates without competition, it lacks the free market competitive forces necessary to keep costs down. She indicated that for regulated industries, the regulator, which in this case is the Commission, substitutes for the competition which would be present in a free market and that the Commission may assess the reasonableness of the costs which will be recovered from the ratepayers through their rates. She indicated that she was defining the reasonable level of salaries to be those which would be received in a competitive market.

Ms. Krug explained that SWBT has defined its competitive market as the five-state region that it serves: Missouri, Kansas, Oklahoma, Arkansas, and Texas. She, therefore, did not compare the salaries of SWBT to Oklahoma-only salaries. She also indicated that she did not compare SWBT's salaries to telecommunication companies in cities such as Atlanta, New York, or Los Angeles because the levels of salaries which would come into play are different in those areas than they are in Oklahoma and in the five-state region.

Ms. Krug explained that, in her audit, she determined that local and GHQ salaries levels were recorded properly. She then reviewed the reasonableness of the level of those salaries through the use of the salary surveys that she was provided by SWBT, which compared SWBT with other companies in the market. She indicated that, based upon her review of the salary surveys, she made a 7.93 percent adjustment to reduce the salaries of management employees and a 2.31 percent adjustment to increase the salaries of senior management for ratemaking purposes. Ms. Krug testified that she applied the adjustment percentages to the total of Staff's annualized base salaries plus TEAM short-term incentives.

SWBT was critical of the adjustment proposed by Staff to senior management and management salaries, arguing that the management salaries are composed of a number of different components including both long-term and short-term incentives. SWBT's witness Troy argued that there is empirical evidence that SWBT's compensation package produces "measurable, concrete operational results that could only be the product of a highly-motivated and highly-coordinated management team."

SWBT acknowledged that, as a general reference point, the Company has a long-term objective to position its total cash compensation (base salary plus potential annual incentive payments) at a level approximating the 75th percentile of regional employers, representing a broad range of industries. SWBT argued, however, that it had no formal written policy specifying that compensation will precisely track the 75th percentile and further stated that such a policy would be inappropriate because of the inherent short-term variability of the survey data and the need to consider similarities and differences between SWBT and other industries represented in the survey group, which make it difficult to exactly hit the 75th percentile. SWBT witness Troy was also critical of Ms. Krug's reliance on a percentile ranking in relation to a diverse multi-industry group as opposed to SWBT's relation to the telecommunications industry only, because, he argued, SWBT should be a leader within the telecommunications industry, not within industry in general.

The record reflects that Mr. Troy acknowledged that the existence of higher nonmanagement wages puts upward pressure on management wages. He indicated that it was his opinion that the greatest impact would be at the lower levels of management and that nonmanagement wages would probably have minimal impact on the senior level people who authorize and approve nonmanagement wage decisions.

Mr. Troy acknowledged that SWBT has a general objective to target its compensation for management personnel at the market 75th percentile

of a multi-industry group, rather than just the telecommunications industry. He further acknowledged that he had relied upon the section of the Hay Survey which addressed the telecommunication industry and had discounted the multi-industry section of the Hay Survey which was relied upon by Ms. Krug.

During cross-examination, Mr. Troy acknowledged that he had not testified in other rate cases or public utility hearings nor had other clients hired him to consult in rate cases. He also acknowledged he was not testifying from a base of knowledge about the way compensation is treated as an item of cost of service in public utility cases. He further acknowledged that his criteria for determining the reasonableness of a compensation package generally did not include "looking at" how the public in general, benefits from the particular package.

Ms. Krug testified it would be inappropriate to consider the reasonableness of SWBT's salaries compared to those of companies in Atlanta, New York or Los Angeles because of different pay levels and other economic factors experienced in those areas, as for example, the cost of housing.

The record reflects that the ALJ properly recognized that the Commission has the authority to make adjustments to salaries for ratemaking purposes when the facts and circumstances warrant.

The Commission is mindful of the fact that SWBT is a monopoly provider of basic local exchange, intraLATA toll, and access services in its Oklahoma service territory. Therefore, the Commission must carefully scrutinize SWBT's labor expenses to determine whether the utility is paying expenses in excess of what a competitive firm could be expected to pay for the same level of services. The Commission notes that in a free market, competitive forces work to keep labor costs down, but in a monopoly environment, such as here, the possibility exists that

the utility may pay excessive wages and salaries believing that the regulator will permit those expenses to be passed on to ratepayers. (Tr. 10/9/91, pp. 23-24, 112.) Although this Commission lacks the authority to order certain salary levels for a regulated utility, in the proper case the Commission may limit the negative impact upon ratepayers of salary levels which are determined to be excessive, by adjusting downward the amounts which are included in the cost of service utilized in setting rates. In Massachusetts Nursing Ass'n v. Dukakis, 726 F.2d 41 (1st Cir. 1984); Southwestern Bell Tel. v. Ark. Public Serv. Com'n., 824 F.2d 672 (8th Cir. 1987); Wash. State Nurses Assn's v. Wash. State Hosp. Com'n., 773 F.2d 1044 (9th Cir. 1985).

The ALJ concluded that SWBT's use of incentive compensation as a component of total cash compensation was more effective than use of base salaries alone because incentive compensation requires management employees to "re-earn" the lump sum incentive payment each year. Further, the ALJ concluded that placing a greater portion of senior managers' compensation "at risk" was justified by senior management's broader decision-making authority and greater influence over achievement of financial and service objectives. Finally, the ALJ concluded that the record did not support Staff's contention that SWBT's management compensation was excessive.

We find Staff's concerns pertaining to management compensation to be meritorious but, on balance, we believe that the recommendations of the ALJ in this particular case are supported by substantial evidence. We note that although we have determined that in this case, SWBT's management compensation was not proven to be unreasonably excessive for ratemaking purposes, the Commission soundly rejects the ALJ's conclusion that management compensation was not imprudent or inefficient, as this conclusion is not supported by the record.

Notwithstanding our above-stated conclusion, it is clear to the Commission that SWBT pays salaries to management employees above the

75th percentile of the companies in the market surveys used as evidence by Staff witness Krug. The Commission believes that, based upon this finding, SWBT should strive to effectively monitor its management compensation prospectively with the objective of emulating a management salary structure consistent with that which would evolve naturally for competitive industries by balancing the economic loss from paying too much for managers with the economic loss from not attracting competent employees. Therefore, Staff should continue to evaluate the reasonableness of salaries paid by regulated utilities. In particular, as it relates to wages and salaries paid by SWBT, Staff should closely monitor and scrutinize wage and salary expenses to insure that these expenses are reasonably based upon market conditions.

Finally, the Commission finds that our decision to allow SWBT to recover the full amount of management compensation paid in this Cause should not be deemed to establish Commission policy for this company or any other regulated utility. This Commission will continue to base its determinations on these issues upon a case-by-case review of the facts.

Rejection of Staff's proposed adjustment is reflected as resulting in $0 impact to test year expenses on Line 8 of Schedule E.

Line 9- Nonmanagement Survey

The record reflects that Staff proposed an adjustment which, for regulatory purposes only, would disallow certain nonmanagement wages which occurred during the test year.

Staff witness Ms. Krug testified that she reviewed several wage surveys in her analysis of nonmanagement wages, and that she compared the total of SWBT's hourly wage for the eight composite positions contained in the Hay Survey, to the market total for the positions. As a result of her comparison, she determined that SWBT's total hourly wage was 13.26 percent above the total market 75th percentile and that the

variance for individual positions ranged from 33.33 percent above the market's 75th percentile to 8.62 percent above the market's 75th percentile. She further testified that all eight of SWBT's Hay Survey composite positions were above the market's 75th percentile and that six of the eight positions were above the market's 90th percentile, with SWBT's total average being 3.86 percent above the total market 90th percentile.

Staff in proposing its adjustment, recognized that nonmanagement wages are established through collective bargaining with the Communication Workers of America (CWA). The record reflects that a new contract was signed and became effective August 13, 1989, and the Hay Nonmanagement Survey utilized by Ms. Krug was commissioned by SWBT in anticipation of the negotiations with the union which resulted in the new contract. Ms. Krug emphasized that Staff's proposed adjustment to nonmanagement wages would not prevent SWBT from paying the contracted-for-wage levels in the future, but would only reduce the level of wages which could be recovered within SWBT's cost of service from its Oklahoma ratepayers. Ms. Krug stressed that the Commission should not be seen as interjecting itself as a party into the collective bargaining process and the Commission's decision should merely be seen as sending a signal to SWBT that in the Commission's view, the level of wages paid by the Company are higher than required by the marketplace. Ms. Krug testified that the Arkansas jurisdiction reduced the level of wages which could be passed through to the ratepayers in a 1984 rate case involving SWBT. She further indicated that in February, 1991, the U.S. Supreme Court declined to hear SWBT's request for certiorari from a decision rendered by the 8th Circuit Court of Appeals. Ms. Krug stated that the the Arkansas Public Service Commission's disallowance for ratemaking purposes of certain wages paid by SWBT was upheld on appeal.

Ms. Krug testified that because public utilities lack the automatic incentive associated with competition to provide service at the lowest possible cost, rate regulation is necessary to prevent monopoly pricing

practices which would otherwise be possible. She further testified that absent competition and regulation, there is no patent assurance that a utility's cost of service is reasonable with respect to the cost for which a competitor could and would provide the same service. She further stated that Staff has an ongoing responsibility to examine the expenditures of SWBT for reasonableness and to disallow any costs which are deemed unreasonable.

Ms. Krug testified that in addition to the 1989 Hay Nonmanagement Survey, she also reviewed the Villareal Survey and that in the Villareal Survey, SWBT's nonmanagement wages were significantly above the market average. She indicated that there was insufficient information in the Villareal Survey which would allow the Staff to make an analysis regarding the market's 75th percentile. She further testified that she used the combined craft/clerical/administrative survey results to make her adjustments to the 75th percentile of the market, because those survey results covered the entire group of nonmanagement employees. Staff suggested that disallowing the nonmanagement expenses was based upon the evidence demonstrating that these expenses were unreasonable. An exclusion from the cost of service of wages above the market's 75th percentile would not preclude SWBT from making those expenditures, just as disallowing certain forms of corporate advertising and political lobbying from the cost of service does not preclude management from continuing to make those expenditures as management deems appropriate.

SWBT argued that Staff's disallowance of nonmanagement salaries was inappropriate, because the nonmanagement wage levels were established through the collective bargaining process. SWBT also argued that the wages were as low as could reasonably be expected. SWBT witness Metz testified that the only way to determine if a level of wages is "warranted" is to determine whether a lower level of wages could reasonably be expected to be ratified by the union membership, without surrendering to other union demands which could be far more costly in the long run. Mr. Metz testified that a lengthy strike likely would

have resulted if the wages negotiated in 1989 had been at a lower level. He argued that when examining SWBT's wage levels in comparison to another company, that it was important to consider differences in average tenure. Mr. Metz asserted that because SWBT has a high average tenure, it was natural to expect higher than average actual wages.

The ALJ recommended rejection of Staff's proposed adjustment. The ALJ noted that SWBT has an economic incentive to avoid unnecessary increases in wages and salaries, even if it is assumed that the full amount of wages and salaries will be included in the cost of service, because any unnecessary increase in wages or salaries represents a reduction in profits which SWBT would otherwise be free to retain up to the point in time that rates are adjusted. The ALJ found persuasive SWBT's argument that since divestiture, wage increases agreed to by SWBT have been at the lower end of the range of increases agreed to by all of the RHC's and AT&T for the six-year period covered by the agreements. The ALJ concluded that there was no evidence presented which demonstrated that SWBT could have achieved a lower wage settlement in either 1986 or 1989 and still have obtained ratification of the contract with the CWA.

The ALJ indicated that he was sensitive to the arguments of SWBT that a reduction to the wages for nonmanagement personnel may have a "chilling" effect on future union negotiations concerning wages. However, the ALJ noted that an adjustment to the wages of SWBT's nonmanagement personnel would not preclude SWBT from paying any level of wages that it deemed to be appropriate. The ALJ concluded that adoption of a wage adjustment would not interject the Commission into the collective bargaining process, but would send a signal to SWBT regarding the appropriate level of wages to be paid for by SWBT's ratepayers.

As noted in our discussion of management surveys, SWBT is a monopoly provider of basic local exchange, intraLATA toll and access services, therefore the Commission must carefully scrutinize SWBT's labor expenses

to determine whether the utility is paying wages in excess of what a competitive firm could be expected to pay for the same level of services. In a free market, competitive forces work to keep labor costs down, but in a regulated environment, there exists the real possibility that the utility may pay excessive wages with the anticipation that the regulator will permit those expenses to be passed on to ratepayers.

The Commission, having reviewed the record in this Cause, finds that the ALJ's recommendations are reasonable and are supported by substantial evidence. However, the Commission is concerned about the potential for abuse which exists when a regulated monopoly is routinely allowed to pass 100 percent of its wage expense through its cost of service. The Commission notes that only wages which are not excessive are appropriately passed through the utility's cost of service and ultimately paid by the ratepayers. In Massachusetts Nursing Ass'n v. Dukakis, 726 F.2d 41 (1st Cir. 1984); Southwestern Bell Tel. v. Ark. Public Serv. Com'n., 824 F.2d 672 (8th Cir. 1987); Wash. State Nurses Assn's v. Wash. State Hosp. Com'n., 773 F.2d 1044 (9th Cir. 1985).

The Commission finds that SWBT pays wages to its nonmanagement employees above the 75th percentile of the companies monitored in the market surveys provided as evidenced by Staff witness Krug. The Commission believes that based on this finding SWBT should approach the bargaining process in labor negotiations with the CWA with the objective of reaching a compensation contract which emulates contracts that would evolve naturally for competitive industries by balancing the economic loss from paying too much for labor versus the economic loss from not attracting competent employees.

In order to maintain this balance, Staff should continue to review and evaluate wages paid by SWBT in future rate proceedings to insure that excessive wage expense is not borne by ratepayers. We note that our decision in this case is not precedential to SWBT or any other regulated utility. The Commission will continue to determine wage and

salary issues on a case-by-case basis and will not be bound by prior determinations.

Therefore, the Commission finds that the ALJ's recommendation is reasonable, supported by substantial evidence and is hereby adopted by the Commission for the reasons set forth above.

Rejection of Staff's proposed adjustment is reflected as resulting in $0 impact to test year expenses on Line 9 of Schedule E.

Line 10 - Signing Bonus

The record reflects that SWBT signed a three-year labor agreement on August 13, 1989, and as a result of the successful negotiations, SWBT paid each nonmanagement employee a "signing bonus." Staff recommended that this signing bonus be disallowed because it was paid in addition to wages agreed to in the contract and represented compensation above that paid for 52 weeks of job performance. SWBT argued that the Staff's proposed disallowance of the signing bonus was based upon an erroneous assumption that the signing bonus was in addition to the contractual wage increase. SWBT further argued that the signing bonus should be amortized over the 36-month life of the contract and indicated that the signing bonus was agreed to in lieu of increased base wage levels. SWBT further argued that the signing bonus was not a component of the base wages which were evaluated by the wage study. Staff maintained that if the signing bonus had been a component of base wages which were evaluated by the wage study, then the signing bonus would have been included in SWBT's wage levels, causing them to be correspondingly greater than the 75th percentile and, therefore, Staff would have adjusted them accordingly.

The ALJ found that the ratepayers received a benefit from the payment of the signing bonus because ratification of a contract meant that a strike was averted, and accordingly, there were no disruptions of telephone service, nor were costs associated with a strike incurred.

Staff and the AG appealed the ALJ's recommendation relating to the signing bonus. Both Staff and AG argued that the signing bonus paid by SWBT should not be permitted in the cost of service. Staff argued that the signing bonus was not part of base wages but, instead, was paid in addition to base wages. Staff stated that even if the signing bonus had been included in base wages, it would still recommend disallowance because the signing bonus would have increased base wages above the 75th percentile market higher than they already were.

The AG supported Staff's adjustment and emphasized that regardless of how the signing bonus was characterized, its inclusion into the test year would increase salaries to even higher levels requiring a corresponding larger downward adjustment to bring nonmanagement salaries to the 75th percentile level for ratemaking purposes. Staff also took exception to the ALJ's assertion that the signing bonus was beneficial to ratepayers because it assisted in averting a possible labor strike.

The Commission finds and the record reflects that the ALJ's recommendations with regard to the signing bonus are not supported by substantial evidence. SWBT acknowledged that there was no evidence presented which quantified any costs which would have been incurred if a strike had occurred. The Commission is unable to discern from the record how the ALJ could have concluded that payment of the signing bonus inured to the benefit of SWBT's ratepayers. Clearly, inclusion of the signing bonus in SWBT's cost of service is improper if the sole reason for inclusion is the avoidance of an event which the facts do not indicate would have occurred. The fact that SWBT contends that the signing bonus was accepted in lieu of a higher base wage increase, does not support automatic inclusion into base wages for regulatory purposes. It should be noted that the reasonableness of the expense is not premised soley upon whether or not the signing bonus was an extraordinary payment or simply part of base wages. This is especially true in light of Ms. Krug's testimony that she would have recommended disallowance even if the signing bonus was included in base wages for

the simple reason that the signing bonus would have increased base wages correspondingly greater than the market's 75th percentile.

Moreover, this Commission strongly believes that SWBT's wages are generous almost to the point of excessive, as is discussed in Lines 8 and 9, supra. Certainly, no justification exists to require the ratepayers to pay any additional SWBT compensation which would ultimately bring SWBT's wages into the 90th to 100th percentile of wages paid in this country.

Accordingly, the Commission finds that the recommendation of the ALJ shall be rejected and the adjustment proposed by Staff, supported by the AG and based on substantial evidence is hereby adopted.

This adjustment is reflected as a reduction to expenses on Line 10 of Schedule E in the amount of $414,652.

Line 11 - "Other" Wages

The record in this Cause reflects that Staff witness Ms. Krug testified she made two proposed adjustments for "other" wages, one at the local level and one at the SWBT GHQ level. Ms. Krug testified that approximately 50 percent of the proposed local adjustment represented termination payments and the remaining 50 percent represented payments for long-term incentives for senior management, and certain short-term marketing incentives, such as Key Contributor Awards (KCA). Staff allowed another short-term incentive, TEAM, up to the 75th percentile of the competitive market as discussed in Line 8.

Ms. Krug explained that approximately 50 percent of Staff's proposed adjustment for "other" wages represents payments made to employees whose employment with SWBT was terminated through attrition or as a result of various workforce reduction programs. Ms. Krug stated that ratepayers received no benefits from termination payments because the employees are

no longer performing services for SWBT. She explained that Staff therefore disallowed termination payments in SWBT's cost of service.

Mr. Troy testified that Staff misunderstood the important role termination payments play in maintaining a motivated work force and their prevalence in industry generally. He stated that SWBT's policy establishes a schedule of severance pay benefits for individual employees who lose their positions as a result of job elimination, and that SWBT recognizes that terminations which are the result of reorganization or staff reductions send a message to all remaining employees. Mr. Troy further indicated that downsizing efforts can have the unintended effect of causing the employees SWBT most wants to keep to begin looking for other jobs, which, in his opinion, could cause productivity to suffer. Mr. Troy indicated that he believed termination payments benefit ratepayers by providing SWBT with a humane approach to downsizing, while creating minimal unrest among current employees.

Mr. Metz testified that the nonmanagement termination programs, SIPP and VIPP, were negotiated by AT&T on behalf of itself and the Bell operating companies in 1977 and 1983, respectively. He further indicated that these voluntary incentive displacement plans were the prices management had to pay in order to retain the right to unilaterally determine the necessity for and extent of workforce adjustments in order to reduce employees.

SWBT also argued that termination payments should not be disallowed because each termination payment did not necessarily represent a net permanent reduction-in-force. SWBT asserted that as it implements new technology, it must frequently eliminate certain types of jobs in certain locations and replace them with different types of jobs in different locations. SWBT also argued that employees holding jobs being eliminated may be unable or unwilling to relocate and fill the new positions and are thereby entitled to contractual termination payments, even if there is no net reduction-in-force.

The ALJ found that the various payments described above do not necessarily represent an ongoing level of expense, and that it would be inappropriate to include an amount in SWBT's cost of service which may or may not be paid in the future. The ALJ also stated that in Cause No. PUD 000260, Staff disallowed $9.2 million in SIPP and VIPP payments. In the present cause, the total adjustment for all other wages is approximately $4 million and only approximately one-half is identified as termination payments for both management and nonmanagement personnel. Upon review of the record, the Commission finds that there is a great fluctuation in termination payments from year to year. Therefore, the Commission finds that Staff's proposed disallowance of termination payments are adopted.

With regard to the incentive programs Ms. Krug stated that the goals and objectives, as well as the organizational structure of individual companies, influence the level of long-term incentives paid as well as the method of payment. She noted there are two basic types of plans, both of which may or may not include stock options, and that these factors inhibit comparison of one company's plan to another. She further stated that absent a comparison, that there is no way to evaluate the reasonableness of such plans or the levels of payment made between various companies.

Ms. Krug stated that based upon her review of various studies, she determined that long-term incentives were less prevalent in the market place. She referred to one study, which had been provided to her by SWBT and indicated that she had not based her position solely on that survey. She testified that particular survey showed 95 percent of chief executive officers (CEOs) in the survey were eligible for short-term incentives while only 74 percent were eligible for long-term incentives. She testified that the prevalence of long-term incentives to other officers would be less. Ms. Krug also testified that she was not able to compare long-term incentives to the local market because they were

not included in the surveys which specifically compared SWBT to the market.

During cross-examination, Ms. Krug noted that SWBT witness Troy represented that the long-term incentives were based on net income and stock prices. She testified that these incentives were of more benefit to the stockholders, unlike short-term incentives, which were based on a weighting of financial performance and customer service and provide a benefit to the ratepayer.

Mr. Troy argued that Staff's disallowance of the long-term incentive plan for senior managers was based on an erroneous assumption about the prevalence of such plans in the industry generally and a failure to recognize the important role a plan plays in the overall compensation package. It was his testimony that a long-term incentive plan was a crucial element in any executive compensation plan because it causes senior management to think strategically by establishing a balance between long-term business goals. Mr. Troy stated that the function of a long-term incentive plan is to create a financial incentive for senior management to resist short-term financial gain at the expense of the long-term health of the company. He explained that long-term incentive plans are generally limited to senior management because only senior level managers have the ability to provide strategic direction over the long-term. It was Mr. Troy's opinion that SWBT offers a comprehensive total compensation program that properly motivates management to achieve appropriate objectives in a cost effective manner while maintaining the essential balance between potentially competing objectives.

Mr. Troy also stated that the features of the program are indicative of a well-conceived and reasonable compensation package and are fully consistent with compensation practices of well-managed companies. Further, he stated that a study he reviewed indicated that approximately 90 percent of the top 200 companies have stock option programs and that approximately 50 percent of those have performance-based, long-term

incentive programs. Mr. Troy further indicated that the value of SWBT's long-term performance plan is determined in part by the level of net income achieved and in part by stock price, and that this type of plan is typically selected by companies who believe it is important to balance internal operating results with appreciation in stock price.

Mr. Troy testified that he reviewed six surveys which were most relevant to the salary issues before the Commission. He indicated that he found the overall aggregate cash compensation levels of SWBT's senior management positions to be fully competitive and completely reasonable with the competitive data that he reviewed. On cross-examination, Mr. Troy acknowledged that the long-term incentives were based on financial performance instead of customer satisfaction and that he did not view the financial performance basis as a deficiency in the long-term compensation plan.

The ALJ found that long-term incentive plans were prevalent in the industry and should be allowed as reasonable based upon the evidence presented in this cause. The ALJ also found that a comparison of long-term incentives should be made for future ratemaking purposes, in view of the fact that Staff stated that it could not make a comparison of long-term incentives.

A review of the record reflects that the findings and conclusions of the ALJ are reasonable and are supported by substantial evidence. The Commission notes that the ALJ did not make an express determination with respect to Staff's disallowance of the KCA short-term incentive. However, the Commission believes that the KCA incentive should be recognized consistent with the ALJ's recommendation and this Commission's finding with respect to another short-term incentive, TEAM, as discussed in Line 8. Therefore, the Commission finds that the recommendation of the ALJ relating to long-term incentives are hereby adopted.

Cash Incentive and Nonmanagement Awards

The record reflects that Staff appealed the ALJ's acceptance of the sales incentives awarded to employees who achieved sales objectives. SWBT argued that the sales incentives disallowed by Staff, were awarded to employees who achieved sales objectives which were designed to generate revenues. SWBT further argued that the cost of generating these additional revenues was more than offset by the incremental revenues produced. SWBT provided examples of the type of payments made in 1990 and the ALJ recommended inclusion of the payments.

The Commission has reviewed the record and finds that there is no evidence in the record which would support the conclusion that the amount recommended by the ALJ is representative of the amount of the incentives paid during the 1989 test year nor of the existence of such programs and any related payments during the time that rates established in this Cause will be in effect. The Commission finds that because such programs could vary dramatically from year to year, depending upon new services offered and other objectives of SWBT's marketing strategies, that the uncertainty of such programs on a " going forward" basis make them inappropriate for adoption in this proceeding. Therefore the Commission rejects the ALJ's recommendation and adopts the adjustment proposed by Staff.

Cola Payments

The Company argued that Ms. Krug's proposed disallowance of other wages included cost-of-living-allowance (COLA) payments. Mr. Metz testified that COLA is a bargained item which can only be removed or modified pursuant to a union agreement.

The record reflects that there is no evidence concerning whether COLA payments were included in base wages in the survey, nonetheless the ALJ found that COLA type payments were prevalent and, therefore,

distinguished these payments from "signing bonuses". The Commission finds and the record reflects that the recommendation of the ALJ with regard to COLA payments is based upon substantial evidence and is hereby adopted.

Nonmanagement Retroactive Wages

The record reflects that SWBT witness Chicoine stated that Staff removed the payment of nonmanagement retroactive wages from the test year. He explained that the retroactive wages were paid to nonmanagement employees as a result of the lag between the signing of the 1989 union contract and the time the payroll system incorporated the new rates. The record reflects that SWBT witness Chicoine stated that Staff appropriately adjusted retroactive wages out of the test year. The Commission finds that no disagreement exists between the parties concerning this adjustment and that the adjustment proposed by the Staff is based upon substantial evidence. Therefore, the adjustment is hereby adopted by the Commission.

GHQ Management and Nonmanagement Wage

The record reflects that Staff witness Krug explained that due to the method used to identify GHQ "other" salaries and wages, that amounts of the specific types of such payments were not available. Therefore, the amount known to be TEAM incentives was deducted and the remaining amount was disallowed.

The method used to determine GHQ management and nonmanagement wages and each group's basic overtime and other wages, will be discussed in Section E which relates to Non 361 Issues. Ms. Krug testified that due to this method, which the ALJ has found to be inadequate, the amounts of all specific types of other wages were not available. The Commission has reviewed the record and finds that Staff's proposed adjustment to disallow GHQ "other" wages is based upon substantial evidence and is hereby adopted.

The net adjustment to other wages is reflected as a $2,833,214 reduction to expenses on Line 11 of Schedule E.

Line 12 - Annualized Wages and Salaries

SWBT experienced wage and salary increases during 1989. Because these changes occurred during mid-year, an adjustment is required to annualize the full test year effect.

SWBT annualized wages and salaries using fourth-quarter wages times four and adjusted for end-of-period employee levels. The record reflects that Staff used December wages times twelve and that the AG used 1989 book results but adjusted for the mid-year wage changes.

The ALJ found that Staff's approach did not correctly recognize all changes. SWBT argued that December, 1989 had only 21 work days and therefore less paid days than the other months within the same year. The ALJ concluded that Staff's use of the December times twelve methodology understated the annual wages for the test year.

The ALJ found that SWBT's fourth-quarter-times-four approach to annualizing wage and nonwage test year results was reasonable and supported by substantial evidence.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as an adjustment to revenues and expenses on Line 12 of Schedule E in the amount of $133,575 and $777,316, respectively.

Line 13 - Annualize Nonwage Expense

The record reflects that SWBT made an adjustment for year-end payroll taxes and benefits to restate payroll taxes and benefits charged to intrastate expense during 1989 to the level of SWBT's Oklahoma employees at the end of the test year. SWBT represented that the amount of this adjustment was determined by developing a monthly average of payroll tax and benefit expenses per employee during the fourth quarter of 1989 and annualizing these amounts based on the number of employees as of December 31, 1989. SWBT made an adjustment to reflect alleged known and measurable increases to SWBT's nonwage expenses deflated by the Gross National Product Implicit Price Deflator (GNP-IMPD). This represented an increase of about 1 percent over mid-year actual expenses. No other parties proposed or supported this adjustment.

After reviewing the record, the Commission finds that SWBT's proposed adjustment is without merit. SWBT failed to meet the burden of proving that the price of goods and services consumed by SWBT during the test year were, in fact, directly related to this external national index. The Commission further finds that it is far more reasonable to keep such expenses at test year levels for ratemaking purposes than to rely upon a speculative and untested method for a nonwage annualization.

The Commission notes that the purpose of a pro forma adjustment is to recognize known and measurable changes which will occur outside the historical test year. The use of the GNP-IMPD does not satisfy the requirement for a known and measurable change. Instead, the use of this deflator has the effect of changing SWBT's historical test year into a future or budgeted test year. Because all other adjustments in this Cause were based upon a historical test year, it would be inappropriate to mix concepts, in this case mix a historical test year with a future test year, and therefore finds that the adjustments shown on Line 13, Columns B, E, and G of Exhibit 361 shall be and they are disallowed.

The Commission decision rejects SWBT's proposed increase in test year expenses which is reflected on Line 13 of Schedule E as $0.

Line 14 - Payroll Taxes

Staff adjusted payroll taxes to reflect Staff's adjustment regarding wages and salaries to the 75th percentile of the market. SWBT acknowledged that to the extent wages and salaries are changed, either upward or downward, payroll taxes should change as well. The record reflects that both Staff and SWBT adjusted payroll taxes to reflect the 1990 Federal Insurance Contribution Act (FICA) changes and to reflect the change in toll pool revenue due to this increased expense. The ALJ found that adjustment to payroll taxes should be made to reflect wage and salary adjustments.

The Commission notes that although Staff did not appeal this adjustment, Staff in its appeal indicated that the adjustment illustrated on Staff Exhibit 436 for payroll taxes did not reflect Staff's recommended adjustment to payroll taxes. Staff emphasized that the level of payroll taxes included in this Cause should be based upon the final level of wages and salaries determined to be appropriate by the Commission once all wages and salary adjustments have been considered.

The Commission has reviewed the record and finds that the recommendation of the ALJ with respect to payroll taxes is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by the Commission.

While the Commission adopts the recommendation of the ALJ, we find merit in Staff's suggestion that the level of payroll taxes should be based upon the final level of wages and salaries. The Commission finds that adoption of Staff's suggestion is necessary to properly reconcile this adjustment. Therefore, in this regard only, Staff's position to

base the payroll taxes level on the final wages and salaries level is adopted.

This adjustment is reflected as an adjustment to expenses on Line 14 of Schedule E in the amount of $332,043.

Lines 15 and 16 - Pro Forma 1990 Nonmanagement Wages and Management Salaries

Staff opposed an adjustment for 1990 wage and salary increases, arguing that the increases occurred beyond the end of the test year. Staff recognized that the salary rate increases were known and measurable, but argued that a reliable count of the number of employees was not available to permit an accurate computation of the amount of the total wage and salary increase. Staff argued that it would be unfair to include wages and salaries as an increased expense when the actual level of expenses after 1989 could not be computed. The AG argued that SWBT's adjustment for 1990 salary increases was inappropriate because the Company's adjustment resulted in a test year mismatch among revenues, expenses and rate base. The AG also argued that SWBT's proposed adjustments did not reflect an ongoing level of salary and wage costs in the 1989 test year.

AG witness, Mr. Carver sponsored Exhibits 323, 323a, Schedule C-7, to reflect an ongoing level of salaries and wages in SWBT's cost of service. His schedules rejected two adjustments proposed by SWBT which would have improperly taken into account two selective post-test year events, the management and nonmanagement salary increases effective in April and August, 1990, respectively. Mr. Carver's reason for rejecting these adjustments was that subsequent to the test year, SWBT's employee levels also continued to decline, a decrease not recognized in SWBT's proposed annualization. Mr. Carver testified that the SWBT proposed annualization represented an inappropriate, piecemeal approach which incorporated certain post-test year factors that increased costs, (i.e. pay raises,) without considering other items that decreased costs, (i.e., a decline in employee levels.)

The record reflects that Mr. Carver tested the reasonableness of his adjustments by annualizing payroll costs based on early 1991 employee levels and salaries and wages. Mr. Carver concluded that his analysis demonstrated that the cost effect of the post-test year decline in SWBT employee levels offset the 1990 salary and wage increases. Mr. Carver did not reflect the post-test year changes in employee levels and wages in his annualization adjustment. Rather, his Schedule C-7 reflects the wage rates and employee levels actually experienced as of the end of the 1989 test year. The record reflects that Mr. Carver prepared SCC-6 to show that SWBT's attempted annualization was flawed, because SWBT attempted to move outside the test year for wage levels, but ignored post-test year changes in employee levels. (Exhibits 137, 137a, Carver prefiled testimony pp. 51-59.)

The Commission finds that the wage and salary increases, which SWBT argues should be included, occurred beyond the end of the test year and their exclusion is consistent with the Commission's policy of adhering to the test year, except as noted in our discussion of attrition adjustments, infra. Additionally, the Commission finds that based upon the testimony of Staff, the AG and SWBT, employee levels have declined from 1989 until 1991. Therefore, the Commission finds that the opportunity does not exist to accurately compute the ongoing wage and salary levels of SWBT, which is a requirement prior to making an adjustment for a known and measurable change which occurs beyond the test year. Consideration of a wage and salary adjustment based solely on pay levels, without consideration of changes in the number of employees, considers only one-half of the equation. Accordingly, the Commission finds that SWBT's proposed adjustment for 1990 wage and salary increases shall be rejected. The Commission further finds that the decision relating to any toll pool impact of the Company's proposed increase in wages and salaries shall be consistent with the treatment of the wage and salary adjustment proposed by SWBT. Therefore, the Commission rejects SWBT's proposed wage and salary adjustments as shown in Columns B and E of Lines 15 and 16 of Exhibit 361.

The Commission rejects the adjustments proposed by SWBT and reflects a $0 impact on expenses on Lines 15 and 16 of Schedule E.

Line 17 - Year End Depreciation & Represcription

The Commission has reviewed the record and finds that the recommendation of the ALJ with respect to year-end depreciation and represcription is supported by substantial evidence, is reasonable, was not appealed by the parties and is therefore adopted by the Commission as set forth below.

The record reflects that as the result of the triennial three-way meeting among the FCC, the Commission and SWBT, new depreciation rates were prescribed beginning January 1, 1990. These new rates reduce SWBT's operating expenses in Oklahoma.

The ALJ found that the use of current depreciation rates, (those being the depreciation rates in effect January 1, 1990, pursuant to FCC Order 90-44,) should be adopted by the Commission as appropriate depreciation rates for SWBT-Oklahoma for intrastate operations. The level of depreciation and represcription expense set forth in Column C and Column F of Line 17 of Exhibit 361, as discussed later, is the result of these depreciation rates being applied. The ALJ found that these amounts were a reasonable quantification of the the year-end depreciation and represcription expense, and of the end of the reserve deficiency amortization adjustments.

The record reflects that Staff, SWBT, and the AG are basically in agreement on this issue. The Commission notes that there is a difference in the expense adjustment amounts on Line 17 between Staff and SWBT. However, in reviewing Exhibit 361, the Commission also notes a similar variance at Line 23, Improved Mobile Telephone Service (IMTS) and at Line 40, End of Inside Wire Amortization. The total of the three lines is basically the same between Staff and SWBT. It appears that the

only difference is the way depreciation expense is distributed between the three lines. The record reflects that the adjustment is premised upon substantial evidence and no disagreement exists between the parties, therefore, the Commission accepts the adjustment proposed by Staff at Line 17 of Exhibit 361 because both SWBT and Staff used the represcription rates which became effective on January 1, 1990.

This adjustment reflects a decrease to revenues and expenses on Line 17 of Schedule E in the amount of $522,735 and $4,496,324, respectively.

Line 18 - Gross Receipts Tax

Gross receipts tax is assessed and paid by SWBT on specific items of local revenues. The record reflects that Staff adjusted gross receipts tax to correspond with their pro forma local revenue level, by applying a ratio of gross receipts tax to total intrastate revenue. SWBT established through testimony that consumer gross receipts tax is more appropriately year-ended with a ratio of local revenue. Neither the Staff nor the AG rebutted SWBT's evidence on this issue. The ALJ found SWBT's proposal for gross receipts tax to be reasonable and supported by substantial evidence.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as a reduction to expense on Line 18 of Schedule E in the amount of $13,145.

Line 19 - Lobbying Expense

The amount contained on Column F of Line 19 of Exhibit 361 is a combination of three Staff adjustments. Staff, in Adjustment No. 4,

Section H, Schedule 3, Exhibit 363, disallowed the cost of the Oklahoma lobbyist, asserting that it was Commission policy to disallow lobbying expense. Additionally, in Adjustment No. 7, Section H, Schedule 3, Staff disallowed 45 percent of the United States Telephone Association (USTA) dues because Staff had analyzed the USTA expenses and determined that 45 percent of the USTA dues are for lobbying. Staff, in Adjustment No. 14, Schedule KM-1, also disallowed all of the cost relating to SBC-Washington, Inc., an organization which performs federal regulatory advocacy duties. Staff stated that it disallowed the federal regulatory expenses because these amounts should properly be charged to the FCC jurisdiction. Staff also stated that the federal advocacy expenses were lobbying costs which were disallowed in accordance with the previously-stated Commission policy.

SWBT disagreed with the Staff's adjustment to disallow SBC-Washington expenses and argued that the Staff had removed not only SBC-Washington lobbying expenses but all other nonlobbying expenses incurred by SBC-Washington as well. SWBT also argued that the portion of SBC-Washington expenses which were allocated to the Oklahoma intrastate jurisdiction were assigned pursuant to the separations manual prescribed by the FCC, based upon recommendations from a federal-state joint board. SWBT argued that it was legally obligated to follow the separations manual and had no means to recover the intrastate allocation from the FCC jurisdiction as proposed by Staff. SWBT recommended that if the Commission believed that the interstate jurisdiction should bear all or a greater portion of federal regulatory expense, then the Commission should petition for a change in the separations manual.

The ALJ found that any changes to the separations manual must be made by petitioning the FCC. SWBT suggested that the Commission should take this action. The ALJ disagreed, recommending that SWBT, and not this Commission, should petition the FCC. The ALJ therefore recommended that Staff's adjustment be adopted and that the regulatory expenses which Staff recommended, be charged to the interstate jurisdiction.

SWBT stated that there were several organizations with which SBC-Washington maintains contact, National Association of Regulatory Commissions (NARUC), USTA, Federal Accounting Standards Board (FASB) and the FCC. SWBT indicated that all of these organizations are involved in local/state issues, but failed to explain what those issues are and how they may benefit the Oklahoma ratepayers. Absent such an explanation, it appears that one could easily envision contacts with organizations such as NARUC as being beneficial to the industry, rather than the ratepayers, by virtue of presenting industry positions to NARUC. The record reflects that the Company did not dispute the disallowance of 45 percent of USTA dues as for lobbying expenses.

The ALJ found that the Company failed to show that the costs which it described as the SBC-Washington nonlobbying expenses benefit Oklahoma ratepayers. SWBT witness Flaherty admitted that his group did not perform any analysis to determine if the interstate versus the *intrastate, or even the state-to-state allocations, were reasonable.*

The record reflects that the purpose and objective of Staff's audit was to evaluate the costs and charges to Oklahoma ratepayers and Staff concluded that these costs allocated by SWBT to Oklahoma intrastate ratepayers did not benefit the Oklahoma ratepayers. The ALJ found no specific evidence to the contrary and therefore adopted the Staff's adjustment set forth in Column F, Line 19 of Exhibit 361.

A review of the record shows that the recommendations of the ALJ are supported by substantial evidence. Therefore, the Commission finds that Staff's adjustment set forth in Column F, Line 19 of Exhibit 361 is adopted by the Commission.

This adjustment is reflected as a reduction to expense on Line 19 of Schedule E in the amount of $624,128.

Line 20 - Inclusion of Nonregulated Services

The ALJ recommended adoption of the AG's position that FCC nonregulated services be treated above-the-line for ratemaking purposes, but that additional revenues be imputed so that the nonregulated services contribute the same return authorized for regulated services. The ALJ reasoned that through adoption of this adjustment, ratepayers of regulated services would not be forced to subsidize SWBT's provision of FCC nonregulated services to Oklahoma customers. In support of this adjustment, the ALJ found that the FCC nonregulated services operated at a loss during the 1989 test year in Oklahoma. The record reflects that the FCC order issued in Docket No. 86-111 (Exhibit 332) employed the fully-distributed cost method as the appropriate mechanism to discourage carriers from subsidizing the costs of nonregulated services by shifting nonregulated costs to regulated activities, and to assure that ratepayers would share in any efficiencies generated from joint use of the network by nonregulated activities.

The record reflects that the fully-distributed cost method assures that services recover their indirect as well as direct costs and thus protects ratepayers. SWBT prepared a Cost Allocation Manual (CAM) which assigned costs consistent with the FCC methodology and, in approving SWBT's CAM, the FCC specifically noted that the methodologies contained therein would discourage cross-subsidy. SWBT's internal operating practices recognized that the FCC cost allocations ensure that there is no cross-subsidy between SWBT's regulated telephone business and any nonregulated business activities. The record reflects that when common, overhead and direct costs are allocated to FCC nonregulated services, consistent with the FCC's costing methodology, those services operated at a loss during the test year thus increasing revenue requirements for customers of regulated monopoly services.

In view of the foregoing substantial evidence, and based upon our review of the record, the Commission adopts an adjustment, for

ratemaking purposes, which imputes the additional revenues to the FCC nonregulated services so as to generate an above-the-line return on investment, or net operating income, equivalent to the authorized level targeted for regulated services. The Commission finds that adoption of this adjustment will protect customers of regulated services from subsidizing nonregulated services. The Commission notes that adoption of this adjustment is also equitable to SWBT, for if in the future, the FCC nonregulated services earn in excess of the return required for regulated services, then SWBT and its shareholders would retain all profits above the level of the regulated return.

These adjustments are reflected as adjustments to revenues, expenses and rate base on Line 20 of Schedule E in the amounts of $9,425,000, $8,564,000, and $5,759,000, respectively.

Line 21 - Maintenance of Service Charges (MSC)

The record reflects that Staff witness Buck testified that maintenance of service charges MSC generally relates to trouble calls, regulated or nonregulated, and how they are reported. Except for Yellow Pages (YP), Staff excluded revenues, expenses, and investments attributable to FCC deregulated services. Staff argued that to the extent deregulated services earn less than the allowed rate of return for regulated services, the deregulated services would create the need for additional revenue requirements from regulated services if the cost of service for deregulated services were incorrectly included with the regulated services cost of service. This would require SWBT's regulated customers to fund losses attributable to FCC deregulated services. Mr. Buck testified that the FCC deregulated services earned less than the allowed rate of return for regulated services in Oklahoma during the test year ending December 31, 1989. Mr. Buck indicated that including the cost of service for FCC deregulated services above-the-line would result in a subsidization of those services by the regulated customers. On cross-examination, Mr. Buck acknowledged that if there were

subsidization, it would result because the tariff rate set by the Commission was not sufficient to cover the costs.

SWBT argued that MSC is a regulated service in Oklahoma which is deregulated for interstate purposes, so the revenue, expense and rate base elements are excluded from the jurisdictional separations process. SWBT argued that in order to comply with the General Exchange Tariff on Service, (Order No. 306994), an adjustment to include MSC in intrastate computations was made by SWBT. SWBT argued that the FCC rules are applicable to equipment beyond the network interface, but that the Commission requires this same service as part of SWBT's Oklahoma operations. SWBT argued that prior to divestiture, the same type of service was included in regulated services.

The ALJ recommended that revenues and expenses of MSC should be included in SWBT's intrastate cost of service. Staff urged the Commission to reject the ALJ's recommendation because inclusion of the revenues and expenses of MSC in SWBT's intrastate cost of service offers SWBT the opportunity to make a double recovery of any current operating losses generated by this activity. Additionally, Staff argued that the ALJ's recommendation unfairly promotes SWBT's position in an otherwise competitive market for customer premises equipment repairs. Staff also requested that the Commission remove MSC charges from SWBT's Oklahoma tariff in recognition of the recommended treatment of revenues and expenses.

The record reflects that the ALJ acknowledged that the earnings from providing MSC were less than the allowed ROR on the investment for these services in Oklahoma during the test year ending December, 1989. The result of this inclusion of these FCC deregulated services above-the-line will result in a subsidization of the investment for these services by the ratepayers of SWBT's regulated telephone operations. Although the ALJ recommended that one way to limit subsidization would be to increase the tariff charge for the FCC

deregulated service, the ALJ overlooked the fact that SWBT is only one of many potential providers of this service. It is clear to the Commission that SWBT would lack any incentive to request an increase in the approved tariff rate for providing these services, as long as the associated expenses were included in SWBT's approved rates, because any higher tariffed rate would lessen SWBT's competitive advantage in the MSC market. The Commission notes that if any resulting loss from MSC is subsidized by SWBT's general rates, as would result under the ALJ's recommendation, then the lack of incentive to increase the tariffed rate would be reinforced.

The Commission notes that the evidence in this Cause established that MSCs were provided at a loss during the test year. If SWBT applied to have these rates increased as recommended by the ALJ, while having this operating loss recovered through its future rates established in this Cause, as also was recommended by the ALJ, then SWBT could earn a double recovery of the current MSC operating deficit.

Therefore, the Commission finds that the recommendation of the ALJ must be rejected. We find that Staff's exclusion of MSC from the cost of service is appropriate because this service has been deregulated by the FCC and the nature of the tariffed service trips is to maintain deregulated services. The Commission recognizes that this will disallow the revenues for services such as In-line, but also believes that this treatment will protect the ratepayers from possible subsidization caused by situations where the tariffed rates for MSC deregulated services do not meet the costs of providing the service. As noted earlier, this is an area where SWBT is one of many potential providers of this deregulated service and if the tariffed rates do not recover the cost of providing the service, then SWBT should consider adjusting these rates. The Commission likewise finds that the argument of SWBT and the conclusion of the ALJ that removal of this service is inconsistent with the treatment proposed by the Staff for YP are not supported by the record and are without merit. Inclusion of the cost of service from YP

is expressly authorized by the Modified Final Judgment (MFJ) U.S. v. AT&T, 552 F.Supp. 131, (D.D.C. 1982), aff'd 460 U.S. 1001 (1983). There is no comparable authority for inclusion of the revenues and expenses associated with MSC.

The distinction between any treatment given to the YP operations and MSC is that the inclusion of YP revenues is specifically authorized by the MFJ, whereas the exclusion of MSC operations is based upon the evidence presented in this Cause regarding the specific facts of the MSC operations. This evidence has demonstrated that the MSC service is a FCC deregulated service offered in a competitive market. The charge for MSC by SWBT should not be subsidized by captive SWBT customers in order to allow a monopolistic advantage over other competitors of SWBT for MSC.

Therefore, the Commission finds that Staff's adjustments to revenues, expenses, and rate base, as set forth in Columns C, F and I, respectively, on Line 21, Exhibit 361, are adopted by the Commission in this Cause. The Commission notes that because these amounts were not included in SWBT's books and records at test year end, no actual adjustment will need to be made.

This adjustment is reflected on Line 21 of Schedule E. Because the Commission's decision excludes the test year MSC revenues and expenses from SWBT's cost of service, the adjustment results in $0 impact on this line.

Line 22 - Imputation of Yellow Pages Operations

The Commission, consistent with its practice in prior post-divestiture rate proceedings, reaffirms its legal authority to impute into the revenue requirements determination of SWBT for ratemaking purposes, the operations of the YP subsidiary of Southwestern Bell Publications, Inc., a subsidiary of SBC. The Commission recognizes

that the MFJ authorized state regulatory commissions to impute YP revenues to SWBT's operations to reduce revenue requirements for regulated local exchange service. AT&T, supra, at 194. Further, the Commission rejects SWBT's apparent claim that the Commission is bound to accept the YP income and expenses as booked and may not make appropriate adjustments for ratemaking purposes. We note that prior to divestiture, when YP revenues and expenses were recorded on the books of the regulated telephone company, the Commission often made adjustments to YP operations for ratemaking purposes. (Exhibit 185, Buck Rebuttal, p. 11). The fact that SBC's management, without prior Commission approval, made a discretionary business decision to place its YP operations in a separate subsidiary, does not insulate YP from a full audit and does not preclude the Commission from making adjustments that are reasonable for ratemaking purposes. The Oklahoma Supreme Court has recognized the Commission's continuing authority to make adjustments to YP for ratemaking purposes. See, Turpen v. Corporation Comm'n, 769 P.2d 1309, 1327 (Okla. 1988).

The record reflects that at the hearing before the ALJ, Staff contended that YP was part of the telephone company's operation prior to divestiture, at which time it was spun-off without the knowledge or permission of the Commission. Staff believed that YP is an affiliated entity with SWBT and its investment, revenues and expenses directly impact this Cause. Staff pointed out that the MFJ specifically notes that the directory operations were to remain with the operating companies, with YP's net contribution available to support local service. Therefore, Staff contended that the investment, revenues and expenses of YP needed to be imputed to SWBT as they have been in previous cases.

SWBT in its responsive testimony, took issue with Staff's adjustments to YP's rate base, revenues and expenses. SWBT contended that in previous cases, Staff accepted the book numbers of YP for imputation purposes. According to SWBT, pro forma adjustments and

revenue requirement methodology are not applicable to an unregulated entity which operates in a competitive environment and that such pro forma adjustments distort the imputation process. Furthermore, SWBT contended that the books and records of YP are kept according to GAAP, are closely audited and controlled and any adjustments are unnecessary and improper. SWBT argued that because YP operates in a competitive environment, it has no incentive to incur unreasonable or unnecessary costs. On rebuttal, Staff argued that if it did not have the opportunity to quantify its findings and make adjustments, then the audit process of YP is rendered meaningless. Furthermore, Staff argued that there was no requirement to accept and use YP booked amounts without adjustment. Finally, Staff stated that the use of its revenue requirement methodology was necessary to prevent cross-subsidization of the competitive sector by the regulated sector. SWBT also argued that the Oklahoma Supreme Court's decision in the Turpen case specifically recommended that Staff concentrate its audit efforts on payments to affiliates due to its limited resources. SWBT asserted that the Turpen case did not mention auditing the revenues received from affiliate-

Initially, the Commission notes that in Cause No. PUD 000260, Order No. 341820, the Commission adopted the Report of the Hearing Officer as follows:

> . . . [t]he Commission should order SWBT to make all YP books and records, and accounting and other YP staff, available to the Commission Staff for a complete evaluation of YP operations and the contribution levels from those operations to the Oklahoma ratepayers.

The Commission further notes that in the opinion issued by the Oklahoma Supreme Court in No. 66,038 regarding General Cause No. 29321, the Court stated:

> "[t]hroughout the United States it is recognized that a public utility's dealings with affiliates require thorough investigation and close scrutiny by a public utility commission."

The record reflects that SWBT did not cite any specific source to support its contention that Staff's adjustments to YP were unnecessary or improper. The Commission finds that it is not only the intercompany charges, such as those between Gulf Printing (Gulf) to YP and YP charges in turn to SWBT, which must be considered, but due to the imputation process, it is also the level of all revenues and expenses of YP which is at issue. Furthermore, it should be noted that SWBT, in considering the Turpen decision, apparently misconstrued the meaning of "payments to affiliates". At page 1321, that Court states:

> "At issue here is whether there is substantial evidence that the Commission sufficiently investigated 1) the prices charged to or by SWBT affiliates for goods and services and 2) the allocation of expenses by SWBC to SWBT and by SWBT to Oklahoma ratepayers. For purposes of brevity these expense items will hereafter be referred to as 'payments to affiliates'."

It is manifest to this Commission that the issues to be considered are not limited to actual payment transactions between affiliated companies, but also include the allocation and/or imputation of all expenses.

The Commission finds that Staff's investigation of YP and the concept of making adjustments based on that investigation are proper. The adjustments themselves will be considered individually by this Commission on their own merits below. Furthermore, the Commission finds that Staff's revenue requirement methodology is proper and necessary in order to properly synchronize the investment, revenues and expenses in the imputation process.

YP Rate Base

(a) cash working capital

The ALJ recommended the lead/lag methodology proposed by Staff as the appropriate methodology for the determination of the YP cash working

capital requirement for regulatory purposes. Staff's method is preferable to that sponsored by SWBT. SWBT's proposed cash working capital calculation method, current assets minus current liabilities, may reflect its liquidity in the financial sense but does not correctly quantify the cash working capital requirement for regulatory purposes. While SWBT criticized Staff's proposal for use of the midpoint of the life of the directory in the calculation of the revenue lag, SWBT overlooked the fact that Staff used the same midpoint criteria to measure expense lead days. Thus, Staff's lead/lag methodology, by treating revenues and expenses consistently, did not distort the cash working capital requirements for YP operations.

The record reflects that with regard to the appropriate level of cash working capital for YP, the ALJ agreed with Staff's position that cash working capital should be established based upon a lead/lag study. The ALJ noted that the Commission has previously found the lead/lag study to be the preferable method of determining cash working capital. The ALJ further concluded that cash working capital should measure the need for working funds, rather than the existence of those funds, and that the criteria in determining lead and lag periods for both revenues and expenses should be consistent. The ALJ determined that Staff's position accomplished this consistency, whereas SWBT's position concerning the measuring point for revenue lags would result in employing inconsistent criteria in the lead/lag study.

(b) <u>deferred income taxes related to bad debt expense</u>

The ALJ also recommended adoption of Staff's rate base reduction of $4,685,476 for accumulated deferred income taxes. This amount represents the difference between the calculated amount of accumulated deferred income tax, less one-half of the excess accumulated deferred income tax portion and the accumulated deferred income taxes per book. The excess deferred income tax balance relates to the recognition of the

timing difference from YP previous use of the cash method of accounting for bad debt expense per book and the accrual method for income tax purposes, and represents the balance that should have been left over and returned to the ratepayers as credits to income tax expense after the timing differences expired on December 31, 1989.

The record reflects that YP apparently had written-off the balance of excess accumulated deferred income taxes, credited retained earnings and, therefore, there was no book balance at the end of the test year. The ALJ concluded that this excess belonged to the ratepayers because ratepayers had originally funded the deferred income tax balance through normalized treatment of income tax expense. In addition, the ALJ agreed with Staff's current treatment of deferred income taxes related to bad debt expense because utilization of the write-off method for computing income tax by Staff was consistent with the method currently required by the IRS. The ALJ noted that both Staff and the IRS required the actual write-off or cash basis method for computing income taxes. The ALJ concluded that since there was no timing difference, presently, between the treatment by Staff for ratemaking purposes and the treatment required by the IRS for income tax purposes, then there was no need for deferred income taxes related to bad debt expense. The ALJ recommended that Staff's adjustment to deferred income taxes related to bad debt expense and excess accumulated deferred income taxes be adopted.

(c) <u>Other</u>

The record reflects that with regard to the rate base of YP, the ALJ adopted Staff's proposed adjustments to: (1) remove works of art from plant in service; (2) decrease accrued accident and health insurance; (3) decrease deferred rental expense; and, (4) decrease deferred compensation.

Adjustments To Revenues

The record reflects that Staff made the following adjustments to the revenues of YP:

Exclude interest income	$ (675,061)
Correct allocation to Oklahoma	336,847
Correct NYPS late fees	13,280
Include foreign directories	761,080
Annualize local revenues	5,437,141
Include license royalties	74,994
Reclassify WPPA revenues	0
Adjust for uncollectibles	24,512
Total Adjustment	$5,972,793

Staff included Oklahoma's allocated share for foreign directories revenues, which are presently booked by World Wide Directory Products (World Wide), stating that the inclusion allows the Oklahoma ratepayers to benefit from the sale of foreign directories. Staff imputed the expenses related to foreign directories as well. SWBT disagreed with this adjustment and argued that World Wide's present foreign directory operations are much larger than those of the Oklahoma YP operation prior to divestiture. They also stated that the associated costs are already included in SWBT's cost of service and that the imputed revenue and expenses from World Wide had nothing to do with SWBT's Oklahoma operations.

The ALJ found that Staff's imputation of revenues and expenses related to foreign directories was proper because such sales are an integral part of directory operations. The ALJ noted that it is the Oklahoma ratepayers who make possible the existence and sale of such foreign directories because it is their telephone numbers which comprise the directories. Therefore, he concluded that there was no reason not to give the ratepayers the benefit of the sales. The ALJ further found that SWBT's assertion that the sales of World Wide have nothing to do with SWBT operations was without merit.

Additionally, Staff annualized local YP revenues based on 1990 booked revenues. Staff stated that they were aware that the 1990 advertising rates by advertising code (UDAC) increased over the 1989 advertising rates and that they attempted to annualize the local revenues by applying the known 1990 rates to the 1989 sales volumes. YP was unable to provide the 1989 sales volumes and, as a result, Staff based its adjustment on 1990 booked revenues. Staff stated that related commissions expense was also adjusted by the same percentage increase as advertising rates. Staff further noted that other expense levels did not increase by the same percentage rate. SWBT objected to the adjustment, indicating that Staff had used selective information and arbitrarily increased the revenues from the amount actually earned in the test year. SWBT indicated that since the YP revenues are more volatile than SWBT's, Staff's adjustment was inappropriate because of the competitive nature of YP.

The ALJ concluded that in the absence of sales volume information, Staff's annualization of local revenues was appropriate.

Uncollectibles

SWBT also disputed Staff's adjustment for uncollectibles, contending that the YP book level of bad debts reflects the accrual method of accounting and is thus in accordance with GAAP. SWBT contended that using actual write-offs, net of recoveries, applied to both 1988 and 1989 revenues caused Staff to understate the true levels because some accounts had aged for only 12 months and that a valid period would require 18 to 24 months of aging experience. SWBT further contended that using YP write-off experience as of June 30, 1991, on 1989 directories, would show an uncollectible level approximately $430,000 higher than what Staff recommended.

Staff stated that according to the outside auditor's work papers, the total YP bad debt reserve was overstated, and that at the December,

1989, Board of Directors meeting it was noted that :. uncollectible levels had dropped significantly. Staff stated that they used an average of actual net write-offs for 1988 and 1989 directories, as of December 31, 1990. The use of the December 31, 1990 date allowed a minimum aging period of 12 months on the 1989 directories and a minimum of 24 months on the 1988 directories, up to a maximum of 36 months. Staff also stated that they were unable to audit a June 30, 1991 amount because the field work on YP had ended prior to that time.

The ALJ concluded that Staff's methodology for calculating uncollectibles was appropriate. Although some receivables have only a 12-month aging period, as SWBT argued, it appears that other receivables, such as those from the 1988 directories, have up to 36-months of write-off history. The June 1991 amount mentioned by SWBT was not available during Staff's field work, and to the extent that it contained a significantly higher write-off amount than the 1988 or 1989 levels, Staff would have to apply auditing procedures to determine the veracity of this amount. Because the issue is not whether YP keeps its books according to GAAP, but whether the book amount represents a proper amount in relationship to Staff's adjusted revenues, and because Staff's bad debt percentage was reasonably calculated and applied appropriately to Staff's pro forma revenues, the ALJ adopted the resulting uncollectible amount, as recommended by Staff.

Wages/Salaries

Staff recommended an adjustment to the wages and salaries of YP management and nonmanagement personnel, consistent with the disallowance percentage applied to SWBT. Staff did not recommend an adjustment to salary levels of employees on commission since there are no corresponding job descriptions at SWBT. SWBT contended that the titles and job descriptions at SWBT are different from those at YP therefore, there was no basis for comparison of SWBT's salary survey with the salaries paid by YP. Staff argued that there was considerable

transferring of personnel between SWBT and YP because the management and nonmanagement jobs were similar and, because SWBT and YP operate in the same geographical labor market, it was appropriate to apply the same percentage disallowance to YP salary levels as that applied by Staff to SWBT salary levels. The ALJ recommended that Staff's proposed adjustment be denied for the same reasons the ALJ recommended disallowance of the adjustments to SWBT wages and salaries.

Chamber of Commerce

Staff disallowed the costs of Chamber of Commerce (COC) dues because SWBT failed to demonstrate any reasonable relationship between COC memberships and increased revenues. The record reflects and the ALJ concluded that COC memberships typically tend to increase only the "goodwill" of SWBT and, therefore, inure to the benefit of the shareholders, not the ratepayers. Consequently, the ALJ recommended Staff's adjustment to disallow COC dues.

Gulf

The ALJ noted that Gulf accounts for the vast majority of YP manufacturing and distribution (M&D) expenses, which comprises 26 percent of total YP operating expenses. Therefore, it was appropriate for Staff, in light of the Turpen directive, to examine affiliated transactions and to audit Gulf. Staff stated that its audit of Gulf revealed that the revenues, expenses, and investment were allocated to the commercial and directory divisions in a manner which caused the directory operations to subsidize the commercial operations. Because the directory revenues are imputed to the ratepayers of SWBT-Oklahoma, it is inappropriate for the ratepayers to, in essence, subsidize the commercial operations of Gulf. SWBT contended that regulatory adjustments to the revenues of Gulf are inappropriate because Gulf is an unregulated enterprise and because the contract with YP was an arms-length transaction which was negotiated prior to SBC's acquisition of Gulf.

The ALJ adopted Staff's adjustment. The ALJ concluded that although Gulf is not a regulated entity, it was appropriate for Staff to audit Gulf and apply a regulatory "yardstick" in order to avoid cross-subsidization.

SBC Cost Center

Staff also disallowed SBC Cost Center Number (CCN) 26-Pension Asset Management, CCN 27-Actuarial Services, and CCN 66-Trustee's Fees and Expense charged to Gulf. Because Gulf maintains its own pension plan and does not participate in SBC's pension plan, Staff argued that Gulf should not be responsible for costs related to SBC's pension plan and proposed an adjustment to remove those costs from the Gulf's costs allocated to YP.

The ALJ adopted Staff's adjustment. The ALJ found that, although Gulf is not a regulated entity, it is appropriate for the Commission Staff to audit Gulf and apply a regulatory "yardsticks" in order to avoid cross-subsidization.

Findings and Conclusions

After reviewing the evidence and exhibits introduced on the issue of YP's revenue imputation, the Commission makes the following findings and conclusions.

The Commission finds that there is merit to SWBT's arguments related to Yellow Page Local Advertising Revenues. The Commission is concerned that as it relates to this adjustment, Staff may have utilized inaccurate or incomplete information in recommending an increase in the associated revenues from the amount actually earned in the test year. The record reflects that Staff's proposed adjustment is premised primarily upon Staff's determination that two of SWBT's YP Oklahoma Directories (Oklahoma City and Tulsa) had price increases in 1990. It

appears that based upon this, Staff proposed to annualize those price increases for all of SWBT's Yellow Page directories (Tr. 12/16/91 pp. 100-101). In accomplishing the annualization of local advertising revenues for the test year, Staff based its adjustment on 1990 book revenues instead of directly annualizing 1989 sales revenues based on 1989 volumes. The Commission finds that under these circumstances adopting the Staff recommendation does not properly synchronize test year cost of service. The record does not support Staff's proposed adjustment, therefore the Commission rejects the recommendation of the ALJ relating to Yellow Page local advertising.

With respect to the other YP adjustments, the Commission adopts the arguments of the Staff and finds as follows:

1. The uncollectible revenue shall be quantified by use of Staff's methodology, which used a bad debt percentage based on an average of the amounts of revenue actually written-off as bad debts over two years and the application of that percentage to pro forma revenues. Staff's methodology presents a more accurate representation of uncollectible accounts than does SWBT's methodology, which was based on estimates. (Tr. 12/16/91, pp. 21-23.)

2. The lead/lag method is the appropriate methodology for the determination of the YP CWC requirement for regulatory purposes. This method is preferable to the method sponsored by SWBT witness Howe, whose CWC method (current assets minus current liabilities) may reflect a company's liquidity in the financial sense, but does not correctly quantify the CWC requirement for regulatory purposes. (Tr. 12/16/91, pp. 12-13; 12/17/91 pp. 53-55; Exhibit 185, Buck rebuttal, p. 11). While SWBT criticized Staff witness McFarlin for her use of the midpoint of the life of the directory in her calculation of the revenue lag, SWBT overlooked the fact that Staff used the same midpoint to measure expense lead days. Thus, Staff's lead/lag methodology, by treating revenues and expenses consistently, did not distort the CWC requirements for YP operations. (Exhibit 185, p. 11.)

The Commission finds that the ALJ's recommendation regarding the appropriate level of CWC is reasonable and is supported by substantial evidence. The record reflects that the ALJ agreed with Staff and concluded that CWC should be established utilizing a lead/lag study. The ALJ concluded that CWC should measure the need for working funds and not the existence of those funds, and that the measuring point for both revenues and expenses should be consistent. The ALJ found that Staff's adjustment is consistent, unlike the Company's position, which would result in a one-sided study. The Commission agrees with the ALJ's recommendation and adopts Staff's adjustment.

3. Staff correctly adjusted the deferred tax reserve account to reflect a flow-back of the unprotected excess deferred income taxes to the ratepayers. The excess deferred income taxes arose because of the reduction in the effective federal income tax rates from 46 percent to 34 percent, and the failure to return these funds to the ratepayers, who paid for them through their rates, would confer a windfall to the shareholders of SWBT's parent company, SBC. The fact that the YP subsidiary had previously written the unprotected excess deferred income taxes off of its books does not in any way limit this Commission's authority to insure that these sums are flowed back to SWBT's ratepayers through the establishment of a pre-tax regulatory liability. (Tr. 12/16/91, pp. 84-85.)

4. The Commission approves an adjustment to the YP revenues to impute to Oklahoma a proportional share of the foreign directory sales, which are sales of directories outside of SWBT's service area for the reasons set forth in our previous discussion of this adjustment.

5. Because the YP subsidiary does not have its own capital structure, the Commission adopts the hypothetical capital structure found appropriate for SWBT in its imputation of the YP operations. This finding is consistent with our finding that we have the legal authority

to treat the YP operations as a regulated entity in order to impute, for ratemaking purposes, the revenues from YP to the SWBT cost of service.

6. The Commission notes that, notwithstanding the fact that Gulf is not a regulated entity, it is appropriate for Staff to audit Gulf and apply a regulatory "yardstick" in order to avoid cross-subsidization. A review of the record reveals that Staff's proposed adjustments relating to Gulf are reasonable and are supported by substantial evidence, as discussed above. Therefore, Staff's adjustments to Gulf are hereby adopted.

7. The Commission finds that the record clearly supports Staff's adjustment concerning COC dues. SWBT failed to establish that there exists any relationship between COC costs and increased revenues. The Commission notes and the record reflects that COC memberships normally only increase the "goodwill" of the company which inures to the benefit of the shareholders, not the ratepayers. Therefore, the Commission finds that the adjustment proposed by Staff is reasonable, is based upon substantial evidence and is adopted.

8. The Commission finds that on balance, the recommendation of the ALJ concerning the YP wage adjustment is reasonable and is based upon substantial evidence. The Commission has previously adopted the recommendations of the ALJ set forth in Lines 8 and 9, concerning salary and wages. The Commission finds that adoption of the ALJ's recommendation concerning YP wages is necessary to avoid any inconsistency with our rulings concerning wages and salaries, Line 8 and Line 9 supra. We note our reservations with regard to excessive salary levels therein likewise apply to YP.

9. The Commission finds that Staff's "other" proposed adjustments to the rate base of YP are reasonable and supported by substantial evidence. The record reflects that Staff proposed adjustments to (1) remove works of art from plant in service; (2) decrease rate base

for accrued accident and health insurance; (3) decrease rate base for deferred rental expense; and, (4) decrease rate base for deferred compensation. Upon review of the record, the Commission finds that SWBT did not specifically address these adjustments. Therefore, the Commission concludes that the "other" rate base adjustments proposed by Staff are adopted.

10. The Commission adopts the ALJ's recommendation to disallow expenses related to the SBC cost center (CCN) 26-Pension Asset Management, (CCN) 27-Actuarial Services and (CCN) 66-Trustee's Fees and Expense charged to Gulf. The Commission finds and the record reflects that Gulf maintains its own pension plan and does not participate in SBC's pension plan. In light of the fact that Gulf receives no real benefit from SBC's pension plan, the Commission finds that it would be inappropriate for Gulf to assume any responsibility for the costs associated with SBC's pension plan.

The Commission concludes that the above-stated findings and conclusions are reasonable and are based upon substantial evidence.

The net effect of the Commission's decisions on revenues and expenses regarding the imputation of YP operations is reflected on Line 22 of Schedule E in the amounts of $60,658,850, and $31,481,361, respectively.

Line 23 - Improved Mobile Telephone Service (IMTS)

Staff and SWBT excluded the plant applicable to Improved Mobile Telephone Service (IMTS) from rate base because it is deregulated in Oklahoma, although it is regulated under FCC costing methodology and is booked as such by SWBT. Staff and SWBT also did not include the related accumulated depreciation and accumulated deferred income taxes applicable to the IMTS plant as a rate base offset. The Commission finds that the rate base adjustments recommended by Staff and SWBT for IMTS should be adopted in this Cause.

The record reflects that with regard to the expenses related to IMTS, SWBT alleged that Staff inadvertently entered an incorrect number in its Section H, Schedule 3, Adjustment No. 28. We have determined that this was not an error because an AG data request response had indicated there was $9,000 in advertising included in IMTS marketing expense which had already been disallowed in Staff's Advertising Adjustment No. 5, in Section H, Schedule 3. Staff, therefore, reduced the amount of marketing expense related to IMTS to prevent a partial duplication of Staff's advertising adjustment. The Commission finds that Staff's reduction of marketing expenses related to IMTS is reasonable, supported by substantial evidence and these adjustments are hereby adopted by the Commission.

As noted in the discussion of Year-End Depreciation and Represcription, the difference in the amount of SWBT's and Staff's expense adjustment appears to be due to the distribution of depreciation expense on Exhibit 361. The ALJ adopted Staff's expense adjustment in Line 23, Column F, of Exhibit 361.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

These adjustments are reflected as reductions to revenues, expenses, and rate base on Line 23 of Schedule E, in the amounts of $1,149,858, $506,051, and $1,510,604, respectively.

Line 24 - Bellcore Dividends and Investment

This line represents a general heading only and contains no issues to be determined by this Commission.

Line 25 - Bellcore Dividend/Investment

Staff proposed an adjustment to reduce expenses to reflect receipt of the Bellcore dividend stating that SWBT received a dividend each quarter from Bellcore which was not included in the operating income. Staff further argued that including SWBT's investment in Bellcore in SWBT's rate base would be "double-dipping" the ratepayers with regards to the recovery for the return on investment and therefore it was appropriate to reflect the return on investment only in the operating costs for SWBT.

SWBT argued that, as an owner, SWBT receives a quarterly dividend from Bellcore and that according to FCC Part 31, this dividend is booked "below-the-line" as other income. SWBT stated that it was inappropriate to make Staff's adjustment moving the Bellcore dividend "above-the-line" and using the dividend to offset SWBT's cost of service. SWBT argued that because SWBT buys services from Bellcore, just as it buys services from other vendors, the Bellcore purchases should be treated as a portion of SWBT's cost of providing service. SWBT argued that in order to correct Staff's adjustment, which recognized the Bellcore dividend stream, SWBT's investment should be included in SWBT's rate base. SWBT argued that only then would Staff's adjustment comply with the principle of matching.

The ALJ found that Staff was correct in including the dividend from Bellcore as a reduction to SWBT's expenses. The ALJ noted that SWBT argued that purchases from Bellcore should be viewed no differently with regard to expenses for services or products than those from any other supplier and the ALJ found that the dividend therefore acts as a rebate to the price paid for services purchased from Bellcore. The ALJ further noted that if the dividend is recorded below-the-line, as SWBT asserts it should be, then SWBT would be earning more than the authorized return on that dividend. The ALJ concluded that Staff's adjustment would have the effect of using the dividend to reduce SWBT's direct costs and that the Company would still receive a return on its investment.

The ALJ also found that SWBT's argument that the Bellcore investment should be included in rate base should be rejected because Bellcore already obtains an equity return as a component of its test year expenses billed to SWBT-Oklahoma. Allowing SWBT to likewise include its Bellcore investment in rate base would constitute a "double-dipping" to the ratepayers. The ALJ recommended that the Commission reject the Company's proposed rate base adjustment at Column H, Line 25 and accept Staff's proposed expense adjustment at Column F, Line 25 of Exhibit 361.

We have reviewed the record and the recommendations of the ALJ. While we agree with the results of the ALJ's recommendations, we believe the reasoning for those results should be clarified. The money SWBT receives quarterly from Bellcore is actually a reimbursement for SWBT's overpayment of its share of expenses. Moreover, SWBT's payments to Bellcore for Bellcore to recover its operating expenses and a return on and recovery of its investment required for its operations on behalf of SWBT. Because these payments to Bellcore are recovered as operating expenses and collected from SWBT's ratepayers through rates, we find that any reimbursement to SWBT from Bellcore in the form of a "dividend" should be returned to the ratepayers as credits to the cost of service used for determining revenue requirements.

The Commission believes this treatment is consistent with its treatment of SWBT's reimbursements from AT&T, <u>infra</u>, and prior Commission policy regarding accounting for payments reimbursed or refunded to utility companies by vendors.

This adjustment is reflected as a reduction to expense on Line 25 of Schedule E in the amount of $369,318.

Line 26 - Bellcore ROE

Staff made an adjustment to limit the Bellcore ROE to the ROE allowed in the Oklahoma intrastate jurisdiction. The Bellcore projects are priced at "costs plus a return on equity." In its response to AG data request No. 104, SWBT stated ". . .in 1989, Bellcore's ROE was 14.1 percent. The target rate of the Bellcore ROE is to approximate the average return being awarded to the operating telephone companies in the 49 jurisdictions. . . ." Staff indicated that the appropriate ROE for the Bellcore projects is reflected by Staff's proposed adjustment.

SWBT stated that the 1989 ROE rate of 14.1 percent represents the 1988 end-of-year average of the authorized ROR for all 49 jurisdictions within the seven RBOCs. SWBT indicated that this rate was approved by the Bellcore Board of Directors for use during 1989 and that Bellcore's averaging method provides a fair means of establishing the return for Bellcore. SWBT further stated that the Oklahoma Division of SWBT could not materially affect Bellcore's ROR, because Oklahoma is only one of 49 jurisdictions served by Bellcore, each of whom influences Bellcore's return. Therefore, it would be inappropriate to establish Bellcore's return based only on SWBT-Oklahoma's ROR.

SWBT further stated that although Staff proposed the disallowance of a portion of SWBT's 1989 expenses associated with purchases from Bellcore, Staff did not take into consideration the fact that included in the amount of Bellcore billing to SWBT is the consideration for a return on Bellcore investment, thereby effectively reducing Bellcore's ROR, but instead, only used Bellcore dividends as an offset to expenses. The Commission finds that Staff's Bellcore ROE proposal should be denied. During the test year, the return included in the cost of Bellcore projects was actually less than that authorized for SWBT by the Commission. Because of the number of jurisdictions involved, the averaging process suggested by SWBT is reasonable, particularly since that process adjusts the return regularly. Therefore, the Commission

finds that the recommendation of the ALJ with respect to the Bellcore ROE is supported by substantial evidence, is reasonable, was not appealed by any party and is hereby adopted by the Commission.

The Commission's decision rejecting Staff's proposed adjustment is reflected on Line 26 of Schedule E as resulting in $0 impact on expenses.

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Line 27 - Bellcore Project Disallowances

By its nature, research and development is oriented towards the provision of future services. Thus, SWBT's research projects are ongoing with many ideas considered at the research stage and some ultimately deployed in the development stage. Even when a research project actually leads to a service or a new technology and deployed in the system, SWBT acknowledged that there may be a gap of as many as ten years before the project bears fruit.

The ALJ found that these uncertainties and time lags, precluded SWBT's proposed inclusion of test year research expenses from being included in its cost of service because it is questionable whether the benefits of successful research and development will be realized in the future. The ALJ determined that such costs should be deferred and matched to the period of benefits to prevent the subsidization of future customers. Additionally, the ALJ recognized that the benefits of research and development may be realized by nonregulated affiliates resulting in the subsidization of SWBT affiliates or in future products or services which are not regulated by the Commission, which could result in the subsidization of SWBT nonregulated services. Further, the ALJ noted that the research and development may be subsidizing speculative business projects which would be too risky if incurred directly by the new business venture as a start-up cost or the research and development may prove unsuccessful, resulting in no benefit to the ratepayers. While SWBT has acknowledged that research expenses are

prospective in nature, SWBT refused to agree to the treatment of future revenues from these services on a regulated, above-the-line basis, suggesting that research dollars spent in the test year might lead to the provision of future services not subject to ROR regulation.

The ALJ found that SWBT's own project descriptions of the purported benefits of these projects emphasized their future orientation, raising a concern about proper matching of test year expense and benefits, as well as a concern as to whether these future benefits will accrue to ratepayers. The record reflects that, to date, customers of SWBT's regulated services have not substantially benefitted from projects to be disallowed. During the test year SWBT had no customers in Oklahoma with High Definition Television services and there was only one customer with high-speed data transmission (ISDN). The record reflects that SWBT acknowledged that a state-of-the-art network was not necessary for the provision of basic telephone services.

Further, the ALJ found that the 1987 Bellcore audit conducted by the NARUC confirmed that many Bellcore expenses should not be currently charged to SWBT's regulated customers. As in the case of applied research funding, the NARUC audit noted the lack of any proven relationship between today's customer funding research, and tomorrow's beneficiaries. NARUC's regional review group recognized that allowing recovery of research expenditures as incurred violated a basic regulatory tenet that current customers should fund only expenditures which are currently used and useful to them.

The ALJ adopted the proposal of the AG and recommended that SWBT be permitted to book the disallowed research expenses in a separate account and seek recovery from regulated customers if and when services actually developed from this research are deployed on a regulated basis. After evaluating the evidence, the ALJ recommended the disallowance of certain research projects and related expenses from rates. After reviewing the record, the Commission finds that the recommendation of the ALJ is based

upon substantial evidence, is reasonable and is adopted by the Commission.

This adjustment is reflected as a reduction to expenses on Line 27 of Schedule E in the amount of $1,669,000. (Oklahoma Corporation Commission Order No. 367808, dated August 26, 1992)

Line 28 - Technology Resources Projects Disallowances

The record reflects that the ALJ recommended disallowance of a portion of the Technology Research, Inc., (TRI) research expenses assessed to SWBT-Oklahoma during the test year. The ALJ recommended approval of the AG's proposed disallowance of 50 percent of all Strategic Technology Areas costs (STA) because these projects were more likely to benefit future customers and SBC's affiliates than SWBT's current ratepayers. The ALJ found that the use of the General Corporate Allocator, which allocates 75 percent of these costs to SWBT based only on SWBT's current relative size, was an arbitrary allocation which ignored the future benefit which would probably accrue to the affiliates and subsidiaries. Finally, the ALJ recommended 100 percent disallowance for certain specific TRI projects, because of their future orientation, such as "Fiber to the Home." The specific TRI projects which were disallowed are set forth in Exhibit 323a, Schedule C-11, and described in appendices MLB-21 and MLB-22. The TRI disallowances represent a $445,000 decrease in test year expenses.

The Commission finds that the recommendation of the ALJ is reasonable and is supported by substantial evidence. For the foregoing reasons, the Commission adopts the recommendation of the ALJ.

This adjustment is reflected as a reduction to expenses on Line 28 of Schedule E in the amount of $445,000

Line 29 - Prepayments/Material and Supplies

Staff appealed the ALJ's recommendation concerning prepayments and materials and supplies, contained in the discussion at Line 29 of the ALJ Report. The ALJ concluded that a 13-month average was appropriate for all components of materials and supplies.

We have reviewed the record and find that the ALJ's conclusion is overly simplistic and ignores the regulator's objective of utilizing a value for prepaid expenses and materials and supplies which will be representative of the TYE required investment in materials and supplies. The record reflects that Staff chose not to utilize a strict 13-month average for all materials and supplies investment categories, because some of the actual 13-month-end investment balances included individual month-end investment levels which were abnormal or which included nonrecurring investments. According to Staff, a strict adherence to the 13-month "book" balance of materials and supplies would violate the premise that pro forma adjustments are appropriate and are routinely made in ratemaking to eliminate unusual or nonrecurring operating transactions in order to set rates based upon normal levels of investments or operating expenses.

A 13-month average for materials and supplies is used for the purpose of establishing or determining a single reasonable and representative level of investment to be included in rate base for the purpose of establishing rates. The approach recommended by Staff also established a single investment level to be included in rates. Staff's recommendation addressed facts and circumstances which should be considered in order to eliminate nonrecurring or abnormal elements contained in SWBT's actual month-end materials and supplies investment balances. After elimination of these abnormal elements, Staff's recommendation is a more reasonable representation of the ongoing investment requirements of SWBT than the method recommended by SWBT and the ALJ.

The Commission must consider the reasonableness of the end result and not simply the mechanics of how an investment balance is determined, when establishing the most appropriate level of materials and supplies. Therefore, the Commission rejects the ALJ's recommendation regarding this issue because it addresses only the mechanics of how an investment in materials and supplies is determined, and not the issue of whether the valuation is the most representative of anticipated investment for the time that rates will be in effect. The Commission finds, based upon substantial evidence, that Staff's recommendations concerning materials and supplies shall be adopted in order to assure that the investment level included in rate base for materials and supplies is representative of ongoing investment requirements for SWBT.

This adjustment is reflected as a reduction to rate base on Line 29 of Schedule E in the amount of $803,174.

Line 30 - Reciprocity Service

The record reflects that Staff did not accept the adjustment made by SWBT and the AG in SWBT's MSFR for reciprocity. Reciprocity represents the revenue, expenses and investment associated with customers located in Oklahoma but served by an exchange located in an adjoining state, such as Kansas or Arkansas.

We find that the basis for SWBT's adjustment is the treatment of reciprocity service by the Commission in prior rate cases for SWBT. Order No. 292337 issued in General Cause No. 29321 reflects that there was an adjustment for reciprocity; but there was no adjustment made for reciprocity in Cause No. PUD 000260. The Commission finds that SWBT has incurred investments and expenses to serve Oklahoma residents from border states. These must be recognized in the Oklahoma test year cost of service by matching revenues, expenses and rate base. The ALJ recommended that SWBT's proposal be accepted because it included all

investment, revenue and expenses used in providing service to Oklahoma residents and was supported by substantial evidence.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

These adjustments are reflected as adjustments to revenues, expenses, and rate base on Line 30 of Schedule E in the amounts of $989,835, $785,221, and $1,854,704, respectfully.

Line 31 - Exclusion Of Aircraft Expense

The record reflects that all parties excluded aircraft expense from SWBT's cost of service and because the issue was not disputed, the ALJ recommended adoption of the adjustment proposed by SWBT. The record reflects that the recommendation of the ALJ is supported by substantial evidence, is reasonable, was not appealed by any party and is hereby adopted by the Commission.

This adjustment is reflected as a reduction to expense, on Line 31 of Schedule E in the amount of $1,094,784.

Line 32 Amortization Of Embedded $200-$500 Investment

The Uniform Systems of Accounts (USOA), Part 32, requires SWBT to amortize the embedded investments in small tools, etc., that are less than $500 in value, over an eight-year period beginning May 1, 1990. SWBT, Staff, and the AG agree on the need to make this adjustment. Staff also embedded an adjustment to leasehold improvement amortization in their $200-$500 adjustment. The amount of the difference is shown on Item 32, Ex. 361, but the associated findings of facts and conclusions of law are presented with Item 66 entitled (GAAP). The ALJ found that no dispute existed between the parties concerning the $200-$500 adjustment, and recommended that the adjustment be adopted.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as an adjustment to revenue and expenses on Line 33 of Schedule E in the amounts of $12,846 and $110,497, respectively.

Line 33 - One-half Percent State Sales Tax Increase

Staff, SWBT and the AG all recommended an adjustment to SWBT's books and records to reflect a one-half percent increase in state sales tax which became effective May 1, 1990. Staff's and SWBT's adjustment reflects the annual impact of the increase on total 1989 purchases that were expensed and subject to sales tax. The AG's adjustment was based on SWBT's MSFR. Additionally, both the Staff and SWBT recognized that this would change the settlements received from the intraLATA toll pool, due to the increased expense level for state sales tax. In view of the fact that this was a known and measurable change to SWBT's books and records which became effective shortly after the end of the test year and is not inconsistent with our findings regarding attrition adjustments, infra, the Commission finds that Staff's and SWBT's adjustments, based upon 1989 purchases, properly recognize the change in the toll pool revenues as a result of the increase in settlements from the toll pool due to the sales tax increase.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as an adjustment to revenues and expenses on Line 33 of Schedule E in the amounts of $10,060 and $88,301 respectively.

Line 34 - End Of Reserve Deficiency Amortization (RDA)

Beginning in 1987, SWBT was authorized in Cause No. PUD 000260 to charge to depreciation expense, an amount for reserve deficiency that arose out of insufficient historical depreciation rates. This intrastate amortization was completed June 30, 1991. A similar amortization was authorized by the FCC for interstate purposes but over a five-year period. For intrastate purposes, the Commission approved a four-year amortization in Cause No. PUD 000260.

Because depreciation rates were historically insufficient, SWBT's reserve for depreciation was understated by $180 million when compared to the value which should have been accumulated had the depreciation rates more accurately reflected the represcribed lives of the assets to which they apply.

Staff and the AG proposed an attrition adjustment to recognize that the RDA ended in July, 1991. As noted earlier, the Commission believes post test year events are appropriate to recognize as a pro forma adjustment if the effects of such events occur shortly after the test year, are known and measurable and if recognition will more accurately represent going-forward events when new rates are expected to be in effect. However, it is necessary for each such adjustment to be reviewed with intense scrutiny to assure that recognition of the adjustment would not render the concept of a historical test year meaningless.

Based upon the facts relating to this adjustment the ALJ found that it was equitable to include this change because it more accurately represents going-forward events related to SWBT operations in 1991 and beyond, and meets the criteria for recognizing attrition adjustments. In this case, failure to recognize this change would result in more depreciation expense being recorded than is required to address the previous existing depreciation reserve deficiency, because that deficiency was fully recovered by the end of July, 1991.

This adjustment is reflected as reductions to revenue, expense and rate base on Line 34 of Schedule E in the amounts of $4,580,877, $24,858,556, and $28,644,244, respectively.

Line 35 - Basic Allocation Factor (BAF)

Separations is the process used to divide SWBT's expenses and investment jurisdictionally between interstate operations and intrastate operations. The federal/state joint board recommended and the FCC ordered the transition from the frozen Subscriber Plant Factor (SPF) to the Basic Allocation Factor (BAF), from 1986 through 1993. This transition occurred one day after the test year, is both known and measurable and is consistent with our view of attrition adjustments, infra. SWBT recommended recognition of the January 1, 1990 step of the BAF transition as a pro forma adjustment to its test year data.

The ALJ found that this BAF change had occurred, it affected SWBT's future operations and that its recognition would provide a more representative view of SWBT's future operations. The ALJ recommended that SWBT's adjustment be adopted. The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable and was not appealed by the parties. Therefore the adjustment to the BAF proposed by SWBT is adopted.

This adjustment is reflected as an adjustment to expense and rate base on Line 35 of Schedule E in the amounts of $2,405,677 and $6,112,000, respectively.

Line 36 - Optional Toll Calling Plan

Staff witness Mr. Manning testified that SWBT proposed that the Optional Toll Calling Plan (OTCP) impact be included in the financial results of this Cause, but that Staff did not agree with SWBT's proposal for two reasons. First, he did not find any OTCP impact on the toll

pool in 1989. Second, claimed that no accurate estimate of the loss of toll revenue could be determined.

AG witness Mr. Brosch also rejected SWBT's plan to include OTCP, stating that the SWBT revenue impact estimates would not provide a reasonable basis for quantification. He testified that selectively reaching beyond the TYE for estimated loses was not appropriate.

Both the AG and Staff appealed the ALJ's recommendation to adopt SWBT's proposal to reflect estimated 1991 and 1992 revenue losses resulting from the incorporation of the optional toll calling plans. The AG argued and the record reflects that it would be inappropriate to permit adjustments which focus primarily on price changes occurring after the test year. The record reflects that a price change alone, cannot be used to quantify ongoing revenue streams which depend on volumetic use. The record reflects and the evidence strongly supports the conclusion that these same changes can also be stimulated by price decreases. (Tr. 10/14/91 p. 137.)

The Commission notes that while a price impact would occur, any attempt to quantify such an impact would amount to merely an estimate or projection. The Commission further finds that the speculative nature of the SWBT adjustment is compounded by the failure to consider volumetric changes with regards to OTC usage.

Therefore, the Commission rejects the adjustment proposed by SWBT because adoption of this post-test year adjustment would distort the test year matching concept. The Commission finds that this adjustment should not be included in revenue requirements using a 1989 test year because it is speculative, not accurately quantifiable and focuses only on price changes occurring after the end of the test year without consideration of the sales volumes and expense changes associated with the service.

This adjustment is reflected on Line 36 of Schedule E and results in a $0 impact on test year revenue levels.

Line 37 - 1990 Step Of The COE CAT 3 Transition (DEM - Dialed Equivalent Minutes)

Staff, AG and SWBT recommended that an adjustment be made to the 1990 increment of the Dialed Equivalent Minutes (DEM). Minor differences in the amounts recommended by the parties resulted from the impact of other adjustments proposed by the parties.

The Commission has reviewed the record and finds that the recommendation of the ALJ is supported by substantial evidence, is reasonable, was not appealed by any party and is hereby adopted.

This adjustment is reflected as an adjustment to revenue, expense, and rate base on Line 37 of Schedule E in the amounts of $226,578, $1,408,292, and $3,182,353, respectively.

Line 38 and Line 75 - 7/1/90 and 7/1/91 CCL Rate Reduction

The record reflects that Staff did not recommend an adjustment to reflect the CCL rate decrease ordered by the Commission in General Cause No. 28309. Staff explained that it did not adjust CCL revenues for anything other than out-of-period adjustments. Staff testified that the CCL rate reduction had been offset by a combination of the associated expense reduction and increased sales volumes for minutes of use. During its audit, Staff found that when the minutes of use increased in excess of 10 percent in each annual period, the CCL rates were decreased by 10 percent. Staff concluded, based upon its findings, that no adjustment was necessary to reflect either the July 1, 1990 or the July 1, 1991 CCL rate reductions.

SWBT argued that Staff should have adjusted for the CCL revenue reduction. SWBT argued that it had recognized the 1989 CCL rate

reduction in its year-ending access revenue adjustment and included a pro forma adjustment to access revenue for the 1990 and 1991 CCL reductions based upon actual billed 1989 CCL minutes at the respective 1990 and 1991 CCL rates. SWBT argued that since Staff included adjustments for the impact of the completion of SWBT's reserve deficiency, that it was appropriate to include what SWBT claimed were "known and measurable" rate reductions which allegedly occurred during that same time period.

The ALJ concluded that the CCL rate reductions were both known and measurable and that these changes should be recognized, as proposed by SWBT.

The Commission disagrees with the recommendation of the ALJ and concludes that SWBT's argument is without merit and must be rejected. The record reflects Staff's conclusion that CCL minute usage increased in excess of 10 percent. The record further reflects that SWBT's recommendation does not include the offsetting impact to its adjustment from a corresponding higher sales volume for minutes useage at the lower rate. It is clear to the Commission that basing the adjustment solely on 1989 minutes of usage would result in a windfall to SWBT from not recognizing the increased revenues available to SWBT resulting from increased minutes of use stimulated by the CCL rate decrease. It is likewise clear to the Commission that the adjustment proposed by SWBT does not rise to the level of an acceptable known and measurable change as described herein. Therefore, the Commission rejects SWBT's contention that the reductions at issue in this adjustment are known and measurable as these alleged changes do not meet the criteria established for adoption of known and measurable changes.

For the foregoing reasons, the Commission finds Staff's refusal to adjust for the CCL rate reduction is reasonable, is supported by substantial evidence and is adopted.

This adjustment is reflected as a $0 impact to revenues on Line 38 of Schedule E.

Line 39 - 1990 Impact of The Toll Pool Stipulation

The record reflects that Staff agreed with SWBT that the Tool Pool Stipulation caused the member companies to move toward the BAF for amounts reported to the toll pool which resulted in movement away from a frozen subscriber plant factor, and transitioning, to a subscriber line usage factor. This adjustment would increase SWBT's toll pool settlements in 1990. Staff proposed its adjustment to be consistent with its adjustment to recognize the taxability of the telephone cooperatives. Both adjustments were made for occurrences at January 1, 1990.

The ALJ found that the adjustments proposed by SWBT and Staff appropriately match the increased toll pool revenue resulting from the Tool Pool Stipulation, which became effective on January 1, 1990.

The Commission notes that a review of Exhibit 361 shows, at Line 39, that SWBT and Staff agreed to the accuracy of this adjustment, which the record reflects was proposed by SWBT. The Commission finds it interesting that on appeal to the Commission, SWBT now argues that the adjustment it proposed is not supported by substantial evidence. Nonetheless, the Commission finds the record supports the adoption of this adjustment. Therefore, the Commission adopts the adjustments as shown in Column B and C, respectively, on Line 39, on Exhibit 361.

This adjustment is reflected as an adjustment to revenue on Line 39 of Schedule E in the amount of $1,200,000.

Line 40 - End Of Inside Wire Amortization

Staff, the AG and SWBT agreed that the completion of the inside wire amortization on December 31, 1990, created the need for an adjustment to SWBT's test year revenues, expenses and rate base. The ALJ agreed and found SWBT's pro forma adjustment was reasonable and was based upon substantial evidence.

The Commission having reviewed the record, finds that the recommendation of the ALJ is reasonable, is supported by substantial evidence and was not appealed by any party. Therefore, the adjustment proposed by SWBT is adopted.

The Commission's decision on this adjustment is reflected as a reduction to revenue, expense, and rate base on Line 40 of Schedule E in the amounts of $1,123,675, $8,578,903 and $6,408,066, respectively.

Line 41 - Uncollectibles

The record reflects that Staff adjusted uncollectibles for the difference between the uncollectible amount per SWBT's books and Staff's calculated pro forma amount. SWBT also made an adjustment for uncollectibles to reflect the level of year-ending revenues. The methodology used by Staff and SWBT was the same. SWBT stated that an analysis of the actual write-offs to revenues was used to develop a percentage for uncollectibles. This percentage was applied to the adjusted year-end revenues to arrive at the uncollectible amount. SWBT further stated that the difference between Staff and SWBT exists because of the different level of year-ended revenues that they each used. The AG's adjustment for uncollectibles was based upon SWBT's minimum filing schedules.

The ALJ found that the methodology used by Staff and SWBT was the same and was acceptable. He recommended that the amount of the

adjustment for uncollectibles should be computed based upon the accepted level of pro forma revenues.

The Commission has reviewed the record and finds that the recommendation of the ALJ is reasonable, is supported by substantial evidence and was not appealed by any party. Therefore the recommendation of the ALJ is adopted by the Commission.

This adjustment is reflected as a reduction to revenues on Line 41 of Schedule E in the amount of $60,112.

Line 42 - SBC:

This line represents a general heading only and contains no issues to be determined by this Commission.

Line 43 - SBC Salary and Wages

Staff made a number of adjustments to SBC's salary and wages. For example, Staff adjusted Senior Management Benefits to remove payments made for the Supplemental Retirement Income Plan (SRIP) noting that in Cause No. PUD 000260 all these costs were retained by SBC and were not passed on to the ratepayers. Because the SRIP is for senior management and is in addition to the regular retirement plan, Staff indicated that there was no perceived benefit to the ratepayers from this additional retirement plan and that it should be disallowed. The AG also disallowed SRIP costs arguing that there were no apparent benefit to ratepayers.

SWBT objected to Staff's and the AG's disallowance of SRIP costs arguing that the costs are normal expenses, which it incurs as part of its operations. SWBT also argued that benefit plans such as SRIP provide the Company with the assurance of a stable pool of senior managers at SWBT and SBC, and are designed to retain SWBT's current

group of experienced, competent senior managers. The record reflects that SWBT witness Troy acknowledged that his testimony was not from a base of knowledge about the way management compensation is treated as an item of cost of service in public utility cases. Mr. Troy further testified that he applied certain criteria to determine if compensation packages are reasonable, and admitted that generally, his evaluation criteria did not include how the public in general benefits from a particular compensation package, nor did it include any evaluation of the reasonableness of the cost being borne by the ratepayers. The ALJ agreed with the arguments advanced by Staff and AG and concluded that the ratepayers received no apparent benefit from SRIP paid by SWBT to its employees.

The Commission finds that it is not sufficient to allege a benefit to the ratepayers exists from the utilization of a compensation package such as SRIP. SWBT failed to adequately quantify the benefit it alleged was experienced by ratepayers. We also not that our prior decisions with respect to SWBT's management compensation, supra, is exceedingly generous to SWBT. Consequently, the Commission must disallow, for ratemaking purposes, the cost associated with this program. We also note that nothing in our disallowance of these costs to the ratepayers prevents SBC as SWBT's stockholder, from funding STIP. The Commission adopts the recommendation of the ALJ to disallow the SRIP costs.

Staff also annualized regular SBC payroll based upon the last pay period multiplied by the number of pay periods for each pay group. Another adjustment made by Staff to SBC wages was the disallowance of long-term awards and a disallowance of miscellaneous "other" wages. Additionally, Staff adjusted senior management, management and nonmanagement wages to the 75th percentile of the market, arguing that these adjustments were necessary in order to be consistent with the treatment of payroll by Staff at the local SWBT level. In addition, Staff adjusted payroll taxes to apply the applicable 1990 rate for the employer's portion of FICA taxes and the federal (FUTA) and state (SUTA)

unemployment taxes. Staff limited FICA wages to the lesser amount of Staff's pro forma wages or the 1990 FICA base wages for each pay group. The FUTA and SUTA 1990 base wages were determined by the December 1989 number of employees multiplied by the FUTA and SUTA base wages. Staff then applied the applicable 1990 rate for all three payroll taxes.

The record reflects that with regard to the "other salary and wage" adjustments proposed by Staff, SWBT witness Mr. Chicoine testifed that the same treatment afforded SWBT should be applied to SBC as well. The ALJ agreed with Mr. Chicoine and recommended that adjustments to SBC salaries and wages be made in conformance with his previous salary and wage recommendations. The Commission agrees that the same treatment should apply to SBC as we afforded to SWBT, and therefore, we adopt the ALJ's recommendation concerning SBC salaries and wages. In so doing, however, we also express our intent to continue to intensely scrutinize wages and salaries which are nearing an excessive level.

The Commission further finds that SWBT does not appear to dispute Staff's adjustment for the payroll annualization and payroll taxes. We find this adjustment is based upon substantial evidence, and we therefore adopt the payroll annualization and payroll tax adjustments as proposed by Staff at Line 43, Column F, of Exhibit 361.

This adjustment is reflected as a reduction to expense, on Line 43 of Schedule E in the amount of $819,806.

Line 44 - Corporate Allocation Factors

Staff witness Mr. Manning testified that corporate allocations are the processes whereby the operating expenses of SBC are allocated to each of its subsidiaries, the largest of which is SWBT. Mr. Manning explained that his recommendation for the allocation of corporate expenses was the result of an extensive review of the SBC's allocation methodology. He stated that the methodology employed by SBC to allocate

costs to its subsidiaries identifies the parent company's functions and categorizes them into "cost centers." He explained that the system is designed to allocate costs in two tiers, with the Tier One cost centers assigning the overhead costs to the Tier Two cost centers, using a salary-based criteria. He then explained that these Tier Two costs, weighted by the Tier One costs, are allocated to each of the subsidiaries using the average of the previous twelve months to derive the factor to apply to the current month. He stated that the test-period data used was for the months of January through December 1989.

Mr. Manning testified that he made adjustments to three allocation factors: investment, employees, and general. He explained that the Investment Factor was applied to all the cost centers having an investment nature but was calculated by SBC using only some of the investment amounts in the general ledger. He included the "Other Investments" valued at $560,971,138, which had been excluded by SBC, to allocate a portion of the corporate costs to these investments.

Mr. Manning explained that the Employee Factor is applied to cost centers of an employee support nature, but was calculated by SBC using less than the total number of all employees. He stated that SBC had calculated the Employee Factor utilizing the total number of employees of only nine of its fourteen subsidiaries. Mr. Manning recalculated the Employee Factor using the total number of employees reported in the December 1989 Force Report.

Mr. Manning explained that the General Factor, which is applied to cost centers which are neither investment nor employee in nature, was calculated by SBC using allocatable expenses attributed to nine subsidiaries, based upon that subsidiary's part of the total. He recalculated the General Factor using all fourteen subsidiaries' expenses and developed each subsidiary's General Factor based upon its part of the total.

Mr. Manning testified that each factor represented that subsidiary's relationship to the total, so that the Investment Factor represented each subsidiary's percent of total investment; the Employee Factor represented each subsidiary's number of employees to the total of all employees; and the General Factor represented each subsidiary's portion of its total to all the expenses. He stated that the calculation of SWBT's General Factor was more complex in that the General Factor for each subsidiary is the ratio between its allocated expenses and the total of all allocated expenses. He stated that these expenses are calculated by applying the Investment Factors to the cost centers, plus the Employee Factors to the employee cost centers, plus directly chargeable expenses. He then calculated each subsidiary's total compared to the grand total of all the subsidiaries, which resulted in the General Factor for that subsidiary, and which was then applied to the cost centers subject to the General Factor.

Mr. Manning further testified that the calculation of these factors and the factors for all SBC subsidiaries were shown on Section K, Schedule 1, Pages 1 and 2 of Staff Exhibit 363. He concluded by stating that these percentages were used by Staff to allocate SBC corporate expenses for the test year.

Mr. Manning proposed an adjustment to the jurisdictional separations factors. He recommended that the expense categories use an average annual factor based upon the twelve months of the test year. He stated that expenses fluctuate based upon operating volumes and that these expenses must be charged to SWBT-Oklahoma using factors which accommodate the seasonality of telephone service usage. He further stated that the investment categories, which are used to allocate jurisdictional shares of ROR and rate base, are not as affected by seasonality as are the expenses, but instead fluctuate based upon changes in the overall value of SWBT. Therefore, he recommended that the investment evaluation be based upon year-end balances for the investment categories.

SWBT witness Mr. Chicoine, argued that Staff's modifications to SBC's allocation factors were arbitrary and unreasonable. SWBT's witness, Mr. Flaherty, also disagreed with Staff's changes to the SBC allocation factors. He testified that SBC costs should only be allocated to the operating subsidiaries which sell products and services to customers. He further testified that SBC should not allocate costs to nonoperating or administrative subsidiaries whose functions are not designed to produce revenues to cover costs. Mr. Flaherty stated that only five of its fourteen corporations set up as independent subsidiaries are essentially cost centers.

Our review of the record reflects that Staff recommended adjustments to the investment, employees and general corporate allocation factors. Staff conducted an extensive review of each of these factors and then used these new factors to allocate SBC's corporate expenses for the test year. The record reflects that Staff also proposed adjustments to the jurisdictional separation factors. SWBT disagreed with the adjustments and modifications to the factors proposed by Staff and stated that they were unreasonable and arbitrary. The ALJ disagreed with SWBT and found that Staff conducted a methodical and systematic approach to develop the proposed allocation and jurisdictional separation factors.

The Commission notes and the record reflects that with regard to utilization of all 14 SBC subsidiaries, certain SBC subsidiaries provide the administrative share of employee-related expenses. As stated by Staff witness Manning, an employee of an administrative subsidiary has as much need for pension planning, health care and insurance provided by the parent as does an employee of an operating subsidiary. Further, many stand-alone companies provide administrative services to other companies, and these stand-alone companies would have to absorb additional expenses compared to those provided by SBC. (Tr. 10/14/91 pp. 148, 149; Exhibit 99.) Therefore, the Commission finds that Staff's proposed adjustments to the allocation and jurisdictional separation

factors are supported by substantial evidence and are adopted by the Commission as shown on Line 44, Column F, of Exhibit 361.

This adjustment is reflected as a reduction to expense, on Line 44 of Schedule E in the amount of $337,201.

Line 45 - Public Issues Research

The record reflects that Staff disallowed costs for Public Issues Research arguing that the associated costs appeared to provide no direct benefit to the ratepayers. The record reflects that the costs are for activities related to understanding the business environment in which all corporate entities exist, including specific understanding of technological, sociological, socioeconomic, economic and ecological issues which might affect SBC and/or its subsidiaries and customers. The AG recommended that SWBT be required to demonstrate and quantify tangible benefits to SWBT's ratepayers prior to any cost for Public Issues Research being included in SWBT's rates. SWBT stated that the products of the Public Issues Research Department have a great benefit to the public because all of the issues addressed by this department in some way impact SWBT and SWBT's customers in Oklahoma.

The ALJ agreed with Staff and the AG and found that SWBT had shown no direct benefit to the ratepayers of Oklahoma as a result of the Public Issues Research Department at SBC.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as a reduction to expense, on Line 45 of Schedule E in the amount of $43,755.

Line 46 - Marketing

Staff disallowed costs charged to Cost Center Number 81 (CCN 81), noting that the typical marketing charges in CCN 81 are for the corporate magazine, Update, sponsorship of Smithsonian World and sponsorship of the PGA Seniors' Tour, etc. Staff argued that Commission policy is to disallow expenditures of this type because there are no direct and quantifiable benefits to ratepayers. SWBT disagreed with Staff's disallowance of marketing expenses, arguing that these types of expenditures result in sales of SWBT products and services. SWBT indicated that Update's wide distribution allows SBC to provide business customers with a comprehensive and current look at products and services offered by SBC's subsidiaries, including SWBT. SWBT also stated that events such as the SWBT Golf Classic in Oklahoma City provide positive recognition for SWBT and, because SWBT is competing on a product-specific basis as well as for the discretionary dollars of customers, positive name recognition is a key influence on customers' buying decisions. SWBT further stated that Smithsonian World provides a positive image for SWBT as well as providing educational benefits which are part of the continuing commitment made by SWBT. The AG agreed with Staff that the marketing expenses of SBC should be disallowed because the ratepayers receive no demonstrated direct benefit from those activities and expenditures.

The Commission fails to see how expenditures of this nature improve the quality of telephone service or in any other way directly benefit the ratepayers of Oklahoma. The record simply does not support SWBT's claim that ratepayers are benefited by these expenditures. On the contrary, it is the Commission's belief that these type of marketing expenditures, if anything, typically increase the goodwill of the business, a benefit which only inures to SBC's shareholders. Therefore, the Commission adopts the ALJ's recommendation that these costs be disallowed and the adjustment proposed by the Staff is accepted. In view of the fact that the Staff's adjustment is made to

SWBT's TYE books and records, and is supported by substantial evidence, the Commission finds that this amount is the appropriate adjustment, rather than the AG's adjustment to the minimum filing requirements.

This adjustment is reflected as a reduction to expense, on Line 46 of Schedule E in the amount of $354,797.

Line 47 - 5th Anniversary Expenses

The record reflects that Staff disallowed vouched expenses associated with SBC's Fifth Anniversary Celebration. SBC produced calendars, banners, cards and a video to celebrate the five years since divestiture and incorporation of SBC. Staff disallowed these costs because they did not provide any direct benefit to the ratepayers. The ALJ found that SWBT failed to prove that there was any direct benefit to the ratepayers from this activity.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as a reduction to expense, on Line 47 of Schedule E in the amount of $25,325.

Line 48 - Nonbusiness Portion Of Conference

The record reflects that Staff disallowed the non-business portion of a corporate conference for senior executives held in October, 1989. Staff reviewed the agenda for the conference and determined the percentage of hours spent in business meetings as compared to total conference hours. The allowed percentage was multiplied by the hotel charges but 50 percent of the airline charges for spousal travel were disallowed. The AG included this adjustment as one of the components of the AG's adjustment on Line 52 for Executive and Executive Support. In

light of the fact that the ALJ had recommended adoption of the AG's adjustment at Line 52 of Exhibit 361, the ALJ rejected the adjustment relating to the Nonbusiness Portion of Conference, in order to avoid adjusting twice for the same expense.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

The rejection of this adjustment is reflected as a $0 adjustment to expense on Line 48 of Schedule E.

Line 49 - Vince Project

Staff disallowed costs associated with the VINCE Project. This project refers to a future goal to find ways to combine visual, voice, information, communication and entertainment (VINCE) technologies to meet long-term emerging customer needs. SWBT stated, in response to Staff data request No. 134, that costs incurred in 1990 and beyond for the VINCE Project would be retained by SBC. Staff adjusted SBC's records to reflect that for ratemaking purposes the 1989 costs should be treated as if they also were retained by SBC. Staff noted in its testimony that because these costs will be retained by SBC commencing in 1990, that there will be no level of expense incurred for this project during the time that rates are expected to be in effect; therefore, SWBT is not harmed by disallowance of the VINCE Project expenses. The ALJ found Staff's adjustment to be reasonable.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as a reduction to expense, on Line 49 of Schedule E in the amount of $29,520.

Line 50 - Common Look Project

Staff disallowed the costs associated with the Common Look Project. This was a program designed to develop a common look identity which would strengthen the SWBT trademarks/service marks. SWBT indicated that this project was designed to help customers understand what SBC has to offer and to insure that the identity clearly and accurately reflects customer benefits associated with SWBT. Staff, in response to the concerns expressed by the Commission in General Cause No. 29231, expended a considerable effort in an attempt to quantify the value or the benefit which the unregulated subsidiaries of SBC received from being able to use the SBC trademarks. At the conclusion of this review, Staff was unable to quantify a benefit received by the unregulated subsidiaries of SBC from using the SBC trademark and, therefore, disallowed the costs associated with its promotion. The AG stated that, if the Commission adopted the AG's revenue imputation on adjustment, then Staff's Common Look adjustment should be rejected to allow SWBT to recover the costs related to promoting the trademark. In light of the fact that the Commission has found that the adoption of the AG's royalty revenue imputation adjustment is appropriate, Line 98, infra, the adjustment proposed by Staff at Line 50 of Exhibit 361 is hereby rejected.

The rejection of this adjustment is reflected as a $0 adjustment to expense on Line 50 of Schedule E.

Line 51 - Custom Care Projects

The record reflects that Staff proposed an adjustment to normalize costs for the Custom Care Evaluation Project and Post-Retirement Health Study. The associated costs were normalized over the number of years that the expenses were incurred, in order to eliminate the "spike" in the test year. The ALJ concluded that Staff's proposed adjustment was reasonable.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as a reduction to expense, on Line 51 of Schedule E in the amount of $25,123.

Line 52 - Executive and Executive Support

The AG proposed an adjustment to remove the expenses associated with SBC's Board of Directors, on the theory that this cost should be absorbed by SBC's shareholders out of dividends from its subsidiaries. The AG pointed out that SBC and SWBT both maintain a separate Board of Directors and argued that ratepayers should not be burdened with the costs of both the SBC and the SWBT Board of Directors. SWBT disagreed with the AG's position. It argued that SBC must comply with applicable legal, statutory, regulatory and other commitments and mandates. SWBT stated that most of these functions cannot be avoided and indicated that if SBC did not provide them, then SWBT would have to provide them on its own. SWBT further argued that sharing the associated costs with other SBC operating subsidiaries reduces SWBT's share of these types of costs.

The Commission agrees with the AG that it is unfair to burden the ratepayers with costs which are created solely by the corporate structure of SBC and SWBT. To the extent that costs are duplicated, such as for the Board of Directors' salaries, compensation, and pension plans, it is unfair to require the ratepayers to bear the costs of this organizational structure. Therefore, in the absence of quantification of costs which are not duplicated by SWBT, such as for legal expenses or regulatory expenses necessary to meet FCC and Commission requirements, the Commission finds that SBC's Board of Director expenses should be disallowed.

The Commission further notes that the AG's level of adjustment for Executive and Executive Support Services includes the Staff's adjustment for the nonbusiness portion of the Corporate Conference for senior executives, in the amount of approximately $20,000 as shown on Line 48 of Exhibit 361. The Commission finds that the adjustment proposed by the AG and adopted by the ALJ is supported by substantial evidence. The record reflects that the expenses identified within the Executive and Executive Support Services either duplicate the expenses of SWBT's own Board, strategic and corporate development or cash management functions. The Commission notes that to the extent that they are not duplicative, these expenses pertain to the achievement of overall objectives of SBC, which includes deregulated businesses such as cellular and paging, and foreign investment such as the SBC investment in the Mexican national telephone company.

The Commission notes that the costs disallowed in this finding are analogous to ownership costs incurred for the management of an investment portfolio, consisting of stock in the subsidiary companies. If the stock in the subsidiaries were owned directly by individuals, then they would have to absorb the ownership costs. SBC is able to seek customer reimbursement for these ownership costs only because its principal subsidiary is a regulated telephone company, subject to rate of return regulation by this Commission.

The record reflects that SWBT failed to rebut the testimony supporting these adjustments, and its own witnesses provided additional support for these disallowances. SWBT witnesses Flaherty and Larkin acknowledged that they had not performed any study which equated these costs with any discrete benefit to Oklahoma ratepayers during the test year. (Tr. 10/24/91, p. 162, pp. 80-86.)

Further, SWBT witnesses admitted that the costs accumulated in the executive cost center No. 36 in the test year of $26 million were twice the expenses in either 1988 or 1990. They acknowledged that this

dramatic increase raised a legitimate regulatory concern, but they provided no analysis or explanation to show that the benefits to Oklahoma ratepayers from SBC executive costs were likewise twice the level in 1988 or 1990.

Finally, SWBT's witnesses acknowledged that SBC executives focused on the global objectives relating to all the subsidiaries, regulated and unregulated, whereas SWBT's senior management focused on the needs of the regulated telephone company. In fact, the Theodore Barry and Associates Study (Barry Study) cited by SWBT did not address the issue of whether the regulated telephone company had any need for the SBC services. The Barry Study defined necessity by reference to the needs of the consolidated holding company, and not by references to the distinct needs of the regulated telephone subsidiary. (Exhibits 155, 155a, Attachment 2, p. I.)

The Commission finds that the adjustment proposed by the AG and adopted by the ALJ is reasonable, is supported by substantial evidence, and is hereby adopted by the Commission. In adopting this adjustment the Commission must reject the adjustment proposed at Line 48 of Exhibit 361 in order to avoid adjusting twice for the same expense.

This adjustment is reflected as a reduction to expense on Line 52 of Schedule E in the amount of $1,836,000.

Line 53 - SBC Board of Directors

The record reflects that the AG testified that both SWBT and SBC maintain a separate Board of Directors, with SWBT's Board being compensated by salary by virtue of the fact that all of its members are employees. The AG stated that the SBC Board has both "inside" and "outside" directors and the cost for directors' fees, expenses and meetings are charged to subsidiaries. The AG argued that the costs of SBC's Board of Directors should be absorbed by SBC's shareholders out of

dividends from its subsidiaries, because the SWBT ratepayers should be burdened only by costs of SWBT's Board.

SWBT argued that SBC must comply with applicable legal, statutory, regulatory and other commitments and mandates and that most of these functions cannot be avoided. They argued that if SBC did not provide them, then SWBT would have to provide them on its own. SWBT further argued that sharing the associated costs with other SBC operating subsidiaries reduces SWBT's share of reasonable and necessary costs. SWBT indicated that SBC has created a parent company and an administrative subsidiary structure that performs the functions, activities, and services which are legally mandated for a company with operational and organizational characteristics such as SBC's. SWBT further argued that many of the functions performed by SBC are typical of those in American industry and, therefore, SBC's Board of Directors is a necessary and nonduplicative part of the effective operation of SBC as a corporation and of the subsidiaries as operating entities.

The ALJ found that SWBT's ratepayers should not be burdened by the corporate structure of SBC and its relationship to SWBT. The ALJ therefore recommended that the adjustment proposed by the AG be adopted.

The Commission finds and the record reflects that these expenses either duplicate the expenses of SWBT's own Board, or, to the extent that they are not duplicative, these expenses pertain to the achievement of overall objectives of SBC, which includes deregulated businesses such as cellular and paging, and foreign investment such as the SBC investment in the Mexican national telephone company.

In any event, the Commission finds, based upon substantial evidence, that the ratepayers should not be burdened by additional and duplicative costs created solely from the corporate structure of SBC and its relationship to SWBT. Therefore, the adjustment proposed by the AG contained on Line 53, Column G of Exhibit 361 is adopted.

This adjustment is reflected as a reduction to expense on Line 53 of Schedule E in the amount of $147,000.

Line 54 - Corporate Policy and Strategic Development

The AG recommended that the cost centers which are responsible for the development of new business to support corporate growth, diversification, business development, development and implementation of subsidiaries' business plans in accordance with corporate strategic plans and identification/assessment of products, be disallowed to the extent they exceed 50 percent of the test year charges to Oklahoma. The AG stated that these cost centers represent holding company endeavors which SBC should have absorbed as part of its cost of ownership and portfolio management. The AG recommended allowing 50 percent of these costs which were charged to Oklahoma in the test year, in recognition of the fact that some benefit to SWBT ratepayers may have resulted from these SBC cost centers.

SWBT disagreed with the AG's adjustment and stated that the AG had failed to recognize how the SBC cost allocation system traded expenses. SWBT stated that activities and costs which can be directly identified with a particular subsidiary are charged to that subsidiary and that expenses which are not directly charged to that subsidiary are allocated to all subsidiaries utilizing a factor which relates the cost to the subsidiary to the value of the benefit received. SWBT stated that Oklahoma was only paying its proportionate share of its expenses and that this proportionate share was based upon the expenses and benefits directly related to Oklahoma.

The ALJ found that the AG's position was reasonable. The ALJ concluded that although Staff evaluated the various cost centers of SBC and determined a reasonable allocation factor to Oklahoma, the analysis did not result in the justification of the cost centers as proposed by

SWBT to its Oklahoma ratepayers. The ALJ concluded that SWBT's allocation of the cost centers to its Oklahoma ratepayers was not justified because the beneficiaries of the cost centers are the SBC shareholders.

The Commission finds that the AG's position is reasonable and is supported by substantial evidence. Therefore, the adjustment proposed by the AG to allow 50 percent of these costs is adopted.

This adjustment is reflected as a reduction to expense on Line 54 of Schedule E in the amount of $346,000.

Line 55 - SBC Cash Management

The AG recommended that the costs allocated to Oklahoma from SBC's cash management cost center be disallowed. The AG stated that SBC should bear the costs of its own cash management, because it involves investor/ownership costs which should be netted against investment income. The AG further stated that these activities are duplicative of SWBT's cash management costs which are already included in operating expenses charged to ratepayers. The AG also stated that effective cash management produces investment income which is credited below-the-line, and, therefore, investment costs should be charged below-the-line. The AG further pointed out that income from investment of SBC's liquid assets is recorded in SBC's books and not allocated to subsidiaries to reduce SBC's billings; therefore, ratepayers should not be charged SBC's cash management costs to control and optimize SBC's investment income expenses.

SWBT disagreed with this adjustment and indicated that these functions are not duplicative of SWBT's management of its cash pool, which consists of the payments made by its customers. SWBT had received a "White Paper" from Touche Ross, which indicated that "the 'other' category also includes functions which provide no direct benefit to the

subsidiaries (such as cash management) and so should be retained" (by SBC). Mr. Flaherty testified that despite the Touche Ross White Paper, he now believed these costs should be allocated to SWBT because they provide a benefit to Oklahoma ratepayers.

The record reflects that with respect to the cash management cost center, SWBT's own White Paper favored cost retention at the parent level, recognizing that these expenses conferred "no direct benefit" to subsidiaries. (Exhibits 137, 137a, Appendix MLB-12; Tr. 10/25/91, pp. 14-15.) SWBT further acknowledged that in response to data requests, the the SBC's cash management function pertained only to the management of the SBC's liquid assets, and did not involve management of any of SWBT's liquid assets. (Exhibits 137, 137a, p. 100; SWBT response to data request 576j.) The Commission notes that SBC's cash management activities generated investment income for SBC which was not flowed back to the ratepayers, therefore, it would be inequitable to require ratepayers to fund the associated expenses.

The ALJ found that SBC's cash management costs benefit SBC, not SWBT's Oklahoma ratepayers, therefore, the ALJ recommended the disallowance proposed by the AG.

The Commission finds that SBC's cash management costs benefit SBC, not Oklahoma ratepayers, and the AG's disallowance on Line 55, Column G, of Exhibit 361 is hereby adopted.

This adjustment is presented as a reduction to expense on Line 55 of Schedule E in the amount of $27,000.

Line 56 - Advertising

This line represents a general heading only and contains no issues to be determined by this Commission.

Line 57 - Corporate Advertising

Staff disallowed corporate advertising because 17 O.S., Section 180.1, prohibits ratepayers from paying for advertising expenses incurred by telephone companies unless the advertisement specifically contains a tag line which states "paid for by the ratepayers." The ALJ found that SBC does not add this statement to its advertising and therefore recommended that all SBC advertising costs be disallowed. SWBT acknowledged that all advertisements which are placed at the corporate level do not have the required tag line and SWBT also agreed to an adjustment to exclude corporate advertising. The ALJ found that the Staff's adjustment for corporate advertising should be adopted.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as a reduction to expense on Line 57 of Schedule E in the amount of $416,964.

Line 58 - Product Advertising

Staff recommended the disallowance of all product advertising because 17 O.S., Section 180.1, requires the disallowance of advertising expenses incurred by telephone utilities unless the advertisement explicitly states "paid for by the ratepayers." Staff did not disallow expenses for SWBT's bill inserts because they are informational to customers and are permitted, pursuant to Oklahoma statutes, without the tag line.

SWBT did not include the requisite tag line on its advertising during the test year, but SWBT testified that it began placing this tag line on all advertising as of September 1, 1991. Because this will represent the practice for SWBT during 1992, SWBT recommended that

SWBT's advertising costs for the test year not be removed. Staff recommended that the advertising expenses be disallowed despite the changed policy which caused SWBT to begin using the tag line in September, 1991. Staff stated that although the statute was in place long before the test year, SWBT did not choose to abide by the statutory requirement and include the tag line on its advertisements until Staff sought the adjustment. Because there are no guarantees that SWBT will continue to add the tag line on their advertisements in the future, Staff recommended disallowance of the test year level of advertising expenses.

The record reflects that the ALJ reviewed 17 O.S. Section 180.1(B)(2), and determined that there were additional criteria other than the tag line which SWBT's communications must meet prior to recovering the costs of providing the information as an operating expense. The ALJ noted that the practice of adding the tag line began long after the test year in this Cause and that it was not possible, short of conducting another audit, to evaluate whether the current advertising met the additional statutorily-mandated criteria. Although the ALJ found that SWBT may believe advertising is a "normal and legitimate business expense that provides benefit to both the Company and customers", in general, any direct benefit to the customers would be difficult to quantify. The ALJ found that, in any event, advertising costs during the test year did not meet the statutory requirements for inclusion as an operating expense and noted that there must be an opportunity to evaluate costs prior to allowing their recovery. The ALJ concluded that the simple addition of the required tag line to advertising appearing two years after the test year did not address whether the advertisements met the other requirements for inclusion as an expense item by SWBT, nor the level of costs incurred. The ALJ recommended that the Staff's proposed adjustment to disallow advertising expenses as shown in Column F, Line 58 of Exhibit 361, be adopted by the Commission.

The Commission agrees with the ALJ's conclusions and finds that they are supported by the record, are based upon substantial evidence and are hereby adopted by the Commission.

This adjustment is reflected as a reduction to expenses on Line 58 of Schedule E in the amount of $3,383,070.

Line 59 - Advertising Salaries

Staff recommended the disallowance of the salaries and benefits related to product advertising, on the theory that if an activity is disallowed, then the salaries related to that activity should also be disallowed. Staff prorated the advertising salaries based upon the percentage of disallowed advertising costs to total advertising costs. Staff indicated that SWBT keeps its advertising salaries booked separately from the general body of employees' salaries, and that Staff's adjustment went only to those separately-booked salaries as opposed to some percentage disallowance of SWBT's salaries as a whole. SWBT objected to Staff's disallowance of the advertising wages and salaries and stated that the individuals in those departments did more than "place ads."

The ALJ found that Staff adjusted only salaries which were recorded in SWBT's books as "advertising salaries." Although SWBT indicated that those individuals' jobs require more than simply advertising-related responsibilities, SWBT failed to offer evidence as to the nature of those responsibilities. We have reveiwed the record and find that Staff drew a reasonable conclusion that salaries recorded as "advertising salaries" are related to work performed with respect to advertising. In light of the fact that there is a procedure for recording these salaries, the burden falls upon SWBT to record any salaries related to activities other than advertising in a different account.

SWBT also seemed to suggest that since this adjustment was not made in prior cases, it was not appropriate to make the adjustment in this Cause. In his report, the ALJ noted that labor-tracking mechanisms were not in place in previous cases and it was plausible to conclude that advertising salaries may not have been identifiable as such in the past. The ALJ correctly concluded that SWBT's argument that it was not aware an adjustment would be made because of prior Commission policy, even if true, was not controlling with respect to our treatment of this adjustment or any other appropriate adjustment. The Commission notes that it is reasonable to expect that when the costs of an activity are disallowed, then all related costs associated with the performance of that activity are likewise disallowed. The Commission finds that Staff's adjustment to disallow advertising salaries is based upon substantial evidence and said adjustment is hereby adopted.

This adjustment is reflected as a reduction to expense on Line 59 of Schedule E in the amount of $217,928.

Line 60 - Customer Deposits

The Commission finds that its rules allow SWBT to require a deposit from customers as a condition of providing service to that customer. These rules also require SWBT to pay interest on that deposit until it is returned to the customer.

In this Cause, Staff deducted such TYE customer deposits from rate base because the item represented cost-free capital to SWBT. SWBT and the AG similarly adjusted the rate base, with only minor variances in the amount of the adjustment. Staff included the interest which SWBT is required to pay on these deposits in the cost of service as an operating expense because the amount of those deposits at TYE was removed from the rate base. SWBT and the AG made similar adjustments to operating expense for this interest although the amounts varied.

We find that past practices of this Commission and the evidence proffered by all parties establishes that deposits should be deducted from rate base and the associated interest should be included as an operating expense. The Commission further finds that Staff's evidence on this adjustment is substantial, was recommended by the ALJ, was not appealed by any of the parties and is hereby adopted by this Commission. These adjustments were reflected at Column I, Line 60 and Column F, Line 60 of Exhibit 361.

These adjustments are reflected as an increase to expense and a reduction to rate base on Line 60 of Schedule E in the amounts of $223,593 and $2,478,125, respectively.

Line 61 - Membership and Dues

Staff disallowed memberships and dues in civic organizations as an operating expense in the cost of service, indicating that they are not directly related to the cost of providing telephone service. Staff witness Mr. Buck testified that Staff has consistently removed these expenses from the cost of service in previous rate cases. He further indicated that recognizing a direct benefit to the ratepayers is extremely questionable and that attempting to quantify such a benefit would be very difficult and time-consuming. SWBT objected to the disallowance of these expenses, indicating that there is a legitimate business objective associated with these memberships and they are, therefore, appropriate business costs. However, SWBT removed them from the revenue requirement calculation to be consistent with prior Commission treatment of these items.

The Commission finds that it has consistently disallowed costs of memberships and dues in civic organizations for utilities in previous rate cases and in this Cause on similar memberships, supra. Based upon the facts of this case, the Commission finds no reason to justify changing this policy to allow inclusion of these expenses. The

Commission therefore, adopts the adjustment made by Staff and SWBT, contained in Columns F and E, respectively, of Line 61, Exhibit 361. The Commission further notes that this was the recommendation of the ALJ and was not appealed by the parties.

This adjustment is reflected as a reduction to expense on Line 61 of Schedule E in the amount of $184,679.

Line 62 - Long-Term Telephone Plant Under Construction (TPUC)

The Commission finds that all parties recommended that long-term telephone plant under construction (TPUC) be disallowed from rate base as not being used or useful during the test year. In addition, the ALJ recommended that disallowance of long-term TPUC be adopted and none of the parties appealed this recommendation.

Based upon the Commission's review of the record, we find the recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties, and is hereby adopted.

This adjustment is reflected as a rate base reduction on Line 62 of Schedule E in the amount of $5,186,972.

Line 63 - Wide Area Calling Plan

SWBT made adjustments to its revenues, expenses, and rate base to reflect the revenue requirement for implementation of the Wide-Area Calling Plans (WACPs) approved by this Commission in Cause Nos. PUD 000899, PUD 000974, and PUD 000975. As testified to by Mr. Larry Schroeder, Staff did not make an adjustment to SWBT's revenues, expenses, and rate base, but instead, included the funding for these WACPs as a part of Staff's recommended rate design. Staff utilized this approach because the WACPs ordered in Order No. 357147 on May 22, 1991 had not been implemented at the time testimony was

prepared for this Cause nor had they been implemented prior to the hearing in this Cause. Further, Commission Order No. 357147 required that funding of the WACPs should be provided through an order to be issued in this Cause, Cause No. PUD 000662, if revenues were available. In order to determine whether revenues were available for the additional revenue requirements pursuant to implementation of WACPs, Staff was required to determine SWBT's revenue requirement before WACP consideration.

Because the funding of the WACPs is accomplished through the rate design, as recommended by the ALJ in this Cause, the Commission agrees with the disallowance of SWBT's adjustment for revenues, expenses, and rate base associated with the WACPs as set forth in Line 63, Exhibit 361.

The Commission's decision on this issue results in $0 impact to revenues, expenses, and rate base on Line 63 of Schedule E.

Line 64 - Artwork

Staff recommended the removal from rate base of SWBT's investment in artwork as not being necessary to the provision of utility service. Staff witness Buck testified that the Commission has historically removed artwork from a utility's rate base. SWBT did not dispute the adjustment and the ALJ recommended that the artwork cost be removed from rate base.

The Commission has reviewed the record and finds that artwork is not necessary to the provision of utility service to the ratepayers of SWBT and, therefore, removes the artwork from rate base as set forth in Line 64 of Exhibit 361.

This adjustment is reflected as a reduction from rate base on Line 64 of Schedule E in the amount of $106,651.

Line 65 - Income Tax Adjustments - (Deferred Taxes Associated with Bad Debts)

The Commission has reviewed the record and finds that the recommendation of the ALJ with respect to Income Taxes was combined with his recommendation on Line 101 entitled "Revenue Requirement Effect of Income Tax Difference (PLR)". For the purposes of this Order, the Commission has reviewed the recommendations and adjustments individually and will discuss them separately. With respect to the adjustment on Line 65, the Commisison finds the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by the Commission as set forth below.

SWBT stated that for book purposes bad debt expense is deductible for income tax purposes on an accrual basis. SWBT stated that for determining the current income tax payment, bad debt expense is deductible only when it is actually written-off. This difference in book and tax treatment results in a timing difference which requires recording deferred income taxes. SWBT also testified that prior to the Tax Reform Act of 1986 (TRA or TRA 1986), taxpayers were allowed to deduct bad debt expense on an accrual basis. However, TRA Section 805 required that taxpayers change to the actual write-off method. For SWBT this change was effective January 1, 1987. TRA provided requirements to taxpayers as to how to treat the change from the accrual method to the actual write-off method for tax purposes under the provisions of IRC Section 481 and accordingly, when SWBT took the adjustments into taxable income, SWBT credited the adjustments to taxable income ratably over a four-year period. SWBT stated that Staff did not use the deferred tax reserves recorded on SWBT's books at the end of the test year, but instead recalculated an amount. SWBT further testified that according to their workpaper, J45.1, Staff computed SWBT's deferred tax reserve by multiplying the unamortized Section 481 adjusted amount as of December 31, 1989 by the appropriate income tax rate. Further, Staff's workpaper J45.1 indicates that SWBT is on the "actual net write-off"

method of accounting for bad debts. Based upon that assumption, it was SWBT's belief that Staff had concluded that no book-tax timing difference existed and that the only deferred income tax reserves which should be included in this Cause are those related to the change from accrual to the actual write-off method for tax purposes.

Staff stated that it did not agree with SWBT's interpretation of Staff's workpaper, J45.1. Staff indicated that SWBT's testimony to the effect that Staff incorrectly concluded that SWBT is on the actual write-off method, is inconsistent to what is shown on Staff's workpaper, J45.1, which is Exhibit 334 in this Cause. Staff recognized that SWBT is not on the actual net write-off method and indicated that for regulatory book purposes, Staff has always used the actual net write-off method while SWBT has always used the reserve method. A note at the bottom of Exhibit 334 indicates that for regulatory purposes in Oklahoma, Staff has always used actual write-offs for determining bad debt expense.

SWBT admitted that if the tax return treatment and the regulatory treatment are the same, there would be no timing difference and there would be no provision for deferred income taxes. However, prior to the TRA, for current income tax purposes, SWBT was allowed to deduct bad debt expense under the reserve method. Because for Oklahoma regulatory purposes, the Commission required the actual write-off method, there should have been deferred income tax reserves recognized for the timing difference between the ratemaking and income tax treatments. SWBT admitted it did not know if Staff had developed its bad debt percentage using actual net write-offs instead of using the books bad debt expense.

The ALJ found that as book and tax were the same pre-TRA, there was a regulatory deferred income tax related to bad debt expense because Staff always used net write-offs. In addition, the ALJ found that post-TRA, there would be no regulatory deferred income tax related to bad debt expense because there is no timing difference for regulatory and tax, and the ALJ recommended Staff's adjustment.

The Commission has reviewed the record and finds prior to TRA 1986 that SWBT used the reserve method for computing bad debt expense for income tax purposes and book purposes. Because of this treatment, SWBT did not recognize deferred income taxes related to bad debt expense for financial reporting purposes. The Commission further finds that the Commission has used the net write-off method for determining bad debt expense for regulatory purposes and this treatment required recognition of deferred income tax reserves related to the timing difference created through regulation prior to TRA. Post-TRA 1986, SWBT is required to use the net write-off method for income tax purposes. Because this treatment of bad debt expense is consistent with the Commission's treatment for ratemaking purposes, a timing difference no longer exists. Therefore, for the period subsequent to the implementation of TRA 1986, deferred income taxes are not recorded for ratemaking purposes. The Commission's review of the record indicates that the ALJ's recommendation shall be adopted as clarified by these findings.

This adjustment is reflected as a rate base reduction on Line 65 of Schedule E in the amount of $10,594,186.

Line 66 - GAAP:

The Commission recognizes that Generally Accepted Accounting Principles ("GAAP") need not be adopted or recognized by regulatory commissions for ratemaking purposes. The Oklahoma Constitution places the authority and responsibility of setting utility rates upon the Commission, not the Financial Accounting Standards Board (FASB). In fact, we note that the FASB has promulgated a Financial Accounting Standard ("FAS"), FAS No. 71 (Accounting For The Effects Of Certain Types Of Regulation) which specifically acknowledges that regulators may make adjustments for ratemaking purposes which are inconsistent with financial accounting standards and GAAP. (Exhibit 364, para. 55, p. 24.) The Commission's determination with regard to the applicability

of GAAP to the regulatory process of setting utility rates on specific issues shall continue to be addressed on a case-by-case basis.

After reviewing the record in this Cause, the Commission finds that while this Line has no dollar effect on revenues, expenses, or rate base, Lines 67 and 68 of this Order, infra, have a dollar effect and are instances where GAAP shall not be adopted for ratemaking purposes except to the extent that FAS No. 71 applies.

Line 67 - Pension (FAS NO.87)

In determining whether to adopt GAAP for pension accounting, the Commission as a public utility regulatory body is faced with the responsibility of determining whether the accrual accounting required by GAAP (FAS No. 87) will result in a reasonable level of costs for ratemaking.

Staff witness Fred Buck recommended adjustments to SWBT's pension expense, deferred income taxes and rate base due to a recent change in pension reporting requirements for financial reporting purposes which requires deviation from prior Commission policy of allowing the actual amount funded as the allowable expense for pensions. He adjusted the negative expense recorded on SWBT's books from approximately $4 million to zero. He testified that zero was the amount deductible for federal income tax purposes and should be the amount allowable by the Commission. He further testified that this adjustment would impact ratepayers because it would increase SWBT's expenses and revenue requirement and therefore generate future ratepayer revenue. Mr. Buck explained that using the actual funding method of zero would be conservative regulatory treatment. He further explained that increases or declines in the value of the pension asset or changes in actuarial assumptions could create volatility in the amount to be funded.

Mr. Buck adjusted accumulated deferred income taxes to eliminate the difference between the IRS's and Staff's expense, and SWBT's per book pension expense at Schedule B-3, Line 3 of Staff's Exhibit 363. He stated this was necessary to be consistent with the use of the actual funding amount of zero as the allowable expense reported to the IRS and proposed for ratemaking purposes by Staff.

Additionally, Mr. Buck indicated that Staff's proposed adjustment to rate base of approximately $15.2 million would remove the amount of the pension asset which has been funded by the ratepayers, including earnings on the asset, in excess of the pension liability. He further stated that allowable ratemaking expense had been provided through rates at the actual funding level in previous years. Therefore, the funding for the pension asset has been provided by ratepayers through rates, and should be excluded from rate base.

Mr. Buck agreed that the Statement of Financial Accounting Standard No. 87 Employers Accounting for Pensions (FAS No. 87) is applicable to SWBT and requires the recognition of the service cost of an employee working and providing labor, for which SWBT accumulates certain retirement benefits during the time the employee's service is provided. Mr. Buck further stated that whether or not funding is required to support the costs incurred depends upon a variety of factors, including how the pension asset's investment income increases during the period. Mr. Buck indicated that GAAP recognizes the pension liability cost at the time it is incurred and matches it with the employees' cost causer. When asked whether Staff's adjustments reflect the funding level required for pension expense during 1991, the refund period, Mr. Buck stated he did not know, because 1991 was not completed. He testified that it was not possible to determine what the funding level or the book expense level would be in 1992 because the expense amount and the funding level would vary depending on the performance of the pension asset compared to the service cost. Mr. Buck agreed that a temporary adverse financial condition would result if FAS No. 71 required a

write-down of the pension asset that had been established under Part 32. He also testified that this would be offset by the increased revenues from the ratepayers which would make up that loss in the future. He also agreed that there would be increased revenues because Staff's proposed revenue reduction would be larger without Staff's proposed pension expense adjustment to zero.

Mr. Buck stated that he agreed with statements by SWBT witnesses Chicoine and Kay that the Staff's proposed treatment of pension expense is not consistent with GAAP; however, he also stated that the Commission is not constrained by GAAP in any way. He referred to page 24, paragraph 55 of FAS No. 71, and stated that FAS No. 71 tells accountants how to apply the effects of regulation for external financial reporting. Mr. Buck agreed that past treatment of pension expense by Staff predated USOA Part 32 and that SWBT's recording of the expense under FAS No. 87 is consistent with USOA Part 32, since it incorporates FAS No. 87 as GAAP. Mr. Buck also agreed that GAAP recognizes that there is some consistency from time period to time period in the accounting reporting process.

SWBT witness Mr. Chicoine recommended the Commission adopt FAS No. 87 to account for pension expense, which would cause a negative pension expense and reduce cost of service during the test year. He testified that FAS No. 87 would require including the pension asset, net of associated deferred income taxes, in the rate base. He stated that the rationale to include the pension asset in rate base was that the ratepayers were afforded a reduction of pension expense through the return on assets component of the pension calculation. Mr. Chicoine stated that the terms of the pension plan which define the benefits an employee will receive (the plan's benefit formula) are the overall basis for computation. He further stated that the FASB believed that the pension plan itself provided the most relevant and reliable indication of how pension expenses and obligations are incurred.

Mr. Chicoine described the five components of determining pension cost. He stated that the initial component in determining pension or service cost, represents the present value of the future benefits earned by the employee during the period. He testified that the second component of pension cost is interest. He further testified that because the pension liability is stated in present value dollars, it is necessary to accrue interest cost on the pension obligation to account for the passage of time. He stated that the third component is the return on plan assets set aside to meet the pension obligation. He further stated return (earnings) reduces pension cost, and that the return offsets the positive components of the pension calculation. He testified that the fourth component of pension cost, prior service cost, represents the increase of cost attributed to additional benefits granted by amendments to the pension plan. Mr. Chicoine stated that the final component of pension cost is the amortization of the transition asset. He stated that the excess of plan assets over the actuarially-determined liability at the date of initial application of FAS No.87 is to be amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan, which was 18 years. He further stated that amortization of the transition asset reduces the current cost to be recognized. He summarized the intrastate pension cost in the 1989 test year as follows:

Components	Millions
Service Cost	$ 5.6
Interest Cost	22.4
Earnings on Plan Assets	(27.7)
Prior Service Cost	1.2
Transition Asset Amortization	(6.1)
Total Pension Cost	$ (4.6)

Mr. Chicoine testified that at the implementation of FAS No. 87, the projected benefit obligation was calculated. He defined projected benefit obligation as the actuarial present value of all benefits attributed by the pension benefit formula to employee service rendered prior to that date. He testified that to the extent that the fair value of plan assets exceeds the projected benefit obligation, an unrecognized pension asset exists. He explained that FAS No. 87 required that this net pension asset (i.e., transition asset) be reflected on SWBT's books.

Mr. Chicoine urged the Commission to adopt FAS No. 87 for ratemaking purposes. He recommended that the Commission not revert back to the funding method which would be equivalent to the cash basis of accounting. He stated that the accrual basis of accounting is widely accepted for ratemaking and is superior to the cash basis of accounting. He further stated that because FAS No. 87 expense levels are currently negative, a zero level of pension expense as recommended by the Staff would actually assign more costs to ratepayers than appropriate under GAAP and would result in an increase in SWBT's cost of service. Mr. Chicoine further stated that the Commission's failure to adopt FAS No. 87 for ratemaking purposes would deny two components of FAS No. 87 methodology which reduce pension expense by approximately $33 million. Under the funding method, Mr. Chicoine stated that the ratepayer would be denied the return component of approximately $27.7 million of pension assets that were funded in the past, as well as the recognition of the transition asset of $6.1 million. Mr. Chicoine further stated that should the Commission adopt the funding method of accounting for pension expense, the cost of service to the ratepayer would unnecessarily increase approximately $4 million. Additionally, he testified that SWBT would have to recognize a reduction in net income of $28.5 million due to the nonrecoverability of the pension asset. He stated that when a regulator affects the recoverability of an asset, then FAS No. 71 requires the recognition of a regulatory liability to reflect the cost the company will be incurring in the future which will not be recovered by rates.

SWBT recorded approximately $4 million negative expense on its books. It attributed this negative expense in 1989 to the amortization of the transition asset, but as was admitted later by SWBT, the earnings could be the cause. SWBT also agreed that FAS No. 87 does not address regulatory accounting.

AG witness Mr. Carver, explained that SWBT's minimum standard filing requirements, the starting point for his analysis, had no pension asset listed and that he did not propose an adjustment to include the pension asset in rate base. To maintain consistency, Mr. Carver recommended removal of the related deferred income tax attributable to the difference between book and tax pension expense. Mr. Carver did not propose adjusting the pension expense to zero.

The ALJ recommended the elimination of the pension asset from rate base for ratemaking purposes, finding that the pension asset reflected on SWBT's books is caused by the collection from ratepayers in excess of what is allowable for ratemaking purposes plus a return on those ratepayer-supplied funds.

The Commission has reviewed the record and consistent with its past treatment for SWBT and other utilities as well as the method used by the IRS, the Commission adopts actual funding levels as the method by which to determine recoverable pension expenses. For the 1989 test year, SWBT had a negative booked pension expense and zero funding. Accordingly, the Commission accepts Staff's upward adjustment to pension expense to agree with the funding level of zero. (Exhibit 185, p. 5.) Staff also made a corresponding adjustment to accumulated deferred income taxes to eliminate those amounts related to pension expense as shown on Schedule 13-3, Line 3.

The Commission further finds that the pension asset represents the accumulation of funds collected through utility rates plus a return on these funds, less the pension liability. Like all customer-supplied capital, these investments should not be in rate base. Therefore, the Commission adopts the ALJ recommendation to remove the pension asset from rate base.

SWBT argues that this treatment of pension accounting will require it to write-off the pension asset. We note that the pension asset was

not created through any prior action of this Commission approving GAAP treatment of pension accounting. Rather, SWBT created the asset on its books in 1988, for financial reporting purposes, to reflect GAAP treatment. Any write-off of this asset will be simply a reversal of a previously booked entry made for financial reporting purposes, and will not reflect any change in Commission policy which requires a reversal of a Commission-authorized asset. (Tr. 11/25/91, pp. 42-43.)

These adjustments are reflected as increases to expense and rate base on Line 67 of Schedule E in the amounts of $3,964,365 and $15,226,000, respectively.

Line 68 - Compensated Absences

Staff witness Michelle Krug testified that compensated absences represent costs paid to employees for periods in which employees are on vacation, sick leave or holidays. She stated that prior to 1988, SWBT recorded these expenses on a cash basis. Beginning on January 1, 1988, however, for financial reporting purposes, GAAP required SWBT to book vacation pay as it was earned. She further explained that this created a double counting of vacation pay accrued in the initial year, 1988. In 1988, SWBT expensed vacation pay earned in prior years, and in addition, SWBT began to book vacation pay earned during the 1988 calendar year which would not be taken until later years. SWBT has requested permission to include in expenses the amortization of vacation expense earned by employees in years prior to 1988 but expensed in 1988, over a ten-year amortization period, and to include accruals for compensated absences accrued in 1989. Because the proposed amortization period includes the 1989 test year, ratepayers would be required to pay for more than 52 weeks total compensation (base salary, sick leave, vacation pay) per employee under SWBT's proposal. (Tr. 1/20/91, pp. 120-121.)

Ms. Krug reduced the 1989 basic wages by that portion representing the amortization of compensated absences, both as to the ten-year

amortization for accruals prior to 1988 and the accruals for the test year to be taken in future years. The effect of Staff's adjustment is to put SWBT on a cash basis for all compensated absences. Staff has made this amortization disallowance consistently in the past.

SWBT disagreed with Staff's so-called "pay as you go" approach to accounting for compensated absences. SWBT witness Chicoine stated that SWBT conforms to GAAP and Part 32 by accruing the liability as an employee earns future vacation time. Mr. Chicoine proposed that the unaccrued compensated absences expense be amortized for intrastate purposes on a straight-line basis over a ten-year period beginning in 1988. He further stated that it should be made clear that GAAP treatment must be accompanied by recovery of the transition year cost. It was his testimony that adoption of GAAP without including recovery of the amortization of the transition year would effectively give no recovery to SWBT for one-year's worth of compensated absences. In addition, Mr. Chicoine asserted that the Commission's decision would invoke FAS No. 71 requirements, which would result in the immediate recognition of the remaining Oklahoma intrastate 1988 regulatory asset as an expense.

Mr. Buck, on cross-examination, indicated that Staff was not suggesting SWBT not follow the accrual method of accounting for compensated absences and that the only topic under discussion was whether to allow the amortization of the ten-year amount to be included in utility rates. Mr. Chicoine indicated that this issue was not one of compensation, but rather, one of accounting. Mr. Chicoine, referring to Mr. Buck's response that the Commission should allow SWBT to utilize the accrual basis for compensated absences, but not allow it to recover the ten-year amortization, stated that if SWBT were denied recovery of the asset associated with the 10-year amortization, the asset would have to be written-off pursuant to FAS No. 71.

Mr. Chicoine further indicated that if the Commission were to rule that SWBT was on a cash basis for vacation pay, then SWBT would not be required to write-off the asset. He cautioned that if the Commission rules the accrual basis is proper but recovery of the catch-up is not, such an action would necessitate a net income write-off at the point in time the Order issues. Therefore, he recommended the Commission very carefully explain what kind of accounting recognition SWBT would be getting for compensated absences.

The ALJ recommended that Staff's adjustment be denied because of the adverse financial impact it would have on SWBT.

The Commission has reviewed the record and finds that GAAP shall not be adopted for ratemaking purposes regarding compensated absences. The Commission finds it inappropriate and unreasonable to require ratepayers to pay more than 52 weeks of compensation in SWBT's authorized rates for each SWBT employee. The Commission has traditionally permitted only 52 weeks of compensation per year, regardless of function (vacation, sick leave, time-at-job). Even though SWBT may be expensing extra weeks of compensation for financial reporting purposes due to its accrual accounting under GAAP, the uncontroverted evidence showed that SWBT, itself, will not be actually paying employees for more than 52 weeks worth of compensation each year. Thus, SWBT's claims of adverse financial impact are unfounded. Further, the Commission agrees that Staff's adjustment puts SWBT on a cash basis with respect to all compensated absences. Accordingly, we reject the recommendation of the ALJ.

This adjustment is reflected as a reduction to expense on Line 68 of Schedule E in the amount of $1,448,430.

Line 69 - 1991 Basic Allocation Factor (BAF) Phase-down

SWBT witnesses recommended increases in expenses and in rate base for the 1991 BAF phase-down period associated with the BAF phase-down which will cease in 1993, four years after the test year end.

Staff and the AG testified that inclusion of the 1991 BAF phase-down in calculating SWBT's 1989 test year revenue requirement was improper and violates the rationale for adhering to a historical test year concept for setting prospective rates for SWBT. Staff witness Manning testified that such a change cannot be used, alone, to quantify on-going revenue streams which depend on volumes of use and which can, in fact, be stimulated by price decreases. (Tr. 10/14/91, p. 137.)

The ALJ's recommendation was to adopt SWBT's proposed 1991 incremental change to BAF because BAF is a jurisdictional, interstate separations change required by the FCC for SWBT's interstate operations.

The Commission rejects this recommendation for two reasons. First, this Commission notes that it is not required to accept this method of cost separation for its Oklahoma intrastate jurisdiction. Historically, the Commission has decided to accept or reject the FCC cost separations methodology after an Oklahoma-specific costing method has been evaluated. The specific changes mandated by the FCC to its costing methodology are irrelevant in this Cause in that an arbitrary 25 percent factor will be applied to SWBT-Oklahoma for interstate investment. We reject the FCC methodology in this instance because it is a national average costing method, and is calculated without relevant consideration of the intrastate costs appropriate to Oklahoma operations of SWBT. The Commission finds it need not surrender its authority to evaluate the costs which apply to the Oklahoma intrastate jurisdiction merely because of the FCC's interstate authority over BAF cost separations.

Second, the Commission finds that this adjustment is an attrition adjustment and rejects the ALJ's recommendation because the adjustment violates the historical test year concept. Adjusting for BAF phase-down changes occurring in 1991 is improper when the test year in use in this Cause ended on December 31, 1989. Rate proceedings take time and, by necessity, rates must be set based upon a "snapshot" of operating conditions existing during the selected test year. The objective is to set rates which provide for recovery of a representative level of costs required to be incurred in order to provide service. It is reasonable to assume that most representative revenues and expenses used in connection with a given test year will change beyond the end of that test year. Some expenses or revenue levels may decrease while some may increase. Selective inclusion of expense level changes occurring far beyond the end of the test year without consideration to matching revenue level changes tends to invalidate the test year concept upon which rates are being set. The Commission finds that this attrition adjustment violates the rationale for adhering to a historical test year concept for setting prospective rates for SWBT and thus, rejects the adjustment.

This adjustment is reflected as resulting in a $0 impact on test year revenue and expense on Line 69 of Schedule E.

Line 70 - 1991 Step of the COE CAT 3 Transition (DEM)

Staff and the AG declined to support adjustments for the estimated impact of the 1991 phase-down of the separations factors, on the grounds that an adjustment would distort the test year relationship and that any adjustment would not be known and measurable but would be based on estimates only. SWBT argued on behalf of the adjustments and the ALJ recommended adoption of SWBT's position. The Commission has reviewed the record and finds that, as with the adjustment on Line 69, this adjustment is an attrition adjustment which occurred July 1, 1991, 18 months beyond the 1989 test year end. This adjustment should be

disallowed because the change to expenses distorts the test year relationship and is not accurately quantifiable.

The Commission also finds that this adjustment is improper in that it is a jurisdictional separations change adopted by the FCC which is not required to be adopted by the Commission. This Commission is not bound to adopt FCC costing methodologies, but in fact, must determine each methodology according to the evidence and circumstances in each cause as it relates to SWBT's operations in Oklahoma. The Commission rejects this adjustment for cost separation for the SWBT-Oklahoma jurisdiction because it does not constitute an Oklahoma-specific intrastate costing method.

This adjustment is reflected as resulting a $0 impact on test year revenue and expense on Line 70 of Schedule E.

Lines 71, 72, 73 and 74 - Cash Working Capital

Staff testified that cash working capital (CWC) is the amount of money a business needs in cash to run its day-to-day operations. For a regulated utility, CWC represents the amount of cash investment required to perform the daily operations of the regulated service until those expenditures can be recovered through the collection of revenues. Staff indicated that CWC is either an addition to or a subtraction from the rate base. The AG defined CWC as the amount of cash needed by a utility to pay its expenses incurred in providing service for the period during which the utility has expended cash in advance of the collection of revenues. SWBT defined CWC as the average investment required for accounts receivable from customers, less accounts payable and taxes payable. SWBT also indicated that CWC can be defined as an estimate of the amount of investment required over and above the investment in net plant and the other items specifically covered in the rate base component.

Staff used a lead/lag study to determine CWC, although it recognized there are two other methods by which CWC can be determined. These are the formula method and the balance sheet method. Staff and the AG indicated that the lead/lag method is considered to be the most reliable of the three methods because it measures the differences in the time frames between the time services are rendered until the revenues from that service are received and the time that labor, material, etc., used in providing services, are incurred until they are paid for. Staff indicated that the differences between these periods are expressed in terms of days and the number of days so calculated, times the average daily operating expenses included in the calculation, produces the CWC required for operations. The revenue lag days were calculated from the mid-point of the service period to when the funds are available for use by SWBT. The expense lead days were calculated from the mid-point of the service period to the "check clear" date.

The Commission approves the lead/lag study as the preferred method of determining a utility's CWC requirements. That study accurately measures the timing of cash flows through a utility. A specific measurement of cash inflows is made from the number of days between the provision of service to customers and the collection of related cash revenues for services rendered. Measurement of the timing of cash outflows for each cash expense element of the cost of service is determined from the average number of days during which the utility enjoys the use of funds owed vendors, represented by the period between receipt of purchased goods (and/or labor) and ultimate cash payment for these items. If more "lag days" are involved in collecting utility revenue from ratepayers than a utility can delay payment of expenses (expense "lead" days), investors must provide cash to fund the payments. On the other hand, if cash disbursements can be delayed, or revenue collections accelerated so that average expense lead days exceed average revenue lag days, ratepayers can be said to be the providers of cash and a negative cash working capital requirement is required from investors of SWBT.

The Commission rejects SWBT's use of the formula method to determine CWC requirements. Even SWBT's own expert witness Jeter stated that the lead/lag study was the soundest approach for making this determination. (Exhibit 200, p. 3.) Further, on cross examination, Mr. Jeter said he could not explain why SWBT had used a one-eighth formula method when the lead/lag approach was theoretically the most correct. (Tr. 10/21/91, p. 106). Further, Mr. Jeter acknowledged that he had performed no analysis to determine how SWBT had arrived at the 45 day and 35 day allowances which SWBT's formula method used for expenses and local revenues, respectively. (Id., p. 115.) The Commission specifically notes that we have historically approved the use of a lead/lag study to support a utility's CWC request. See, Order No. 250987 in Cause PUD No. 28002.

Finally, the Commission affirms that there is nothing inappropriate or illogical about the use of a negative cash working capital allowance when supported by a lead/lag study. In fact, SWBT witness Jeter acknowledged that when the formula method yields a positive result and the lead/lag study a negative result, exactly the situation here, the lead/lag study is more likely the correct result. (Id., p. 110.)

Staff calculated the revenue lag days from the mid-point of the service period to when the funds are available for use by SWBT. The expense lead days were calculated from the mid-point of the service period to the check clear date. Staff used a zero lag day for depreciation and amortization expense because accumulated depreciation is already deducted from rate base. Staff explained that a zero lag day was also used for deferred income taxes because accumulated deferred income taxes are deducted from rate base.

As required by the Commission in Cause No. PUD 000260, SWBT performed a lead/lag study for this Cause. The study was originally performed on 1988 data and provided to Staff. Staff then requested SWBT to recalculate it on a 1989 test year basis. Staff used SWBT's 1989 study as a starting point for its CWC calculation. SWBT argued that

Staff included the debt component in their CWC requirement but did not include equity. SWBT argued that equity should not be excluded from the lead/lag study because the investor must supply funds to cover the lag in payment and therefore should earn a return for that period of time while the monies are invested.

The Commission has reviewed the record and finds that a lead/lag study is the most accurate way to determine the appropriate level of CWC. The Commission further finds that the definition of CWC requires that SWBT have enough money on hand to pay expenses, and that expenses do not include a return on equity.

The Commission declines to adopt SWBT's recommendation that an equity component be included in a lead/lag study. The lead/lag study focuses on delays in the flow of cash receipts related to operating revenues and cash disbursements related to operating expenses. Investors' equity returns are paid out of the profits of the firm, however, and are not obligatory nor operating expenses. Equity returns are normally reflected in dividend distributions which are discretionary with management.

Therefore, the Commission finds that Staff and the AG appropriately excluded equity from their calculations of CWC. The Commission finds that because interest expense does involve a mandatory cash outlay from the utility, it shall be included in a proper lead/lag study. (Exhibits 137, 137a, pp. 64, 84.) Accordingly, the Commission adopts the recommendation of Staff and reduces rate base for CWC as set forth in Column I, Line 73 of Exhibit 361.

This adjustment is reflected as a reduction to rate base on Line 73 of Schedule E in the amount of $17,910,386.

Lines 75 - 7-1-91 CCL Rate Reduction

This issue was discussed at Line 38, supra, of this section. The Commission's recommendations regarding Common Carrier Line charges (CCL) are included in that discussion.

Line 76 - 1991 Impact of Toll Pool Stipulation

SWBT proposed an adjustment to increase revenues based upon the projected 1991 impact of the toll pool stipulation. Staff and the AG did not recommend this adjustment. Staff witness Manning testified that a price change, in and of itself, cannot be used to quantify ongoing revenue streams which also depend on volumes of use. (Tr. 10/14/91 p. 137.) SWBT's witness Chicoine acknowledged that despite the implementation of the optional toll calling plans by virtue of Order No. 344396, issued January 24, 1990, toll revenues increased by $6.0 million in 1990 over 1989 levels. (Tr. 11/20/91 pp. 101-103.) The ALJ recommended adoption of SWBT's adjustment, apparently, by comparing these and other attrition adjustments to his recommendation regarding the June 30, 1991, expiration of the amortization of the reserve deficiency.

The Commission has reviewed the record and finds that the 1991 toll pool settlements occurred outside the test year and constitute attrition adjustments. Moreover, the amount of the settlements had not been finalized during the hearing and the evidence showed that the impacts to revenues could only be estimated. Thus, the proposed change to the historical test year was not known and measurable in order to be considered as an acceptable attrition adjustment to test year revenues.

Further, this Commission rejects the ALJ's use of the adoption of the reserve deficiency amortization (RDA) adjustment, for ratemaking purposes, as a basis for recognizing distortive post-test year changes, such as the 1990 and 1991 decrease in the Common Carrier Line (CCL)

charges (Lines 38 & 75), the Optional Toll Calling Plans (Line 36), the Basic Allocation Factor (BAF) phase-down (Line 69), the Step of the COE CAT 3 Transition (Line 70), and this one. Unlike the RDA, which arose from depreciation inadequacies prior to the test year, and which rate impact was fully known and quantifiable, these other post-test year changes have a dynamic impact on ongoing post-test year revenue requirements which cannot be fully assessed without a full consideration of post-test year volumes of access and toll services, and other related cost of service implications.

As previously discussed at Line 34, this Commisison finds that unlike the distortive post-test year adjustments, the RDA adjustment is an appropriate "known and measurable change whose inclusion does not result in any distortions of the test year, or matching concept". First, there was a specific regulatory intent, memorialized in an order, to provide for a recovery of known, verifiable costs over a predetermined time period. Second, the reserve deficiency originated in the purported inadequacy of past depreciation rates which existed prior to the 1989 test year, unlike the attrition adjustments discussed above.

For these reasons, the Commission rejects this adjustment. This adjustment is reflected as resulting in a $0 impact on test year revenues on Line 76 of Schedule E.

Line 77 - Co-op Taxability

As of January 1, 1990, the telephone cooperatives operating within the State of Oklahoma began paying income taxes which will be recovered from the toll pool, thereby reducing SWBT's settlements from the toll pool. Staff and SWBT proposed an adjustment which recognizes a stipulation entered into between the participants in the toll pool which allows the cooperatives to recover their income taxes from the toll pool, effective January 1, 1990. The ALJ recommended that this adjustment be adopted as set forth in Columns B and C of Line 77 of

Exhibit 361. This recommendation was not appealed by any of the parties.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as a decrease to revenues on Line 77 of Schedule E in the amount of $787,400.

Line 78 - Postal Rate Increase

SWBT made an adjustment to recognize the increase in postage rates which became effective in February, 1991. SWBT argued that this postage increase was a known and measurable change which was caused externally and was beyond SWBT's direct control, thereby meeting Staff's and SWBT's criteria for pro forma adjustments. In support of its argument, SWBT further stated that in General Cause No. 29321, which had a test year of 1984, the Commission allowed a postal increase which became effective February 17, 1985.

Staff objected to the adjustment for the postal rate increase because this postal increase occurred more than a year beyond the December 31, 1989 test year-end, unlike that which occurred in General Cause No. 29321 approximately two months beyond the end of that test year. The ALJ recommended that the adjustment be adopted.

The Commission has reviewed the record and finds that this adjustment is so far outside of the 1989 test year as to violate the historical test year concept. The Commission notes that Staff and the AG have consistently opposed such attrition adjustments in this Cause. The Commission further notes that rejection of this adjustment is consistent with the Commission's ruling on similar attrition adjustments sought by SWBT. Thus, the Commission rejects the adjustment contained in Column B and E on Line 78, Exhibit 361.

This adjustment is reflected on Line 78 of Schedule E as resulting in $0 impact on test year revenues and expenses.

Line 79 - Debt Refinancing

SWBT made an adjustment to reduce its expenses to reflect the lower cost of debt which resulted from retiring $732 million of high-cost, long-term debt and replacing it with lower-interest cost, intermediate debt in June, 1991. SWBT stated that the ratepayers will benefit from the refinancing through a lower cost of debt component in the ROR calculation. SWBT acknowledged that the savings initially will be partially offset by the costs of the refinancing of the call premium and unamortized discount. SWBT proposed recovery of the refinancing costs over a five-year period, which represents the average term of the intermediate debt issued to refinance the retired debt.

Staff rejected the use of this adjustment to refinance debt because Staff utilized a hypothetical capital structure, which implicitly assumes a hypothetical cost of debt. Therefore, post-test year changes in the actual cost of debt would not impact the hypothetical cost of debt previously recommended by the ALJ and adopted by this Commission. Moreover, Staff rejects the inclusion of this post-test year adjustment consistent with its treatment of other attrition adjustments proposed in this Cause. The ALJ recommended inclusion of this adjustment.

As set forth hereinabove, this Commission has adopted the use of a hypothetical capital structure. For this reason, post-test year changes in SWBT's actual debt costs cannot be considered to impact the hypothetical cost of debt.

Moreover, this Commission has consistently rejected attrition adjustments to the test year ending December 31, 1989. Even though the acceptance of the debt refinancing costs might result in a lower cost of

debt in the capital structure than would occur if the cost of debt at December 31, 1989, is utilized, we believe it is inappropriate in this case to go 18 months beyond the test year to include this adjustment. Therefore, the Commission rejects the adjustment.

The rejection of this adjustment is reflected as resulting in a $0 impact to test year expenses on Line 79 of Schedule E.

Line 80 - Minimum Cash Balances Required

All parties proposed an adjustment to increase rate base for minimum cash balances. Staff's adjustment to increase rate base for minimum cash balances is included as an adjustment to the CWC. The ALJ recommended that the adjustment contained in Column I of Line 80, Exhibit 361, be adopted as an increase to the rate base of SWBT. This recommendation was not appealed by any of the parties.

The Commission has reviewed the record and finds that the recommendation of the ALJ is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission. The Commission therefore approves the adjustment quantified in Column I of Line 80, Exhibit 361.

This adjustment is reflected as an increase to rate base on Line 80 of Schedule E in the amount of $3,236,516.

Line 81 & Line 96 - Advance Payments

Staff reduced rate base for advanced payments, which are received from customers prior to the establishment of service. SWBT did not contest this adjustment and SWBT's Schedule GRC - 3A, Page 5 of 6 entitled "Summary of Adjustments" includes the same amount proposed by Staff for this adjustment. The ALJ found that the adjustment, as contained in Column H of Line 81 and repeated in Column I of Line 96,

Exhibit 361, was agreed to by all parties and should be adopted by the Commission as appropriate adjustments to rate base.

The Commission has reviewed the record and finds that the recommendations of the ALJ are supported by substantial evidence, are reasonable, were not appealed by the parties and shall be adopted by this Commission.

This adjustment is reflected as a decrease to rate base on Line 96 of Schedule E in the amount of $29,634.

Line 82 - Internal Audit - Marketing Non Reg

Staff testified that it reviewed SWBT's Cost Allocation Manual (CAM), its application, and SWBT's internal audit reports, and these reports indicated that a timesheet reporting problem existed in the marketing department for time reports from January to July 1989. Staff relied upon Exhibit 304, SWBT Audit Report No. 09-81, dated September 6, 1989 which found that a sample of time reports for January through July, 1989 showed 47 percent of the unregulated hours incorrectly reported. Further, the Audit Report found that 14 percent of the samples were incorrect after GHQ training was completed during June, 1989. Because the timesheets are used to allocate all expenses within the marketing department between regulated and nonregulated activities, Staff recommended a conservative 14 percent adjustment to correct time reporting errors not corrected or discovered during the test year.

Staff testified that it used the 14 percent error rate to quantify the amount of the adjustment to regulated marketing salaries and wages. Staff's Adjustment No. 30 in Section H, Schedule 3, was to adjust the marketing salaries and benefits. The Internal Audit Report No. C9-11 dated March 28, 1989, stated " . . . employee time reporting supports the CAM by assigning salary and wage costs to the appropriate function. CAM provides FCC approved procedures for separating the costs of

regulated and unregulated activities. SWBT must follow CAM procedures to maintain eligibility to compete in the unregulated market . . ." The Internal Audit Report No. C9-11 included a review of the 1988 time reports which found that the marketing sales personnel were not in compliance with the CAM.

Staff also testified that internal Audit Report No. 09-81 dated September 6, 1989 was a follow-up internal audit undertaken to evaluate compliance with CAM time reporting requirements. This report stated that " . . . unregulated hours were not correctly reported for 134.5 of 287.5 (47 percent) hours reviewed; however, only 18.5 (14 percent) of the incorrectly reported hours occurred after GHQ training (completed during June 1989). . . " The 14 percent correction sponsored by Staff was applied to the total marketing salaries and benefits. This adjustment removed the expense from the Oklahoma jurisdiction.

SWBT stated that Staff's adjustment was unnecessary because SWBT had corrected the amounts for the errors found in the sample of the audit report.

The ALJ found that there was no evidence presented that SWBT had corrected the percentage of errors found within the sample to the entire universe of the marketing department's time reports. Additionally, there was no evidence presented that the corrections reallocated the marketing department expense. SWBT's marketing department's timesheets are used to allocate all of the marketing department expenses between the regulated and nonregulated activities. The ALJ determined that ratepayers should not subsidize the nonregulated activities of the marketing department because of incorrectly reported nonregulated hours as regulated activity hours. Therefore, the ALJ recommended that Staff's adjustment to the marketing department expenses was reasonable and should be adopted.

The Commission has reviewed the record and finds that the ALJ's recommendation is reasonable, is supported by substantial evidence and is hereby adopted.

This adjustment is reflected as a reduction to expense on Line 82 of Schedule E in the amount of $1,157,110.

Line 83 - GHQ Prorate

Staff adjusted the allowable GHQ expenses for the prorate factors it sponsored. Additionally, Staff adjusted the allowable SBC expenses which were charged to SWBT for the Oklahoma prorate factor it sponsored. SWBT objected to the use of the 1990 GHQ prorate factors to allocate the expenses in the test year despite the fact its witnesses testified that the true-up for this data is available within a very short time after it is experienced. Staff stated that due to the short timeframe for true-up data availability, it appears reasonable to use the most current data available.

Staff utilized 1989 test year actual expense data to develop prorate factors to allocate GHQ expenses to SWBT-Oklahoma. Staff testified that the use of the SWBT 1989 prorate factors advocated by SWBT, which are based on 1988 expenses, would cause the GHQ expense allocated to Oklahoma to be overstated for the test year. Staff also stated that the procurement allocation factor should be based upon the actual 1989 procurement expense rather than the 1989 level of purchased goods. This would more properly reflect the amount of overhead support necessary to serve the Oklahoma ratepayer.

SWBT believed that it would not be possible to develop prorate factors for any test period. The intent of the prorate factors is to develop a reasonable and cost-causative basis to be used to allocate actual costs. SWBT has an obligation to produce financial reports and allocate costs as they are incurred throughout the year.

SWBT stated that Staff's GHQ adjustments were inappropriate for adjusting the prorate factor because it was developed based upon information available from 1989. SWBT further testified that it is impossible to develop prorate factors using the actual data to which they are being applied, because a year's worth of data must be studied to compute the new prorate factors. Further, these amounts are never trued-up. If Staff reached out beyond the test year, then SWBT could never recover the expenses associated with the test year prorates and Staff had the luxury of looking back at what was actually booked in 1989 and adjusting to that amount.

SWBT stated that Staff has not followed the same methodology in other areas of its revenue requirement determination of using a year-ending methodology. Therefore, it was not appropriate to use 1990 factors as Staff recommended.

The ALJ found that SWBT develops GHQ prorate factors for each year based on the historical experience of the actual expenses from the prior year. Therefore, there is always a lag between the current activity and the way it is being prorated. Staff took the 1990 factors which were based on 1989 information and applied them to the total GHQ expenses which were prorated to the state in 1989. The ALJ found that Staff's procedure was entirely reasonable and appropriate. He stated that although it may be necessary to use historical factors when it is too burdensome or cumbersome to restate the factors based on current test year expenses, this is not the situation here, where the true-up data is available within a short time after it is experienced. Staff did have the luxury of hindsight, but it is appropriate that Staff used it to make this adjustment. It would be unreasonable to the ratepayers of Oklahoma to charge them with expenses which historical experience shows were greater than they should have been.

The ALJ concluded that it is proper to adjust the test year GHQ prorate factors to reflect the synchronization of the test year expense

level with the resulting prorate factor. SWBT's argument, that the resulting shift of expenses from Oklahoma to the other states could not be recovered, is without merit. It was established through cross-examination by the AG that the year's changes in these prorate factors made by SWBT do not automatically result in a reshuffling of the recovery of these costs between states served by SWBT, because new rate orders are not issued in each state on the same date these new prorate factors change each year.

The Commission has reviewed the record and finds that the recommendation of the ALJ is supported by substantial evidence, is reasonable and is hereby adopted by this Commission. Accordingly, the Commission recommends that the GHQ prorate factors be adjusted to reflect the actual 1989 expense level as proposed by Staff. This will more accurately reflect the actual expenses incurred by GHQ and allocated to SWBT-Oklahoma ratepayers on a prospective basis.

In addition, the Commission finds that there was no evidence to support a direct relationship between the cost of an item and the amount of administrative cost associated with procurement of that item. Therefore, the Commission finds that the GHQ procurement allocation shall be based upon actual procurement costs, not upon the dollar amount of purchases, and adopts Staff's procurement factor as reasonable. The Commission, therefore, finds that Staff's adjustment based upon the recalculation of the GHQ prorate factors and the GHQ procurement allocation factor be adopted.

This adjustment is reflected as a reduction to expense on Line 83 of Schedule E in the amount of $1,457,093.

Line 84 - Net Compensation Study

Each year SWBT performs a compensation study for the purposes of determining intercompany investment compensation necessary to ensure

that each state/regulatory jurisdiction within SWBT is appropriately compensated for the costs related to the portion of property located within its boundaries which is used or shared by another state/regulatory jurisdiction. This compensation expense is referred to by SWBT as the carrying cost and is comprised of an allowance for depreciation, the amortization of leasehold improvements, property taxes, maintenance costs and a return on investment.

Staff proposed adjustments to maintenance costs, amortization of leasehold improvements and the return on investment portions of SWBT's net carrying cost expense.

SWBT calculated its projected test year maintenance expense amount by dividing an expense amount contained in a monthly operating report by the associated categories of plant investment. Staff stated that SWBT utilized estimates for the maintenance cost portion of the carrying costs, because SWBT does not maintain its accounting records in a manner which would present the actual maintenance cost associated with each compensation facility. Staff's analysis indicated the SWBT experienced less in actual maintenance expense than projected by SWBT's maintenance expense calculation methodology. Therefore, Staff developed its compensation maintenance cost recommendations based on actual 1989 expenses rather than SWBT's 1989 expense projections.

SWBT disagreed with Staff's methodology for calculating the maintenance expense portion of these carrying costs. SWBT stated that Staff misinterpreted SWBT's monthly financial reports and that Staff's proposed adjustment contained errors because it excluded corporate loadings, and plant specific and plant nonspecific carrying charges applicable to certain types of plant.

The ALJ found that the compensation maintenance cost adjustment presented by Staff was reasonable because it is based on actual test year data which proved to be lower than the maintenance expense

estimates utilized by SWBT. The ALJ determined that SWBT's argument that Staff excluded certain costs in this calculation, thus resulting in the possible under-recovery of the maintenance portion of these carrying costs, is without merit because the failure of SWBT to specifically account for compensation maintenance costs by plant facility makes such an occurrence impossible to establish. In addition, the fact that actual maintenance expenses were lower than projected by SWBT would support not raising the compensation maintenance costs level calculated by Staff.

Staff also testified that the leasehold improvement amortization portion of these carrying costs associated with SWBT's leased space in the Thomas Jefferson Building and Syndicated Trust Building should be normalized in order to spread the leasehold improvement investment balance over the remaining life of the leases on the facility involved. According to Staff, the remaining life of these leases has been extended since the end of the test year due to lease arrangement renewals. The amortization of the remaining leasehold improvement balances over a shorter timeframe, as proposed by SWBT, would result in an over-recovery of the value of these leasehold improvements.

The ALJ recommended Staff's adjustment to SWBT's leasehold improvement amortization, because it was clear from the evidence presented that SWBT's accelerated amortization of the leasehold improvement balance will result in an over-recovery of the value of these leasehold improvements. In addition, the ALJ determined the evidence supported the fact that by renewing the leases of these facilities, SWBT has extended the period of leasehold improvement amortization beyond the period utilized by SWBT during the test year.

Staff proposed an adjustment of the ROR component of these carrying costs using the net plant balances associated with compensation property assets and the overall ROR for SWBT determined by Staff. Staff stated that the methodology utilized by SWBT to compute the ROR component of

the carrying cost on the compensation property assets was based on SWBT's gross investment in these assets. Staff stated that SWBT's approach is comparable to a replacement cost method, which advocates that the investment has the same value presently as the day the investment was placed in service, despite the fact that SWBT has already recovered a portion of its investment through the recognition of depreciation expense as a cost of service item.

SWBT stated that Staff failed to properly determine the accumulated depreciation associated with the specific compensation property assets that were subject to Staff's ROR adjustment. While Staff admitted that this was a problem, it stated that because SWBT does not maintain detailed accumulated depreciation records by specific plant asset, such a specific determination was not possible.

The ALJ recommended Staff's proposed adjustment to the ROR component of the carrying costs associated with compensation property assets. A basic premise of utility regulation is that a utility is entitled to an appropriate ROR only on its net, or after accumulated depreciation reduction, investment in plant. To provide a utility with an ROR on its gross plant investment would over-compensate the utility's investors because the depreciated portion of these assets has already been returned to investors through recovery of depreciation expense through rates. SWBT's argument, that Staff incorrectly calculated the accumulated depreciation reserve on the compensation plant assets, must be disregarded because it results from a deficiency in the capabilities of SWBT's accounting record system, thereby making a specific determination of these reserve levels impossible.

The Commission has reviewed the record and finds that the recommendations of the ALJ are supported by substantial evidence, are reasonable and shall be adopted by this Commission.

This adjustment is reflected as a reduction to expense on Line 84 of Schedule E in the amount of $1,623,268.

Line 85 - AT&T Reimbursements

The Oklahoma Supreme Court, in Turpen, supra, indicated that the Commission could give consideration to amounts received by SWBT from AT&T as reimbursement for prior year's expenses. Staff, in this Cause, recommended an adjustment to reduce SWBT's rate base for the total of the 1985 and 1986 AT&T reimbursements, in the approximate amount of $292,000 plus interest, at SWBT's authorized ROR computed to August, 1991, and added to the reimbursement amount. SWBT objected to this rate base reduction and the refunding of these amounts, stating that these were one-time reimbursements which were received outside of the December 31, 1989 test year. Staff also stated that it did not include the interest expense in operating expenses for determining revenue requirements because it would be self-defeating to accrue the interest for refund and then allow it as an operating expense for recovery from customers.

The AG also made a rate base reduction for the reimbursements received from AT&T in 1985 and 1986. Both Staff and the AG indicated that they received the information concerning the amount of the AT&T reimbursements from a data response furnished by SWBT.

The AG pointed out that, as a general rule, unless a specific disallowance of costs occurs within a rate proceeding, the Commission should presume that the costs in question are recovered by the ratepayers. Both Staff and the AG stated that the original costs relating to the refunds from AT&T were paid by the ratepayers and therefore, they both recommended this adjustment to allow the ratepayers to also recover the refund related to those costs. The AG and Staff calculated interest on the AT&T refunds at the Commission-authorized overall ROR in effect from the time the refunds were received by SWBT until April 19, 1991 for the AG and August, 1991 for Staff.

SWBT stated that the reimbursements in question are not of the same nature as those addressed in the Turpen decision. SWBT also indicated that the interest calculated by Staff and the AG is similar to interest on customer deposits and, therefore, an expense recognition should be made.

The ALJ found that SWBT made an invalid comparison between interest on customer deposits and the interest Staff and the AG calculated on the AT&T reimbursments. The interest on customer deposits has been paid by SWBT and is recognized as an increase to operating expenses. The interest on the AT&T reimbursement has not been paid by SWBT. This interest, in effect, represented the carrying charge on the refunds which were received in 1985 and 1986 and which have not been returned to the customers who originally paid the costs.

The ALJ found that SWBT should not receive a windfall by virtue of receipt of these reimbursements from AT&T. The record reflects that ratepayers paid for costs of the same type as the reimbursed type of expenses, through rates prescribed in prior rate cases. Although the amounts received from AT&T were received outside the December 31, 1989 test year, the ALJ recommended that it would be appropriate to refund these amounts to the ratepayers over the five-year period that the rates in this Cause are expected to be in effect. Additionally, the ALJ recommended that it would be appropriate to apply interest, calculated at SWBT's overall ROR, for the period of time between the receipt of the AT&T reimbursements and the date of the final Commission Order in this Cause, but that it was not appropriate to allow that interest to be recognized as an expense.

The Commission has reviewed the record and notes that it has consistently rejected the allowance of adjustments to revenues or expenses which occurred outside the test year for the reasons given. However, with respect to this adjustment, the Commission finds that the Oklahoma Supreme Court in Turpen specifically indicated that AT&T

reimbursements of this type were appropriate adjustments to prior year expenses, given the fact that these funds were supplied by the ratepayers and would constitute a windfall to SWBT were it allowed to retain them. The Commission finds compelling equity reasons exist to allow this adjustment in order to recognize the liability incurred by SWBT to refund these amounts to customers. The Commission further finds that it is appropriate to apply interest to these refunds, but rejects the ALJ's recommendation to set interest at SWBT's ROR. Instead, this Commission has determined that the more appropriate interest rate, consistent with the interest rate for the refund ordered herein for the reasons given, infra, is SWBT's ROE. In all other respects, the Commission finds that the recommendations of the ALJ are supported by substantial evidence, are reasonable and shall be adopted by this Commission.

These adjustments are reflected as reductions to expense and rate base on Line 85 of Schedule E in the amounts of $180,826 and $723,306, respectively.

Line 86 - Ad Valorem Taxes

Staff, based on Commission policy, stated that it used a "cash" rather than the "accrual" method for its ad valorem tax calculations. This caused a reduction in the amount of ad valorem tax expense that Staff proposed.

Because ad valorem taxes have increased each year and the actual 1990 tax was greater than 1989, SWBT proposed bringing ad valorem tax to an end-of-period level. SWBT stated that its proposal would then accurately reflect actual going-forward levels.

The ALJ found that the use of cash basis for this expense was inconsistent with the ratemaking concepts applied in other areas of Staff's proposals and Staff's adjustment understated actual taxes for

1990. Because actual post-test year ad valorem taxes increased, Staff's adjustment to lower the tax was contrary to other going-forward adjustments and the ALJ recommended that SWBT's proposal be adopted.

The Commission has reviewed the record independently of the ALJ's recommendation and notes that Staff's position with respect to its use of the cash method is not inconsistent with other adjustments herein. We, however, adopt the recommendation of the ALJ with respect to the use of the accrual method for calculating ad valorem taxes, but decline to find, as the ALJ seems to have, that this is an attrition adjustment. The Commission notes that no party appealed the recommendation of the ALJ.

The Commission believes the result obtained by the ALJ's recommendation is correct and supported by substantial evidence, but we disagree with the ALJ's description of the SWBT's position as an attrition adjustment. The record is clear that the difference between Staff and SWBT on this adjustment results from Staff's use of a cash basis for treatment of ad valorem taxes as opposed to SWBT's use of an accrual method, and not, as the ALJ implied, a request by any party to adopt an attrition adjustment.

The Commission has reviewed the record and finds that the recommendation of the ALJ, as clarified herein, is supported by substantial evidence, is reasonable, and was not appealed by the parties and shall be adopted by the Commission.

Acceptance of this adjustment is reflected on Line 86 of Schedule E and results in a $0 impact on test year expenses.

Line 87 - U.S. Olympic Festival

In 1989, SWBT incurred expenses through sponsorship of the U.S. Olympic Festival held in Oklahoma City. SWBT objected to the removal of

the U.S. Olympic Festival costs from the cost of service stating that the staging of the festival helped to bolster the local economy. Moreover, SWBT claimed that as a direct result, additional revenues were generated from sales of telephone services to customers. These resulting revenues were part of test year revenues, which SWBT stated, should be matched with the expenses that generated them.

Staff disallowed the costs incurred by SWBT for this sponsorship. Staff reasoned that the Olympic Festival would have been held regardless of the sponsorship of SWBT and that the revenues which SWBT attributed to the Olympic Festival would have been received by SWBT for the sale of those services in any event. Staff also indicated that the ratepayers did not receive any direct benefit from this expense. The AG adopted Staff's recommendation.

The ALJ found that there was a direct benefit to Oklahoma associated with this expense and, because the associated revenues were included in the test year, he recommended that the adjustment be adopted.

The Commission has reviewed the record and rejects the ALJ's recommendation to allow these expenses in the cost of service. The Commission finds that the ratepayers received no direct quantifiable benefit as a result of this expense and that the sponsorship was a one-time expense which will not occur again during the time for which rates are in effect. The effect of the ALJ's recommendation would be to allow SWBT to recover the total cost of $134,162 of sponsoring the U.S. Olympic Festival in Oklahoma City for each year that SWBT's rates are in effect. Thus, if the ALJ's recommendation were adopted, SWBT would have recovered a total of $670,810 from Oklahoma ratepayers if SWBT's rates remain in effect for 5 years.

Moreover, this Commission has historically disallowed costs associated with a utility's operations which are not related to the ability and obligation of that utility to provide utility service. The

sponsorship of these Games was not required for the provision of utility service. We find no evidence or compelling reason to support a deviation from our long-established policy in this instance and thus reject the adjustment.

This adjustment is reflected as a reduction to expense on Line 87 of Schedule E in the amount of $134,162.

Line 88 - Company Outing

Staff disallowed the expenses associated with the SWBT picnic stating that there was no direct benefit to the ratepayers as a result of this type of expense. SWBT objected to the disallowance of the expense, stating that this was a reasonable and normal cost of doing business. Further, SWBT stated that the outing was an outing for all of its Oklahoma employees and the cost per employee was merely $5.00. SWBT stated that such activities are intended to boost employee morale and productivity and the expense was minimal.

The ALJ found that there was no direct benefit to the ratepayers from this type of expense and that this type of expense has historically been disallowed by this Commission. The ALJ believed that merely because other unregulated companies provide this type of activity is irrelevant to the determination of whether the ratepayers should pay for this activity here. The ALJ found that employee morale and job satisfaction also benefits the stockholders of SWBT and that any increased productivity which would create a benefit for the ratepayers would be almost impossible to quantify. The ALJ further found that the relatively low cost of the adjustment is an irrelevant consideration, because any cost which does not directly benefit the ratepayers through improved quality of service should not be borne by the ratepayers no matter how insignificant the amount. The ALJ thus recommended that Staff's adjustment disallowing the expense be adopted.

The Commission has reviewed the record and finds that the recommendation of the ALJ is supported by substantial evidence, is reasonable, was not appealed by the parties and shall be adopted by this Commission.

This adjustment is reflected as a reduction to expenses on Line 88 of Schedule E in the amount of $28,492.

Line 89 - Antitrust Expenses

Staff made an adjustment to disallow costs allocated to Oklahoma by General Headquarters ("GHQ") which were associated with antitrust legal expenses. Staff indicated that a similar adjustment was accepted by the Commission in Cause No. PUD 000260. The amount adjusted by Staff was the result of SWBT's response to a data request concerning outside legal fees related to contingent liabilities from pre-divestiture antitrust cases. SWBT objected to Staff's adjustment indicating that the legal expenses that Staff proposed to disallow were related to defense of lawsuits pending at divestiture. SWBT introduced Exhibit 372, Staff Data Request No. 197 and SWBT's response thereto, as an explanation of the types of lawsuits included in the legal fee account disallowed by Staff.

SWBT stated further that the prior Commission antitrust adjustment used by Staff was for an out-of-period settlement expense and not for legal fees recorded in Account No. 6752. In General Cause No. 29321, legal fees associated with antitrust expense were normalized to equal a two-year average leaving $1.8 million in the cost of service.

The ALJ found that the legal fees were for ongoing suits, were normal business expenses and recommended allowance of the costs.

The Commission has reviewed the record and finds that the recommendation of the ALJ is supported by substantial evidence, is reasonable and shall be adopted by this Commission.

Rejection of Staff's proposed adjustment is reflected on Line 89 of Schedule E and results in a $0 impact to test year expenses.

Line 90 - Short-term TPUC Disallowance

Staff recommended the disallowance of all telephone plant under construction, (TPUC), both short-term and long-term, as not being currently used or useful. (The Commission has found on Line 62, supra, that long-term TPUC should be disallowed.) Staff testified that the basic principles of ratemaking would require synchronization of the level of investment, revenues and expenses, and that if any additional revenues or any expense savings were not recognized, the related investment should not be included. Staff testified that it had reviewed Exhibit 366, which is a list of projects under construction and found that it was impossible to determine from the review whether the listed projects would create new revenues. A sample of the projects reviewed which were included in Exhibit 366 were related to the Service Improvement Program which is discussed at Line 97.

SWBT stated that short-term TPUC is used and useful to current ratepayers and therefore should be included in rate base. SWBT indicated that TPUC often reflects increased customer demand for technologically-advanced telecommunication services rather than growth in customer base and TPUC is often used for customer service improvements such as equal access, replacements or civic improvements. SWBT stated that TPUC is often used to ensure that adequate telecommunication facilities will be available in usually two-to-three months on the average. SWBT also testified that short-term TPUC is allowed by the FCC. SWBT further stated that, at the very least, interest during construction (IDC) should be authorized to compensate the investor for investment in short-term TPUC.

evaluating whether CWIP or TPUC should be included in rates. SWBT failed to provide the classification of its TPUC projects as revenue-producing or nonrevenue-producing. Therefore, though the Commission rejects the notion that Staff be required to "forewarn" the Company of any future policy changes which might affect the Company's financial standing, it is clear in this Cause that SWBT was adequately "forewarned" by virtue of this Commission's decision regarding CWIP in Cause No. PUD 000260.

The Commission also rejects the argument that disallowance of short-term TPUC will act as a disincentive for SWBT to meet customer service demands on a timely basis. The Commission's Telephone Rules establish timeframes for meeting customer demands and the ALJ's recommendation that the Staff should have the burden of establishing that SWBT is not meeting service objectives improperly shifts the burden of proof from SWBT to Staff. The Telephone Rules establish minimum guidelines for quality of service standards and installation times and the burden should be placed squarely on the shoulders of SWBT, who is in a position to better evaluate its ability to meet these minimum requirements, to show that disallowance of short-term TPUC will cause SWBT to be unable to meet the service requirements mandated by the Telephone Rules in the future. SWBT did not meet this burden here. In contrast, however, Staff witness Mr. Buck testified that his review of a sample of the short-term TPUC projects revealed that a number of them were related to the service upgrades ordered by this Commission in Cause No. PUD 000260, projects which Staff recommends not be included in rate base because SWBT's ratepayers have already paid for them through rates which were not changed in Cause No. PUD 000260.

Accordingly, the Commission finds that short-term TPUC shall be disallowed in this Cause in recognition of the principle that only short-term TPUC whose revenue requirement impacts can be synchronized with related known and quantifiable increases to revenue and changes to operating expenses shall be allowed in rate base.

This adjustment is reflected as a $11,131,832 reduction to rate base on Line 90 of Schedule E.

Line 91 - Employee Concessions

Staff recommended that toll revenues be increased to recognize the impact of usage by employees who qualify for concession use of the intraLATA toll network. SWBT's monthly reports to the intraLATA toll pool include employee concession amounts recorded as billed revenues and the more billing reported, the more SWBT recovers in settlements as its share of the total revenues reported by all toll pool member telephone companies. Staff's proposed adjustment recognizes an amount in the revenue category of intraLATA toll which represents the intraLATA toll provided to employees at no charge or at reduced charges. The concession revenues reported to the toll pool should be added to the revenues earned by SWBT according to Staff because they increase the settlements received by SWBT after expenses are recovered.

SWBT stated that this benefit is provided to active and retired management employees. This benefit helps create employee job satisfaction and allows the employees to monitor the service quality of the network at all times. It also provides the opportunity for efficient repair and maintenance of any possible problems occurring in the network.

SWBT further stated that pooling procedures require a Local Exchange Carrier (LEC) to report to the pool its concession revenue. This revenue is equal to the toll concessions given to its employees, less an associated amount of concession expense, even though real revenue is not collected or booked by the LEC. As a result of the revenue sharing that takes place in the pool, the other LECs participating in the pool actually receive additional cash flow equal to about one-third of SWBT's net concession revenue. SWBT further stated that not only does SWBT

The AG proposed the inclusion of IDC on short-term TPUC only on a prospective basis because any benefits from the completion of 1989 TYE TPUC projects will only be realized in periods subsequent to the 1989 test year. Because post-test year savings or revenues resulting from the TYE TPUC projects have not been recognized in determining revenue requirement, it would be inappropriate to include those expenditures in rate base, due to the inherent mismatch such inclusion would introduce into the ratemaking process. The AG further testified that rather than include short-term TPUC in rate base and allow SWBT to earn a current cash return from ratepayers, the Commission should authorize SWBT to capitalize the IDC thereon in a manner similar to long-term TPUC through off-book or memorandum records. Once a short-term construction project is completed and ready for service, the AG recommended that computation of IDC cease. Further, because any IDC "capitalized" would occur prospectively, the AG stated that the corresponding net addition to rate base should only be recognized in future rate proceedings. Staff stated that they would have no objection to allowing IDC on short-term TPUC on a prospective basis.

Both Staff and the AG pointed out that SWBT does not classify its short-term TPUC projects as revenue-producing or nonrevenue-producing. The absence of this classification precludes identifying increases to revenue from increased sales or decreases to operating expenses from operating efficiencies related to these projects that could have off-setting effects to the revenue requirements associated with inclusion of the TPUC in rate base.

SWBT stated that if short-term TPUC is disallowed by the Commission, then $910,000 of IDC should be included in rate base plus related depreciation expenses of $55,000 in the current case, as this is the accumulation during 1989. Because of the burden of keeping different intrastate and interstate records with respect to this issue, as the FCC considers short-term TPUC an includable rate base item, SWBT stated that the inclusion of short-term TPUC in rate base would be preferable. SWBT

further testified that Staff's position was a change in policy which should have been conveyed to SWBT at the time it was made in order to "forewarn" SWBT of the pending change.

The ALJ recommended that short-term TPUC be allowed as consistent with past Staff policy. He also recommended that Staff be required to "forewarn" SWBT of any future policy changes.

The Commission has reviewed the record and finds that we are not bound to follow the FCC rule related to short-term TPUC when setting Oklahoma intrastate telephone rates subject to Commission jurisdiction. Rather, the Commission has the right to decide its own ratemaking policy for its jurisdicitional customers, regardless of the policy decisions made by any other regulatory body. Additionally, the Commission is not required to adhere to any particular ratemaking formula and may be guided, but is not bound, by prior ratemaking policy decisions. Although many policies remain unchanged and continue to be a guide currently, the Commission must have the freedom to continually reevaluate previous positions based on the evidence presented in each case, because otherwise, neither the Staff nor SWBT could ever hope to effect changes of regulatory policy.

The Commission rejects the ALJ recommendation which would require Staff to "forewarn" utility companies of changes in policy because this would severely hamper Staff's ability to properly discharge its responsibility to investigate and make recommendations to the Commission concerning a reasonable level of rates for each respective utility.

The Commission also takes judicial notice of its Order No. 341630 issued by this Commission in Cause No. PUD 000260 with regard to SWBT. That order disallowed revenue-producing construction work in progress (CWIP) from SWBT's rate base, as well as the revenues associated with the CWIP. Prior to this Cause, SWBT was therefore aware that Staff considered revenue-producing/nonrevenue-producing status as criteria for

receive less cash flow from the pool because of the inclusion of this net concession revenue in pooling, but SWBT does not receive any reimbursement from the pool for the concession benefit. SWBT recommended that no adjustment be made to test year revenue for this employee concession.

The ALJ found that if the other LECs report employee concession revenue to the pool and receive cash flow from the pool, then SWBT must also receive cash flow from the pool, albeit, two-thirds of SWBT's net concessions revenue. Because SWBT does receive cash flow from the pool, Staff's adjustment to include this as income appears reasonable, and therefore the ALJ recommended the Commission adopt Staff's adjustment.

The Commission has reviewed the record and finds that the recommendation of the ALJ is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as an increase to revenues on Line 91 of Schedule E in the amount of $547,449.

Line 92 - CATS Revenue

Staff recommended that toll revenues be adjusted in recognition of the impact of credit card usage and third-party billing from other states (CATS) as this is an adjustment to SWBT's miscellaneous revenue which is identified and reported to the toll pool as a billed revenue. GHQ has a Bellcore-provided billing system which extrapolates from the amounts contained in FCC Account No. 5164, "Miscellaneous Other Revenues", the Calling Card and Third-Number Billing. Staff proposed that the CATS revenue reported to the toll pool be added to the revenues earned by SWBT because it increases the settlement to SWBT from the toll pool.

SWBT stated that the CATS process involves a [illegible] handling charge for performing the customer billing function and is booked by SWBT in Account No. 5264.299 - Other Incidental Regulated Revenue, Intrastate, Miscellaneous, Other. Further, CATS revenues do not represent a usage charge. The handling charge revenue was booked in Oklahoma and included in the test year booked revenue in this Cause, and already included in Staff's year-end revenue. Therefore, SWBT recommended that because Staff's adjustment was basically a double-counting of SWBT's revenues, Staff's adjustment should be disallowed.

The ALJ found that because the CATS charge is already included in miscellaneous revenue, no additional adjustment is required and, therefore, Staff's adjustment should be denied.

The Commission has reviewed the record and finds that the recommendation of the ALJ is supported by substantial evidence, is reasonable, was not appealed by the parties and shall be adopted by this Commission.

Acceptance of the ALJ's recommendation is reflected as resulting in a $0 impact on revenues on Line 92 of Schedule E.

Line 93 - SBC Deferred Compensation Liability

Staff recommended an adjustment to remove the liability account which contains accrued deferred compensation for senior management maintained at the SBC level but expensed through SWBT to Oklahoma. Staff computed an Oklahoma allocated amount and deducted it from rate base.

SWBT objected to Staff's disallowance of the SBC deferred compensation liability from Oklahoma rate base. SWBT indicated that these funds are not cost-free to SWBT nor are they customer-supplied.

SWBT stated that SBC maintains a deferred compensation plan for middle and upper_level management wherein these employees voluntarily invest in SWBT by choosing to defer a portion of their earned wages. SBC records the funds supplied by the employees as a liability which ultimately must be repaid to the employees. SWBT further maintained that because this liability represents wages which are reinvested in SWBT by the employee, customers are not entitled to those funds. They also indicated that the customer receives a benefit in these reinvested funds because SWBT does not have to go to the debt market or to the equity investor to get the additional funds supplied by the participants in this plan. SWBT indicated that although Staff is viewing the issue as one of SWBT having cost-free funds, the funds are not customer-supplied funds because the customers receive their service and the employee earns his wage or salary.

Staff witness Buck testified that the actual expense occurred when the employee was paid and that the total payroll expense was included in the cost of service. Mr. Buck stated that although these are employee's funds which are being held by the corporation, these funds have been expensed to cost of service and recovered through rates by virtue of being payroll payments. Because they were include in cost of service, the funds were provided by the ratepayers.

The ALJ rejected SWBT's argument that these are not cost-free funds. The Company includes the full amount of payroll expense in its cost of service, which is then recovered from the ratepayers. However, SWBT does not pay out the full amount due, after taxes, to the employee. Instead, SWBT retains a portion of the employee's wages until they must be repaid to the employee, presumably many years later. During the hearing, SWBT used the analogy of the employee taking these extra funds to the bank. The ALJ found that this is exactly what the employees are doing, only SBC is the bank. SWBT witness Chicoine admitted to the cost-free nature of these funds when he stated that their existence enables SWBT to avoid going to the debt market or equity investor,

either of which would cause SWBT to incur a cost. Although Mr. Chicoine attempted to draw a distinction between paying for services and paying cost, the ALJ found that is a question of semantics. Whichever you call it, the ratepayers have provided the funds because the total expense was recovered in rates which included the payroll costs in the cost of service.

The Commission has reviewed the record and finds that SWBT did not dispute the fact that ratepayers paid for the full expense through their rates. The employees, instead of taking the full amount due them, banked it with SBC, thereby providing SBC with cost-free capital provided through SWBT's customer rates. Based upon these facts, the Commission finds that Staff's proposed adjustment to remove the liability from rate base as set forth in Column I of Line 93, Exhibit 361 and, as recommended by the ALJ, is hereby adopted.

This adjustment is reflected as a reduction to rate base on Line 93 of Schedule E in the amount of $5,406,966.

Line 94 -GHQ Liabilities

Staff stated that certain liabilities are maintained at the SWBT (GHQ) level although the related expenses are included in the cost of service at the state level. Those liabilities which were not addressed by the lead/lag study were then allocated to Oklahoma by Staff and deducted from rate base. Staff also indicated that a Voluntary Employee Benefit Association (VEBA) account is associated with the liabilities as a result of an IRS provision requiring there to be an asset established as well as a liability. In response to questions concerning whether it was contrary to GAAP principles of matching to only adjust the liability side and ignore the asset side, Staff indicated that it did not believe that the questions were relevant because ratemaking is not subject to GAAP restrictions.

SWBT stated that Staff had reduced rate base for certain liabilities because it believed that these liabilities were a cost-free source of funds but that Staff's position should be rejected because Staff used a lead/lag study to calculate the CWC then deviated from this approach and used the balance sheet method for these liabilities. SWBT believed that Staff failed to take into account the fact that the liability was paid for out of a prepaid benefit account. SWBT objected to Staff choosing certain liabilities to deduct from rate base without also including the corresponding asset account and asserted Staff should apply consistent procedures in the development of CWC.

SWBT stated that the VEBA account was recently instituted as a tax planning measure and is a funding mechanism or an asset to offset the liability. The asset is contained in the records at GHQ in Account No. 1330, "Other Current Assets". Exhibit 392, Form M/Schedule B-1, shows the Balance Sheet Accounts for all of SWBT's "Other Prepayments" on a total company basis. This Exhibit indicates there is a total of $24 million in the summary account where the VEBA asset is maintained. Staff work paper B-118 shows the total SWBT liability as $49 million. SWBT clarified that VEBA is focused on medical payments and, therefore, it would relate only to the Custom Care portion of the total liability amounting to $32.6 million. The other portions of the total liabilities have no offsetting asset. SWBT acknowledged that "Other Prepayments" would also include, on a total company basis, items such a motor vehicle license fees, postage and other miscellaneous payments. These other items would reduce the asset of $24 million used to offset the Custom Care liability of approximately $32 million.

The ALJ found that Account No. 1330 contains $24 million in assets. This account is the account which will be used to offset the liability for Custom Care and its appears that the liability is approximately $32 million. In view of the fact that Account No. 1330 also contains other items such as motor vehicle license fees, postage and other miscellaneous payments, it is apparent that there is not a

dollar-for-dollar offset to the liability contained on the books and records of GHQ. Accordingly, the ALJ found that Staff was correct in not including any corresponding asset. Therefore, the ALJ recommended that Staff's reduction to rate base for the GHQ liabilities should be adopted because this liability is a cost-free source of funds. The ALJ further found that it is appropriate, as is addressed in the Line 73-Staff Lead/Lag Study section of his report, for Staff to use the balance sheet approach for the GHQ liabilities which were not included in Staff's lead/lag analysis. The ALJ therefore recommended that Staff's adjustments to GHQ liabilities be adopted.

The Commission has reviewed the record and rejects the ALJ recommendation that Staff was correct in not including any corresponding asset. The Commission believes that such an offset, even though it is not dollar for dollar, is reasonable and supported by substantial evidence. The Commission finds that the remaining recommendations of the ALJ are supported by substantial evidence, are reasonable and are hereby adopted by this Commission.

This adjustment is reflected as a reduction to rate base on Line 94 of Schedule E in the amount of $2,035,311.

Line 95 - GHQ Outstanding Drafts

Drafts are issued by SWBT in payment for services and those which have been outstanding for more than one year are recorded as a liability. If these drafts are not cashed within specific periods of time, they will escheat to the appropriate state. Staff stated that certain liabilities are maintained at the GHQ level although the related expenses are included in the cost of service at the state level. The liabilities which were not addressed in the lead/lag study, such as outstanding drafts, were then allocated to Oklahoma by Staff and deducted from SWBT's rate base.

SWBT disagreed with Staff's adjustment for outstanding drafts, indicating that it believed Staff had mixed its CWC methods because it had used the lead/lag study to determine CWC. Staff's lead/lag methodology requires that items which are excluded from the lead/lag study be indentified and handled separately, which is why Staff made this adjustment. The ALJ, having previously accepted Staff's method for determining CWC, found this adjustment is appropriate and recommended that it be adopted.

The Commission has reviewed the record and finds that the recommendation of the ALJ is supported by substantial evidence, is reasonable, was not appealed by the parties and is hereby adopted by this Commission.

This adjustment is reflected as a reduction to rate base on Line 95 of Schedule E in the amount of $351,085.

Line 96 - Advance Payments

Staff reduced rate base for advanced payments which are received from customers prior to the establishment of service. SWBT and Staff agreed to this adjustment. The ALJ found that this adjustment should be adopted by the Commission as an appropriate adjustment to rate base. This adjustment was also discussed at Line 81, supra.

The Commission has reviewed the record and finds that the recommendation of the ALJ is supported by substantial evidence, is reasonable, was agreed to by the parties and is hereby adopted by this Commission.

This adjustment is reflected as a decrease to rate base in the amount of $29,634 on Line 96 of Schedule E.

Line 97 - Service Improvement Program

Staff excluded plant applicable to the Service Improvement Program indicating this was the amount of funds invested in plant in service at December 31, 1989 and carried on the books as such. Staff stated that in Cause No. PUD 000260, the Commission ordered SWBT to invest its excess earnings in certain service improvements and plant upgrades, but that SWBT was not to earn a return on such investment because those funds were supplied by the ratepayers. Additionally, Staff removed accumulated depreciation applicable to the Service Improvement Program investment.

SWBT eliminated 1989 test year plant in service in the amount of $3,674,000 which represented the amount of service improvement placed into service in 1989. SWBT also eliminated the installation expenses associated with the service improvement placed in service in 1989 from its cost of service.

The ALJ found that although Staff excluded depreciation expense related to the Service Improvement Program as part of its depreciation adjustment on Exhibit 363, Schedule H-3, Line 10, it appears that SWBT did not exclude depreciation expense or accumulated depreciation which was related to the Service Improvement Program. This investment was made pursuant to the Commission's Order in Cause No. PUD 000260 and the additional investment was required in lieu of refunding excess earnings to ratepayers. That order also indicated that SWBT was not to be allowed to earn a return on the Service Improvement investment and it seems logical that depreciation expense on disallowed plant should also be excluded in order to preclude SWBT from recovering an expense that is based on the improvements paid for by ratepayers' funds.

The ALJ further found that all rate base items, investment and accumulated depreciation and all operating expenses, depreciation expense and installation costs associated with the Service Improvement

Program should be eliminated from SWBT's test year expenses and rate base. The ALJ therefore recommended that Staff's adjustments be adopted.

The Commission has reviewed the record and finds that the ALJ's recommendation is supported by substantial evidence, is reasonable, and is hereby adopted by the Commission.

This adjustment is reflected as reductions to expense and rate base on Line 97 of Schedule E in the amounts of $343,505 and $3,305,349, respectively.

Line 98 - Royalties

The AG proposed an adjustment to impute an affiliate compensation fee or "royalty" to be recognized as revenues to SWBT-Oklahoma for ratemaking purposes. The AG stated that the royalty was determined by applying a 5 percent royalty fee to certain gross operating revenues of SWBT's affiliates to recognize the franchise-like benefits such affiliates realize as a result of their relationship with SWBT. The AG addressed the royalty issue because failure to do so would unfairly overstate SWBT's revenue requirements. Valuable, intangible assets of SWBT which are derived from its operations as a high-visibility public utility are strategically relied upon by nonregulated affiliates of SWBT without compensation to the regulated telephone operations, and SBC's diversified nonregulated affiliates trade upon the market value of SWBT's image and reputation which has been built through decades of telephone service at ratepayer expense.

Further, the Oklahoma Supreme Court, in the Turpen decision, supra, stressed the importance of examining SWBT's relationship with the other subsidiaries of the parent corporation to ensure that the ratepayers were not subsidizing the operations of the unregulated affiliates. The AG stated that absent the implementation of a royalty adjustment in this Cause, the Oklahoma ratepayers will continue to subsidize the operations

of other SBC nonregulated affiliates. The AG chose to use the royalty terminology and methodology because it is used both within and without the regulatory arena. The AG testified that this is a very common business practice in a franchise industry wherein royalties are typically paid for the right to use a business reputation/image or intellectual property through direct use of copyrighted or patented innovations, trademarks, logos, names, proven methods of operation and specific technical knowledge and expertise as well as the associated goodwill which accompanies such intangible assets.

The royalty the AG proposed represented a compensation mechanism to SWBT from certain of its affiliates to account for the substantial intangible benefits the affiliates enjoy due to their unique association with SWBT. These intangibles which inure to the affiliates include, but are not limited to: use of the SWBT trademarks and logos; use of the SWBT name, reputation and public image; access to and use of SWBT's proven methods of operation and technical knowledge; awareness of telecommunication industry issues and opportunities; and, reduced business risk, access to capital and creditworthiness. Intangible benefits are benefits which do not have physical substance, but which have considerable worth to the income of a company. The proposed imputed royalty acts as a surrogate for reasonable compensation to SWBT when intangible benefits are enjoyed by affiliates with no explicit accounting for such intangible transactions on the books of SWBT or the affiliates. SWBT did not actually receive any royalty revenues from any affiliates during the test year.

It was the AG's testimony that SWBT and its parent, SBC, had no incentive to record royalty revenues on the books of SWBT as such an action would decrease the revenue requirement or cost of service of SWBT while simultaneously decreasing the profits of nonregulated affiliates. The current transfer pricing procedures for transactions between SWBT and affiliates do not compensate SWBT for the intangible benefits received by affiliates and therefore do not adequately protect against

cross-subsidization. SWBT's status as the long-standing franchised provider of monopoly SWBT telephone service has created nearly universal market awareness and penetration of the SWBT name, official marks and business reputation, and because the intangible assets of SWBT were developed through many years of franchised utility service and continue to be maintained at ratepayer costs, the failure of affiliates to compensate SWBT for use of intangible benefits results in a form of cross-subsidization.

The AG cited SWBT's response to AG Data Request 404, which included a contract between AT&T and the RHCs, including SBC, wherein AT&T assigned its title and interest in the United States in trademarks, trade names, and service marks, together with the goodwill of the business symbolized by such trademarks, etc., to the RHCs. Even though SBC technically owns the SWBT trademarks, trade names and service marks, it was the AG's opinion that it is the significant accumulated history of the telephone company which has created the goodwill associated with the trademarks, trade names, and service marks because when most people hear, read or use the name "Southwestern Bell", it is the public utility image of the dependable telephone company which comes to mind, not that of a diversified regional holding company.

SBC spends substantial sums in its "Trademarks, Patents and Graphics Services", CCN 51, which is allocated to SWBT and the other SBC subsidiary companies, to enhance, protect and exploit the value of such intangible assets. The AG asserted that such expenditures clearly indicate SBC's appreciation of the value of the need to safeguard such intangibles. The response to AG Data Request 275 reflects that the test period expenses incurred by SBC for such activities were approximately $1.7 million, of which $155,000 was allocated to Oklahoma. SWBT-Oklahoma did not pay SBC directly for use of the trademarks, tradenames and Bell service marks to which SBC has title, but SWBT in Oklahoma and other states, as well as certain other affiliates, are allocated expenses from CCN 51.

The AG recommended application of a royalty to only two of SWBT's affiliates, Southwestern Bell Mobile Systems (SBMS) and Southwestern Bell Telecom (SBT). These affiliates were selected because they use the SWBT name and logo, have substantial domestic revenues and their sales are primarily to nonaffiliate entities and individuals at market prices. In the AG's opinion, it would be improper to impute royalties to those affiliates who trade primarily with SWBT because an added royalty cost would simply be allocated back to SWBT. For this reason, no royalty should be charged to YP since the YP income is imputed back to SWBT. The exclusion of 100 percent of such affiliates introduces an element of conservatism into the calculations because the nonaffiliate transactions of such entities also realize benefits from the SWBT intangibles. The AG explained that imputed royalty revenues are comparable to imputed YP profits and therefore need not be recorded on SWBT's books. Instead, the royalties should be accounted for only during the rate case process, recognizing that the actual benefits of SWBT's intangible assets are used by affiliates and the value of the same is imbedded in the affiliates' financial results.

SWBT argued against the 5 percent royalty fee imputed by the AG, indicating that SWBT-Oklahoma customers pay rates for services provided but they do not pay expenses or own assets of SWBT-Oklahoma. SWBT stated that even if there were an intangible asset associated with the name of SWBT, the asset would be the property of SWBT's investors and not the property of the ratepayers. There is not an asset recorded on the books and records of SWBT-Oklahoma for the value of the purported intangible asset and there is no rate base element provided for this asset by either the AG or Staff. If a royalty fee were to be imputed, an appropriate rate base allowance should also be granted. SWBT explained the difference between fair value rate base and "per books" investments to be attributable to goodwill and that under this assumption, a conservative estimate would be a rate base allowance of $311 million. Further, SWBT claimed that the AG has not established

that the SWBT name is actually of value to SBMS and SBT and the AG presented no evidence which would suggest that there is a direct, causal relationship between the SWBT name and specific sales for SBT. Further, the costs associated with creating and maintaining a company name had been excluded in prior rate cases by the exclusion of items such as charitable contributions, corporate image advertising, dues and memberships, and other activities which would enhance SWBT's image.

SWBT stated that not all the sales generated by SBMS are made under the name of Southwestern Bell. SBMS sales under the primary Southwestern Bell name accounted for less than one-half of the total sales of SBMS for 1989. And, pursuant to Oklahoma Statutes, mobile telephone services are deregulated in Oklahoma, and Staff, SWBT and the AG all removed 100 percent of the effects of IMTS from SWBT's operating results. SWBT stated that the imposition of a royalty fee on SBMS is inconsistent with the IMTS treatment and conflicts with state law and the Commission's Telephone Rules. SBMS has never been a part of SWBT and therefore its assets, revenue and expense, and start up costs were never recorded on the books of SWBT.

SWBT believed that the royalty fee was inappropriately applied by the AG because not all sales by SBMS are made under the SWBT name. Therefore, these sales should be excluded from the 5 percent royalty calculation. Additionally, even if it is assumed that the SWBT-Oklahoma customer has some type of ownership right in the SWBT name, only sales within the State of Oklahoma should be used for computation of the royalty fee because under the AG's theory, SWBT's Oklahoma customers have only paid for the value of the SWBT name within the State of Oklahoma.

The ALJ found that the name SWBT is commonly associated with the telephone company by most of the public. Accordingly, there is some benefit to affiliates which utilize the SWBT name and logos and the ratepayers should receive a portion of that benefit. The ALJ noted

that Staff disallowed the costs associated with the Common Look Project because they were unable to quantify the benefits associated with the use of the SWBT name and logos. The ALJ further noted that the Oklahoma Supreme Court in the Turpen decision, directed the Commission to consider the benefits which might accrue to SWBT from the use by affiliates of the SWBT name, logos, and trademarks. The ALJ found that the royalty adjustment proposed by the AG should be adopted, but only as to sales within the State of Oklahoma, in order to give the ratepayers the benefit of the use of the SWBT name and goodwill. The ALJ further found that if the Commission adopts this proposed adjustment that the adjustment proposed by Staff on Line 50, to disallow the expense associated with the Common Look Project, should be disallowed.

The Commission has reviewed the record and finds that SBC itself recognized that the name, reputation and image of the telephone company benefited its affiliates. The evidence included: (1) reports by independent consultants, used to develop the "common look identity" program, which concluded that Southwestern Bell's image in consumers' minds was that of a telephone company; (2) statements by senior Bell executives concerning the "tremendous edge" over competitors that results when consumers regard highly the "Southwestern Bell" brand name; (3) the SBC Corporate Graphics Identity Guidelines, which require the use of the identifier "Southwestern Bell" with the various operating names of the affiliate companies; and, (4) the substantial costs incurred by SBC to enhance and protect its intangible assets such as the "Southwestern Bell" name and related trademarks.

The evidence also demonstrated that SWBT's affiliates also benefited by the access to the experienced SWBT work force, proven methods of operation, and SWBT's technical and market-knowledge expertise. In support of this testimony, AG witness Mr. Brosch sponsored Exhibit 321, a SWBT response to Staff data request No. 77a, where SWBT described over eighty different services SWBT provided to its affiliate companies during the 1989 test year and demonstrated the benefits occurring to the

SWB Telecommunications, Inc. (Telecom) affiliate as a result of a joint marketing agreement with SWBT. He pointed out that by virtue of their connection with SWBT, the affiliates had the option of acquiring services and products from SWBT, when such goods and services could be purchased more cheaply than from outside the corporate umbrella, an option not generally available to outside competitors.

The Commission further finds that failure to recognize, for ratemaking purposes, the value of these intangible assets to SWBT affiliates could result in a cross-subsidy as discussed generally in Turpen. The Commission finds that the 5 percent royalty amount on gross sales is less than the average franchise royalty fee as reported by two national surveys.

The Commission is unconvinced by two arguments proffered by SWBT to defeat an imputation of a royalty for ratemaking purposes. First, SWBT argues that such an imputation is inappropriate because technical legal ownership to the "Southwestern Bell" trademarks rests with the parent company, not the regulated subsidiary. The Commission finds this irrelevant. Technical legal ownership of these intangible benefits has had no practical impact upon the historical public association of the "Southwestern Bell" name, reputation, and image with the telephone company. In fact, SWBT witness Trawicki acknowledged that many customers of nonregulated services are not aware of the technicalities of legal ownership of the Bell trademarks, but are nevertheless influenced by positive image associated with the name "Southwestern Bell". The Commission further finds that the appropriateness of inclusion of a royalty imputation for ratemaking purposes should not be dependent upon whether legal ownership of trademarks rests at the SBC corporate level or subsidiary level. The relevant criteria upon which a royalty imputation is based more appropriately includes a determination as to where the related benefits from the trademark and logos are generated. The Commission firmly believes that these related benefits accrue to SBC shareholders from goodwill generated from its regulated subsidiary SWBT.

Second, the Commission is not convinced by SWBT's arguments that because the image and reputation associated with the telephone company are not reflected as an item in SWBT's books, imputation is inappropriate. In accordance with USOA, SWBT can only reflect in its books those assets which are purchased at a cost. However, this Commission still has the authority, in the ratemaking process, to recognize imputed benefits accruing to the consolidated company by virtue of the goodwill and reputation associated with the telephone subsidiary, regardless of whether the asset is reflected on the telephone company's books. These intangible assets have conferred a genuine economic benefit on SWBT's affiliates, and need not be reflected as a separate account to be recognized for ratemaking purposes in this docket.

The Commission approves the AG's methodology for quantifying the value of these benefits. This method imputes a royalty based on the sales of two SWBT affiliates, Southwestern Bell Mobile Systems, Inc., and Southwestern Bell Telecommunications, Inc., because they employed the Southwestern Bell name and logo, enjoyed substantial domestic revenues, and sold products primarily to non-affiliated entities and individuals at market prices. Sales made under trade-names other than "Southwestern Bell" were excluded from the quantification. The Oklahoma jurisdictional amount of the royalty income was determined by an allocation based on Oklahoma's GHQ Prorate factor, and is quantified on Exhibit 361, Line 98, as an increase in revenues of $1,161,000. For these reasons, the Commission adopts the adjustment at Line 98.

This adjustment is reflected as an increase to revenues on Line 98 of Schedule E in the amount of $1,161,000.

Lines 99-100

These lines are totalling lines and are not issues to be decided by this Commission.

Line 101 - IRS Private Letter Ruling

There are two tax issues pertaining to SWBT in addition to the one previously addressed during the discussion of YP at Line 22, Investment Tax Credit (ITC) Catch-up and Deferred Taxes Associated with Bad Debts. The issue regarding Deferred Taxes associated with Bad Debts is discussed in Line 65, supra. Line 101 at issue here deals with ITC catch-up.

Staff indicated that in Cause No. PUD 000260, it had a concern regarding normalization of taxes. This was reflected in Commission Order No. 341630, as corrected by Order No. 341820, which required that SWBT seek a Private Letter Ruling (PLR) from the IRS regarding the amortization rate to be used for existing ITC. The law under Tax Code Section 46(f) governing the amortization of the ITC also falls under the Tax Code's normalization requirements. The tax regulations require that the ITC for 46(f) Option 2 companies be amortized over the regulatory life of the property. Normally, an Option 2 company uses its depreciation rates to amortize ITC in order to qualify under the normalization regulations. Although this had been the practice at SWBT in Oklahoma, this method was not adjusted to take into consideration the depreciation reserve imbalance catch-up. The ITC amortization would have been higher if this catch-up percentage was also considered.

Staff discussed this issue with the IRS Normalization Division and the IRS recommended that SWBT request a PLR in order to safeguard its normalization requirements. Subsequent to the Commission order directing SWBT to seek a PLR, SWBT requested a PLR from the IRS which outlined two possible alternatives: (1) develop ITC amortization using rates currently in effect, plus over the same time period, a recognition of the reserve imbalance catch-up percentage; and, (2) develop ITC amortization using true remaining life rates. It was Staff's belief that Method 1 would have given the full benefits of the ITC amortization to those customers who were also paying for the depreciation reserve imbalance catch-up.

Staff stated that the ITC amortization shown, on Line 16 of Section J, Schedule 1 and Line 11 of Section J, Schedule 2 of Exhibit 363, includes an out-of-period adjustment and recognition of the catch-up which was needed to correct the ITC balances amortized over a two-year period. Staff stated that it did not believe that the investment tax credit catch-up adjustment caused a normalization violation based on the fact that the PLR was silent regarding the treatment of ITC related to the reserve deficiency amortization. Staff was seeking to reflect an out-of-period adjustment to capture the additional ITC. SWBT made this adjustment in 1990 to true-up the 1989 amortization and its entire adjustment was a result of a 1990 true-up which is not reflected in the 1989 books of SWBT. Because the adjustment was made in 1990, it could not have affected the 1989 books.

SWBT stated that Staff's adjustment results in more than a ratable portion of ITC being included in cost of service. The tax laws allow for such a reduction by only a ratable portion of ITC which is determined based on the depreciable life of the underlying asset.

SWBT acknowledged that in Cause No. PUD 000260 Staff disagreed with the method SWBT was using to determine the Investment Tax Credit Amortization (ITCA) rate. Staff, in that Cause, contended that the depreciation reserve deficiency amortization (RDA) should increase the ITCA rate. SWBT's position was that inclusion of the impact of RDA in the ITCA rate will result in amortization which was not ratable, thereby, causing a violation of the IRS normalization rule.

SWBT and Staff sought a PLR in order to determine whether Staff's method or SWBT's method was correct. In addition to requesting a ruling on the two options discussed above, Staff requested a ruling on whether catching up the amortization to the corrected balance would violate normalization.

Exhibit 369 in this Cause includes the PLR dated May 31, 1990, which SBC's legal department sent to the IRS as well as the response from the IRS dated December 6, 1990. The request for the PLR indicated, at page 4, that the IRS was asked to rule upon the request of both SWBT and Staff, and indicated that the positions of both parties were set forth in the request for a PLR. The request for the PLR also indicated that Staff was requesting a ruling with respect to the retroactive adjustment of ITC amortization should either Method 1 or Method 2 be found acceptable. The request indicated that although SWBT was making no such ruling request, it did respectfully request that the arguments presented by Staff be given full consideration.

In its response to the PLR, the IRS determined that SWBT's method for calculating the ITCA rate would not violate the normalization provisions and that Staff's method would result in a normalization violation. The IRS did not directly address the issue of a "catch-up" adjustment in their ruling.

The ALJ reviewed the PLR and agreed with Staff and SWBT that it did not directly address the issue of the "catch-up." Item 3 of Staff's Addendum I describes the action Staff would take with respect to the catch-up should either Method 1 or Method 2 be found not to violate the normalization rules. The ALJ further found that, if the IRS determined that the proposed treatment by Staff to catch-up amortization to the corrected balance would violate normalization by the utilization of Method 1, then the PLR by its very silence on the catch-up issue was accepting SWBT's proposal and such proposal was recommended to the Commission.

The Commission has reviewed the record and finds that the PLR does not address the catch-up issue specifically. The Commission rejects the notion of the ALJ that, by its silence, the IRS has implicity adopted any parties' proposal. However, the Commission finds that the treatment of the ITC catch-up as proferred by SWBT in Method 2 is reasonable, is supported by substantial evidence and is herby adopted.

The Commission's decision regarding this adjustment is reflected as resulting in a $0 adjustment to test year expenses on Line 101 of Schedule E.

D. ADDITIONAL RATE BASE, EXPENSE AND REVENUE ISSUES - WHICH ARE NOT ON EXHIBIT 361

"Other" Adjustments to Southwestern Bell Corporation

Staff made adjustments to SBC expenses which were not specifically included in Exhibit 361, but were contained in Exhibit 363, Schedule KM-1. Adjustment No. 15 was made to remove an out-of-period invoice from an insurance carrier in order to avoid having ratepayers pay for more than one year of insurance premium in their rates. Additionally, Adjustment No. 21 to Schedule KM-1 was made to bring the pension expense up to the funding level allowed for income tax purposes, which is zero. This adjustment was consistent with Staff's adjustment to increase SWBT's pension expense.

Although SWBT did not specifically address any of the foregoing "Other" SBC adjustments made by the Staff and the AG, Mr. Chicoine's schedule at GRC-3C, Schedule 17, page 2 of 12, indicates they made no corresponding adjustment for these items.

Based upon Staff's description of the foregoing adjustments, we find that such costs, with the exception of the adjustment to pension expense, are of a nature which should not be borne by the ratepayers. Therefore, the Commission finds that Staff's proposed adjustments to SBC costs, as set forth in Adjustments 15 and 21 to Exhibit 363, Schedule KM-1, are based upon substantial evidence and are adopted.

These adjustments are reflected as a net increase to expense on Line 102 of Schedule E in the amount of $5,176.

Gulf Printing Asset Lives

Staff witness Steve Wilt testified that he reviewed the asset lives utilized by Gulf, a subsidiary of SBC, to determine whether the asset lives and depreciation rates flowed through to SWBT for Gulf, were reasonable. Based upon his review, it was his recommendation that the Commission adopt the lives and depreciation rates provided by SWBT for Gulf in this Cause.

The Commission finds that there is no testimony which contradicted the testimony of Staff concerning the appropriateness of the depreciation rates for Gulf which are charged through to SWBT. The Commission, therefore, finds that Staff's recommendation concerning the asset lives and depreciation rates for Gulf is reasonable and supported by substantial evidence, and shall be adopted by the Commission.

Gulf Printing Depreciation Rates

With regard to the appropriate asset life analysis of the depreciable plant of Gulf, Staff witness Steve Wilt testified that based upon his review of the appropriate life assigned to the K & B Press, the lives and depreciation rates utilized by SWBT for Gulf should be adopted by the Commission in this Cause. The record reflects that no other party directly addressed this issue in its testimony. Therefore, the Commission finds, based upon substantial evidence, that a ten-year life for the Gulf K & B Press is appropriate and shall be adopted by the Commission. The Commission also finds the other depreciation rates utilized by Gulf and recommended by Staff to be appropriate and likewise adopts those depreciation rates.

Monthly Plant Balances/Accumulated Depreciation/Reserve Ratio

Staff witness Wilt testified that he reviewed the 1990 monthly plant balances and the accumulated depreciation account balances to determine

if any of the accounts had activity, such as additions to plant balances and/or accumulated depreciation additions or removals, which did not appear appropriate. He also indicated that he reviewed the reserve ratio levels for 1990 to ascertain if they were acceptable. It was Mr. Wilt's recommendation that the Commission find that the accumulated depreciation account balances of SWBT are reasonable and that the reserve ratios are reasonable. At the time of hearing, there were no objections to the information which had been reviewed by Mr. Wilt nor did anyone ask to have the information produced in open court for review.

In view of Mr. Wilt's explanation concerning his account-by-account analysis, the fact that no other party gave testimony in opposition to Mr. Wilt's testimony, and that the ALJ recommended adoption, the Commission finds that the monthly plant balances, accumulated depreciation reserve accounts, and reserve ratios are reasonable and they are hereby adopted by the Commission in this Cause.

Interest synchronization

AG witness Carver proposed an adjustment reflected in Exs. 323, 323a, Schedule C-14, which adjusts income tax expense to take into account the tax deductibility of an annualized level of interest expense. He stated that the appropriate level of interest expense was determined by applying the weighted cost of debt contained in the AG's capital structure recommendation, (sponsored by AG's witness Kahal,) to the AG's recommended investment in rate base. He stated that this method of annualizing interest expense is commonly referred to as interest synchronization.

Mr. Carver explained that interest synchronization is a method which provides for the allocation of an interest expense deduction for tax purposes, equal to the ratepayers' contribution to SWBT for interest

expense, regardless of SWBT's actual or estimated interest payments on its tax returns. Since revenue requirements are partially driven by the application of a rate of return to the rate base investment, SWBT will recover from its ratepayers an amount of interest expense equal to the effective weighted cost of debt embedded in that rate of return, as well as interest on customer deposits included in the cost of service.

Mr. Carver stated that interest synchronization merely "synchronizes" the ratemaking tax deduction for interest with the interest expense the ratepayers are required to provide SWBT in utility rates. Mr. Carver explained that SWBT had proposed an interest synchronization adjustment in its MSFR schedules. However, because the AG's rate base and cost of capital adjustments differed from those of SWBT, it was necessary to make a separate adjustment to synchronize the components of the AG's revenue requirement recommendation. (Exhibits 323, 323a, Carver prefiled testimony, pp. 60-62.)

The Commission finds based upon substantial evidence that an "interest synchronization" adjustment is appropriate in order to insure that the tax benefits of the interest expense deduction are properly quantified for ratemaking purposes. The Commission finds that the interest synchronization adjustment depends upon the final quantification of other rate base, capital structure and customer deposit interest expense adjustments in this Cause. Accordingly, after taking into account all other adjustments to rate base, capital structure, and customer deposit interest expense, the Commission finds that the interest expense deduction for computing income taxes is $32,007,230. ($796,422,702 rate base X 3.9908 percent weighted cost of debt = $31,783,637 plus $223,593 in interest on customer deposits reflected as an expense on Line 60 of Schedule E.)

E. EXCESS CAPACITY REVIEW

The record reflects that Staff witness Bill Burnett testified that he reviewed the utilization of SWBT's plant and facilities as required by this Commission in General Cause No. 29321, Order No. 292337. Mr. Burnett testified that, in his professional opinion, SWBT does not have an unreasonable amount of excess capacity. He indicated that SWBT has a practice, which he deemed to be prudent, of increasing its facility capacity to meet future projected growth, once usage of a plant/facility reaches 85 percent capacity. Mr. Burnett concluded that when excess plant did exist, that it existed for legitimate reasons. In support of his conclusions, he cited instances where economic downturns reduced the number of access lines needed, as well as instances where system bypass occurred. In response to questions from the AARP, Mr. Burnett stated that he was unaware of any excess capacity related to fiber optics.

The AARP has taken exception from the ALJ's recommendation that there was no testimony which allegedly contradicted Staff's findings concerning the prudency of SWBT's design and implementation of a telephone network in Oklahoma. Notwithstanding AARP's arguments to the contrary, there is insufficient evidence to support its contention that SWBT acted imprudently in the design and implementation of its telephone network in Oklahoma. While it might be possible, with the benefit of hindsight, to question SWBT's actions or inactions related to the issue of system capacity, based upon a review of the facts, testimony and evidence provided in this Cause, the Commission is not persuaded that SWBT's actions or inactions were imprudent. The Commission, however, will continue to review the issue of prudency on a case-by-case basis. Thus, our decision in this case should not be considered to be policy with regard to future decisions concerning capacity.

Therefore, the Commission finds that no further action shall be taken in this Cause concerning excess capacity and that the excess capacity review required by Order No. 292337 has been completed.

F. GHQ - LABOR TRACKING SYSTEM

Staff argued that the GHQ Labor Tracking System left much to be desired and that Staff experienced great difficulty in determining the source of GHQ payroll costs prorated to Oklahoma. Ms. Krug stated that nowhere in SWBT's records is total GHQ payroll identified, summarized and reported. Ms. Krug described a cumbersome and time-consuming process whereby total GHQ wages and salaries were finally quantified some ten months after the request was made by Staff. Ms. Krug expressed concern that the labor tracking process used in this audit may not have been continued after Staff's audit. (pp. 20, 21, Krug Prefiled Testimony, Exhibit 115, 115a.). The record reflects that Staff strongly recommended that a more direct method be developed to readily identify and report total GHQ salaries and wages in the future. (Id.)

Staff also indicated that the procedure to determine total management and nonmanagement payroll, and each group's basic wages, overtime wages and other wages and salaries, was less than ideal. Staff recommended that a more straightforward process be developed to identify GHQ management/nonmanagement and basic overtime and other salaries and wages in the future. (p. 22, Krug Prefiled Testimony, Exhibit 115, 115a.)

The ALJ found that although SWBT had developed a local labor tracking system based upon job function codes and expenditure type codes, the total GHQ payroll costs were difficult to track and that the tracking problem might continue to exist prospectively. The ALJ found that it was reasonable for Staff to be able to determine whether the total amount of GHQ salaries prorated to Oklahoma was accurate. The ALJ recommended that GHQ develop a payroll tracking system which would enable Staff, in future rate cases for SWBT, to identify total GHQ payroll and more easily track the costs which are prorated to Oklahoma. The ALJ also recommended that GHQ develop a payroll tracking system which would also identify GHQ's management and nonmanagement basic, overtime and other wages and salaries.

The Commission finds that the ALJ's recommendations are meritorious and are premised upon substantial evidence. The Commission is not persuaded by SWBT's arguments which suggest that it would be unduly burdened by adoption of this recommendation and finds that SWBT's arguments lack credibility. The Commission is most concerned with SWBT's reluctance to participate in a process which would facilitate the production of accurate and timely information and benefit the entire regulatory process. We are convinced that we possess the authority to impose this requirement upon SWBT, that the requirement is beneficial to ratepayers, and that Staff's request for a GHQ payroll tracking system is not unduly burdensome to SWBT. Therefore, the Commission adopts the recommendation of the ALJ, to require SWBT to develop a payroll tracking system which enables Staff to identify total GHQ payroll, track costs prorated to Oklahoma, and identify GHQ's management and nonmanagement basic, overtime and other wages and salaries.

G. RATE DESIGN

As reflected in Schedule A attached to this Order, the Commission has found that a revenue excess in the amount of $100,557,297 exists with respect to SWBT's intrastate Oklahoma jurisdictional operations. The Commission finds that $7,800,000 of this annual revenue excess shall be used to fund the implementation of the network modernization program ordered by the Commission in Section I of this Order. The Commission further finds that implementation of the provisions of this Order related to the remaining revenue excess of $92,757,297 requires rates for SWBT's intrastate services to be decreased. Each category of rate reduction is discussed below.

1. Wide Area Calling Plan Funding

Three Wide Area Calling Plans (WACPs) were approved by the Commission on May 22, 1991 in Order No. 357147. That Order required the

revenue losses and additional annual revenue requirements associated with the Oklahoma City, Tulsa and Lawton WACPs to be replaced and also identified the investigation of SWBT's revenue requirements in this Cause as a potential source of revenue (Order No. 357147, pp 11-12, 14).

An additional WACP was approved for Enid on November 4, 1991, in Order No. 361185. (Order No. 361185 is on appeal to the Oklahoma Supreme Court and, pursuant to a request by SWBT, the Commission on December 23, 1991, suspended the effectiveness of Order No. 361185 until the final disposition of the appeal). Additionally, expansions of the Tulsa, Oklahoma City, and Enid WACP's were approved on March 30, 1992 by Order No 364264. (Order No. 364264 is on appeal to the Oklahoma Supreme Court).

The following language contained in Order No. 357147 is noted:

> "...the Commission finds that the revenues of the LECs affected by the implementation of the new WACPs should be replaced as directed herein..."
>
> "...the Commission further finds that revenue replacement should be accomplished through the intrastate toll pools..."
>
> "The Commission's pending investigation of SWBT's revenue requirements (including SWBT's reserve deficiency amortization) and rates in Cause No. PUD 000662,... may allow a sufficient reduction of costs allocated to the toll pools by these companies <u>to secure the balance of unrecovered lost toll revenues and additional revenue requirements.</u>" (emphasis added).
>
> "The Commission will identify the reduction of costs allocated by these companies to the toll pool and will incorporate those reductions in the final orders to be issued in Cause Nos. PUD 000662 (SWBT)..."

Order Nos. 361185 and 364264 contain similar or identical provisions to those cited above.

Staff testified to a recommendation that WACP funding be accomplished through rate design. SWBT also acknowledged the provisions of Order No. 357147 regarding the WACP revenue requirement and recommended an amount of $24,814,000 to be included in its revenue

requirement resulting from attrition adjustments to SWBT's test year revenue, expenses and rate base occurring more than two years after the TYE in this Cause, describing this amount as a "...difference between the Staff's postition and the Company's position... ."

The ALJ noted that the revenue excess identified elsewhere herein had not been adjusted to account for the WACP impact. The ALJ believed that it was not necessary to adjust the revenue excess for the WACP impact in order to comply with Order No. 357147. The ALJ believed it was appropriate to first identify the revenue excess and then determine which rate changes and programs should be adopted to prevent said excess from occurring in the future. The ALJ suggested that the revenue excess so identified was large enough to allow for the funding of the WACPs as suggested in Order No. 357147. Therefore, the ALJ recommended that the first priority rate design recommendation of Staff regarding the WACP funding be approved.

The ALJ further recommended that the pooling Local Exchange Carriers (LECs) be directed to develop formulas to implement the WACP funding level approved herein and to submit the formulas to the Commission for final approval.

With regard to the information presented in late-filed Exhibits 414 and 433 concerning funding an Enid WACP, and expansion of the OKC, Tulsa and Enid WACPs, respectively, the ALJ found that funding should be provided through this Cause. The Commission Order approving the Enid WACP, Order No. 361185 dated November 4, 1991, has been stayed by the Commission at the request of SWBT pending SWBT's appeal to the Oklahoma Supreme Court. But, if such order becomes a final order of the Commission, then SWBT should be provided appropriate funding. Failure to provide for such funding in this Cause would result in further delays in the implementation of these services. The Commission has also issued Order No. 364264 dated March 30, 1992 approving the expanded WACPs. The ALJ found that the level of funding recommended in Exhibit 433(B) should

be adopted by the Commission and should become effective at the time the WACP expansion is complete. Failure to provide for such funding would be unreasonable regulatory action toward SWBT.

The Commission has reviewed the WACP funding recommendations of the ALJ and finds that they are supported by the substantial evidence, are reasonable and are hereby adopted by this Commission. With respect to the ALJ's recommendation that the pooling LECs be directed to develop formulas to implement the WACP funding level, the Commission further finds that these formulas shall be developed jointly by the Administrator of the intrastate pools and the companies involved, with oversight by Staff, and submitted to the Commission for approval within 15 days from the issuance of this Order. In addition to the foregoing findings, the Commission makes additional findings as set forth below.

We find that Order No. 357147 as quoted above is an unappealed final Order of this Commission, therefore, the Commission finds that SWBT's rates shall be set to allow for WACP revenue requirements to be funded as required by that Order. Staff Exhibit No. 407 identified the funding amount required as $24,475,044. The Commission further finds the $24,475,044 amount cited above includes $9,000 to fund the provisions of Commission Order No. 350150, Cause No. PUD 000953, related to incorporating the Oklahoma portion of SWBT's Caney (Kansas) Exchange into SWBT's Copan, Oklahoma exchange.

The Commission finds that Staff properly complied with the intent of Commission Order No. 357147 in quantifying the LECs' revenue requirement to be recognized as reduced revenues available to SWBT and adopts the funding amount in Exhibit No. 407.

The ALJ requested late-filed Exhibits No. 414 and No. 433 from the parties quantifying the funding level required for the WACP's approved by Order Nos. 361185 and 364264, respectively. Staff's late-filed Exhibit No. 414(B) identifies an amount of $697,404 required to fund the

WACP approved by Order No. 361185 and Exhibit No. -[illegible](B) identifies $6,738,228 required to fund the WACP expansion approved by Order No. 364264.

The Commission finds that the funding requirements identified in late-filed Exhibits No. 414(B) and No. 433(B) shall be adopted in this Cause as recommended by the ALJ. The Commission further finds that the funding for the Enid WACP shall be set aside under bond subject to refund with interest at SWBT's authorized ROE adopted elsewhere herein for refunds generally, due to the fact that Order No. 361185 has been stayed. The amount identified shall be available upon implementation of the Enid WACP, and the Commission further finds that in lieu of temporary rate reductions of $697,404 on an annual basis for SWBT customers for the time period between the issuance of this Order and implementation of the Enid WACP, SWBT customers shall be provided refunds with interest computed by using SWBT's authorized ROE, adopted herein, for the period between the effective date of the final Order in this Cause and the implementation date of the Enid WACP. If, however, the Enid Plan is not implemented, SWBT's rates shall be lowered further, prospectively, by $697,404 on an annual basis from the date at which a final determination is entered concerning the implementation of the Enid Plan.

The Commission also finds that Staff and SWBT have acknowledged the effect the WACP's will have on the refund calculations required in this Cause. The Commission finds that there have been various implementation dates for the many telephone exchanges which are now a part of the WACPs and there will be various implementation dates for the exchanges remaining to be added in the future. The impact to SWBT's revenue requirements from exchanges being converted to WACP's at discrete points in time during the periods revenues are subject to refund shall be quantified and accounted for in determining the refunds as set forth in Section M of this Order. Many exchanges have been cut-over into the WACPs during the period in which SWBT's rates have been interim, subject

to refund. This fact shall decrease the refund below the level it would be otherwise. Many other exchanges remain to be cut-over to WACPs. This fact will increase the refund calculations above the level they would be otherwise. This results because full funding for the WACPs is being ordered herein even though some exchanges will not cut-over to WACP service until after the implementation date of this Order. Therefore, the Commission finds that the refunds determined and ordered herein shall be adjusted to account for these timing differences associated with the WACP implementation.

In summary, the Commission finds that the WACPs funded herein shall have the combined effect of reducing revenue available to SWBT by $31,910,676 annually.

2. IntraLATA Long Distance and WATS

Long Distance Message Telecommunications Service (LDMTS) is provided jointly by SWBT and the other LECs within the LATAs in Oklahoma at LATA-wide averaged rates based on time-of-day, distance of call, and length of call. Wide Area Telecommunications Service (WATS), like LDMTS, is provided by SWBT and other LECs intraLATA at LATA-wide averaged rates.

In addition to intraLATA toll services, customers utilize interLATA and interstate long distance services provided by interexchange companies. Staff witness Schroeder testified that his recommended pricing strategy would decrease intraLATA LDMTS to the approximate level of the dominant interexchange carrier's intrastate interLATA LDMTS rates. Mr. Schroeder indicated this strategy would require toll reductions to mileage bands over 35 miles. The Commission finds that no party opposed Staff's pricing strategy, and therefore, it is adopted by the Commission. The Commission further finds that WATS prices shall be decreased in proportion to the LDMTS price reductions as follows, in order to recognize the pricing relationship between LDMTS and WATS. The

LDMTS and WATS rates shall decrease by $35,581,[illegible] and $[illegible],677,10[illegible], respectively, on a statewide basis.

The Commission finds that reducing intraLATA, intrastate toll rates will be a step towards eliminating customer confusion associated with different toll rates for different jurisdictional toll services.

The record indicates that intraLATA LDMTS and WATS Services are provided at statewide averaged rates regardless from which telephone company territory or community the call originates or terminates. The Commission finds that the statewide average rate policy shall continue as this is a reasonable policy and no party to this Cause proposed otherwise.

As such, the Commission further finds that if no adjustments are made to the pooling formulas, lowering toll rates statewide by $39,258,114 would decrease SWBT's revenues by less than that amount, because the reduction would decrease the pool revenues available to the other pooling LECs. The effect of this pooling process would be such that all other pooling LECs would incur a prorated portion of the $39,258,114 decrease ordered for SWBT by this Commission. It is not the Commission's intent to require any LEC to share in this decrease ordered for SWBT's LDMTS.

The Commission further finds that the revenue requirements of the other pooling LECs are not at issue in this docket, that the notice in this docket is not sufficient to allow this issue to be addressed and, therefore, the other pooling LEC's revenue requirements have not been investigated herein. Therefore, the Commission finds that pooling formula adjustments necessary to ensure that only SWBT's revenues are decreased herein shall be developed jointly by the Administrator of the intrastate pools and the companies involved, with oversight by Staff, and filed with this Commission for final approval within 15 days from the issuance of this Order.

Finally, the Commission finds that such significant reductions in LDMTS and WATS rates, according to economic theory, will stimulate additional demand for these services. The additional demand will result in additional sales volumes (minutes of LDMTS and WATS use) and revenues available to SWBT which will then increase its earnings above the level ordered in this Cause. However, the Commission finds that no party quantified the impact of this relationship. Therefore, the Commission finds that additional data is required in order to estimate the causal relationship between the independent variable, price, and the dependent variable, sales volumes, pertaining to LDMTS and WATS services. SWBT should be required to monitor monthly LDMTS usage for a period of eighteen (18) months from the date of this Order and report the same to the Director of the Public Utility Division, by submission of quarterly reports. Staff shall estimate the effect of LDMTS prices on sales volumes and report this data in future proceedings as determined appropriate by Staff.

In summary, the Commission finds the combined LDMTS and WATS rate reductions shall decrease SWBT's revenue by $39,258,114.

3. Access Service

Access Services Tariffs define the relationship between SWBT and interexchange carriers for the carriers' provision of interLATA long distance and provide for the carriers' access to end-users connected to SWBT's network. All parties presenting evidence on the subject of access charges supported the rate design strategy of achieving parity with interstate access rates.

Staff recommended comprehensive revisions to SWBT's intrastate access tariff design to achieve parity with interstate access tariffs with three noted exceptions. AT&T also recommended parity with respect to access rates with the same three exceptions as those Staff had noted. The exceptions are: (1) all local switching rate elements should be

combined at the interstate LS1 level; (2) nonpremium discounts would continue to not apply in Oklahoma; and, (3) the Directory Assistance Operator Surcharge Rate would be reduced from $0.50 to $0.35 and a revenue-neutral white pages additive of $0.000549 per switched-access minute of use should be adopted.

SWBT supported Staff's concept that access rates should be set at parity with current interstate rates. SWBT stated that most rates, rules and regulations should be the same for all access services and described the problems created by different interstate and intrastate access rates and discussed the benefits of parity rates.

The ALJ recommended that the access rate design proposals and the Directory Assistance and White Pages Surcharge as discussed herein be adopted as agreed to by the parties. However, the ALJ rejected the proposal that rules and regulations should be the same for all access services as no specific proposals were put forth.

With respect to future changes of access rates in an effort to maintain parity with the FCC, where appropriate, the ALJ recommended the following procedure: (1) SWBT files an access tariff revision at the FCC and simultaneously gives notice of that revision to Staff and any certified interexchange carrier; (2) within 30 days after the FCC approves the access tariff revision sought in Step 1 above, SWBT shall file a tariff application with the Commission to adopt the same revision as part of its Oklahoma tariff; and, (3) the proposed Oklahoma tariff revision would become effective in Oklahoma on a prescribed effective date identified in the Oklahoma tariff application, which date shall not be sooner than 30 days after the Oklahoma tariff application is filed unless the Oklahoma tariff is suspended by the Commission upon Staff's or another interested party's objection. Any objection must be filed within 30 days of the Oklahoma tariff application being filed.

New procedure for parity filings

The Commission has reviewed the record and finds that the recommendations of the ALJ regarding the terms and conditions of access service are supported by the record, are reasonable and are hereby adopted as clarified below by this Commission.

The Commission finds that SWBT should not only give notice to Staff of its access tariff filings at the FCC, but should also simultaneously provide Staff with copies of all filings and data as submitted to the FCC. Further, the Commission finds that objections to SWBT's Commission access tariff applications should be filed within 15 days of the Oklahoma tariff application being filed. The Commission also finds that SWBT access tariff filings which are not FCC parity filings shall continue to be processed using current procedures.

The Commission finds that access rates shall be decreased by $6,765,046 and adopts the prices shown on Exhibit No. 407 (revised Exhibit LAS-2, page 12) and also adopts the pooling formula adjustments as required above for LDMTS and WATS rate decreases.

Interexchange carriers are required by Commission Order No. 282453 issued July 24, 1985, (Exhibit 384(A), Schedule LAS-3, p. 18), to reflect in their rates decreases in intrastate access charges. Therefore, the Commission finds that the Oklahoma customers of the interexchange carriers shall benefit from the above ordered decreases.

The Commission further finds, pursuant to Order No. 282453, that the interexchange carriers shall file tariffs decreasing their rates to reflect the decreases in access charges ordered herein. The interexchange carriers' tariffs shall become effective upon the effective date of the access charge decreases.

4. Compensation on IntraLATA Traffic

Testimony in this Cause indicated that interexchange carriers (IXCs) in Oklahoma are allowed to provide intraLATA 800 services to their customers who also subscribe to interstate 800 services. During the test year, the Commission previously ordered compensation be made to the LECs for revenue losses which occur when IXCs carry intraLATA traffic. IXCs were charged $0.276 per originating access minute for intraLATA traffic. Since the dates of hearing regarding this issue, the Oklahoma Supreme Court has issued its Opinion in Case No. 73,136, which was the appeal of Cause No. PUD 000254, affirming this Commission's decision that the appropriate compensation rate should be $.192 per originating access minute for intraLATA traffic.

The Commission finds that our policy requiring compensation on intraLATA traffic carried by IXCs shall remain in effect. However, the Commission finds that the compensation rate shall be recalculated pursuant to the methodology set forth in late-filed Exhibit No. 410. The Commission finds the revenue decrease associated with the compensation rate reduction shall be $921,153 as detailed on Exhibit No. 407 (revised Exhibit LAS-2, p. 12).

5. General Exchange Services

a. Touch-Tone

All parties agreed to eliminate Touch-Tone monthly charges making Touch-Tone an integral part of basic service where available. The ALJ found that Touch-Tone is often considered by customers to be an integral part of their basic telephone service and therefore the ALJ recommended that Touch-Tone rates be eliminated.

The Commission has reviewed the record and finds that the recommendations of the ALJ are supported by substantial evidence. The

iCommission further finds that implementation of the rate design ordered herein and summarized in Section G of this Order is supported by substantial evidence, and shall take priority over the ALJ's recommendations eliminating Touch-Tone rates. Therefore, the Commission rejects the ALJ recommendation to eliminate Touch-Tone rates due to placing a higher level of priority on other rate design issues as set forth herein.

b. Outside Base Rate Area Mileage

SWBT customers residing outside of an area in each exchange identified as the "base rate area" on maps filed with the Commission by SWBT pay additional monthly fees known as mileage charges (OBRA). Rural customers are presently facing rate increases in some cases upon conversion to single party service required by Commission Order No. 341630, in Cause No. PUD 000260 due to these OBRA mileage charges. The elimination of these mileage charges will equalize urban and rural rates. SWBT also supported eliminating mileage rates for administrative ease and customer relations reasons. The ALJ recommended that OBRA mileage rates be eliminated.

The Commission has reviewed the record and finds that the recommendations of the ALJ are supported by substantial evidence, are reasonable and are hereby adopted by the Commission. The elimination of these revenues decrease SWBT's annual revenues by $6,916,853.

6. Service Charges (General Exchange and Local) and Service Connect Charges

Staff, citing economic theory and real-world telecommunications examples, proposed reductions in residential and business service charges and service connect charges. SWBT stated that some of these charges could be reduced toward their cost level, but criticized Staff's proposal as proposing rates substantially below cost. Staff stated that these charges represent monopoly pricing practices and generate revenue streams which would not be possible in competitive markets.

The ALJ found that service connection and service charges should not be reduced below their incremental cost because greater reductions would burden more stable customers and because other mechanisms for encouraging subscription exist. The ALJ further found such fees of SWBT are not inconsistent with a competitive market and do not promote monopoly pricing. To the extent the service charges are priced less than incremental cost, the ALJ recommended that the total service cost be recovered by the prices for the optional services to which the service charges apply. Thus, the ALJ found such costs will not be borne by other customers and SWBT should file appropriate applications to remedy such situations. With regard to service connect charges, the ALJ found that the charges presently utilized by SWBT are proper and sufficient to deter arbitrary disconnects and reconnects by customers.

The Commission finds the recommendations of the ALJ to be somewhat unclear, requiring further clarification. The ALJ found that service connection and service charges should not be reduced below their incremental costs, but then added that to the extent they are thus reduced, then total service cost should be recovered by the optional service to which service charges apply.

The Commission finds that the record supports the recommendation of the ALJ that total service cost, including the cost to connect and disconnect customers from a service, should be recovered from the prices for the services to which the charges apply. The Commission further finds that there is insufficient evidence in the record to support the ALJ's finding that service charges should not be reduced below their incremental cost because greater reductions would burden more stable customers. In fact, the Commission finds that the record is clear that optional services provide substantial contributions in support of basic services. The Commission finds that service charges shall be reduced to promote higher subscription levels for the optional services.

The Commission, therefore, rejects the finding of the ALJ which would prevent service charges or service connect charges from being priced below SWBT's measure of their incremental cost. The Commission finds that it is inconsistent with economic theory and the record in this Cause to find, as the ALJ did, that such fees of SWBT are consistent with a competitive market and do not promote monopoly pricing. The Commission finds the services in question are provided under monopoly conditions by SWBT and, as such, absent proper regulatory control, SWBT can practice monopoly pricing to recover part of its revenue requirement. The record is clear, through the example presented by Staff, that as monopoly markets become competitive, firms within those markets reduce one-time sign-up fees or service connect charges to remain competitive in their pricing and to remove barriers that would dissuade customers from taking their services. The Commission further finds that the record does not contain examples of the ". . .mechanisms for encouraging subscription . . ." referred to by the ALJ.

The Commission also finds that, if optional service prices are set to cover the cost of the optional services, including the cost of connecting the service, then other customers shall not be burdened. The Commission further finds that the level of service connect charges proposed by Staff is sufficient to deter arbitrary disconnects and reconnects. SWBT's current service connect charges are far higher than the charges of other major public utilities in Oklahoma. As such, customers who simultaneously connect electric, gas and telephone utility services frequently criticize SWBT's connect charge.

Therefore, consistent with the above findings, the Commission rejects the ALJ's recommendations concerning service charges and service connect charges. The Commission finds that Staff's proposed service charges and service connect charges are reasonable. However, the Commission notes that the rate decreases found to be proper in this Cause leave only $6,603,060 for decreases to service connect charges and service charges. Therefore, the Commission finds that Staff's proposed

decreases to local service charges as developed on Exhibit 407 (Revised Exhibit LAS-2, p. 9) and the proposed decreases to General Exchange Service charges as set forth on p. 14 of Exhibit 407 (Revised Exhibit LAS-2) should be amended to reflect that on Lines 26 and 27, the Touch-Tone service rate shall remain $5.00 and $10.00 for residential and business customers, respectively. With this adjustment to p. 14 of Exhibit 407, the Commission finds that SWBT's local and general exchange service charge should be approved as set forth in Exhibit 407. The Commission finds that the above decreases to local and general exchange service charges result in annual revenue decreases of $586,894 and $3,632,197, respectively. The Commission further finds that SWBT's service connect charges should be reduced by $2,383,969 with porportionate decreases to business and residence charges utilizing the billing quantities from Exhibit 407 (Revised LAS-2, p. 8).

7. Other General Exchange Tariff Issues

Staff stated that it advocated two additional changes to the general exchange tariff. First, it was recommended that Special Service Arrangements (SSAs) should be restricted to business customers only and that the business customer SSAs should be presented to the Commission for approval using a proposed flexible pricing procedure. This recommendation was supported by citing an example of what Staff considered an abuse of the SSA procedure.

The ALJ found that SSAs should be restricted to business customers only and recommended utilizing the same procedure being recommended for changing access rates, beginning with the filing of the application with the Commission in Step 2. This procedure protects both SWBT and the ratepayers and is effective for rate change filings by interexchange carriers. There appears to be little need for residential customer SSAs, and filing for approval of business customer SSAs would allow for proper Commission oversight and regulation of services and prices being offered through SSAs. Under the current tariff procedure, the

Commission has no way of knowing how SWBT is administering the SSA tariffs.

Second, Staff and SWBT both recommended a tariff change allowing bulletin boards operated without remuneration at a single line residence to be charged the residential rate. With no opposition to this proposal, the ALJ recommended that the Commission approve this tariff change.

The Commission has reviewed the record and finds that the recommendations of the ALJ regarding SSAs are supported by substantial evidence, are reasonable and are hereby adopted by this Commission.

8. Lifeline Program

The Lifeline Program proposed by Staff in this Cause allows for state matching of the funding from the FCC-approved Lifeline Program. The Program will allow qualifying local exchange telephone customers to have local telephone services at $7.00 below tariff rates. The FCC has authorized the waiver of the Subscriber Line Charge ($3.50 per month) when the state provides for a matching $3.50 reduction in local service rates.

The ALJ found that the Lifeline Program proposed should be approved in this Cause because no party objected to implementation of a Lifeline Program in Oklahoma and the costs of the program can be recovered appropriately.

The Commission has reviewed the record and finds that the recommendations of the ALJ are supported by substantial evidence, are reasonable and are hereby adopted by this Commission. The Commission further finds that the Lifeline Program shall decrease SWBT's annual revenues by $382,395.

9. Basic Local Service and Other Local Services

Staff and the AG proposed reductions in Basic Local Service Rates although those parties disagreed on the priority to be assigned to Basic Local Service Rate Reductions. The AARP argued that the basic exchange ratepayer should be the primary beneficiary of any rate reductions.

Staff also proposed reductions in rates for three services in the Local Exchange Tariff - Line Status Verification, Busy Line Interrupt and Hunting Service.

The AG argued that basic local service rates should be given priority based upon the belief that said rates are priced above cost. Staff assigned higher priority to rate decreases for other services and prices, notably long distance services.

SWBT argued that basic local service rates should not be reduced. SWBT stated that the Franchise Service Cost Study indicated SWBT's basic service rates are priced below cost. SWBT argued that basic service should be residually priced as the Commission has done in the past.

SWBT, the AG and the AARP each proposed a different method for quantifying the cost of basic local service. SWBT supported its Franchise Service Cost Study. The AG supported Embedded Cost Studies and the AARP supported Stand Alone Cost Studies. Neither the AG nor the AARP quantified current Oklahoma local exchange service costs utilizing their recommended methods. Only SWBT provided estimates of basic local exchange service costs. Even so, SWBT did not argue that the costs so determined should form the basis for pricing decisions. Instead, it stated that the Franchise Cost Study should be used as a "reasonableness check" on current local exchange rates.

The Commission finds that due to the lack of sufficient revenue reductions to find any reductions in Basic Local Service, and based upon

the rate design priorities adopted herein, there should not be any reductions to Basic Local Service at this time. The Commission further finds that it is not necessary to adopt a particular local exchange service cost study methodolgy at this time. Elsewhere herein, the Commission has directed further review of cost study methodologies for telecommunications services.

10. Rate Design Summary

The Commission finds that the revenue decreases adopted herein are supported by the record, are an appropriate prioritization of the possible alternatives and generally provide for prices more closely aligned with costs.

The Commission finds that the rate design adopted herein appropriately balances the interests of SWBT's customers. In addition to the intraLATA toll and intrastate access rate reductions, which shall result in rates for those services being more in line with interstate toll and access rates, the Commission finds that certain local service rates have been reduced. Specifically, the Commission finds that local rate mileage charges for rural customers have been eliminated and local service connect charges are reduced. The Commission finds that the quality of both urban and rural local service shall be improved by this Order. Specifically, the Commission notes that the rate design funds the WACPs which improve local service. Further, the Commission notes the local service improvements that are provided through central office upgrades such as enhanced service quality and the universal availability of Touch-Tone and other calling features. Finally, the Commission finds that the rate design adopted herein provides for a lifeline telephone rate for low-income Oklahomans at substantial savings from the regular basic service rates.

For the reasons noted above, the Commission finds that the rate design adopted herein provides benefits to virtually all of SWBT's

Oklahoma customers and appropriately balances the interests of customers using SWBT's various services.

The Commission finds that the revenue effect of the rate design adopted herein can be summarized as follows:

Wide Area Calling Plans	$(31,910,676)
LDMTS and WATS	(39,258,114)
Access	(6,765,046)
Compensation	(921,153)
OBRA Mileage	(6,916,853)
Service Connection Charges	(6,603,060)
Lifeline Program	(382,395)
Total Decrease	$(92,757,297)

11. Rate Design Implementation

The Commission finds that SWBT shall file tariffs with the Commission conforming to this Order implementing the herein adopted rate design within 30 days of the issuance of this Order. Said tariffs shall be effective immediately upon approval by the Director, Public Utility Division.

12. Flexible Pricing Procedures

Flexible pricing procedures were proposed for most of SWBT's services. Flexible pricing refers to establishing an alternative regulatory procedure for the pricing of designated SWBT services. Several proposals were made regarding which services should be flexibly priced and which methodology or procedure should be utilized.

Staff stated that flexible pricing refers to establishing an alternative regulatory procedure to those procedures currently authorized for the pricing of certain SWBT services and proposed that an alternative regulatory procedure apply to certain SWBT services which are considered discretionary or nonbasic services.

SWBT also proposed flexible pricing but disagreed with Staff on several points. SWBT stated that Staff's proposals are not truly flexible as SWBT proposed flexible pricing for all services, except basic local service, with LDMTS, WATS and 800 services price-capped for five years. SWBT further disagreed with Staff on the relevance of embedded (fully-allocated) cost studies to flexible pricing of discretionary nonbasic services. SWBT justified its rejection of embedded cost analysis on grounds that the Commission has used incremental cost in the past and the proper application of economic theory leads to the rejection of embedded cost for pricing, and the use of incremental cost as a price floor promotes economic efficiency and prevents predatory pricing.

SWBT believed incremental cost should be used as the price floor for nonbasic services, absent special social considerations, because pricing services above their incremental costs insures that each service is not receiving a subsidy from any other service.

The AARP proposed that costs should not be assigned based on opinions as to what type of technology is necessary for particular subscribers, but rather on the basis of actual utilization of technology. MCI proposed developing a building block approach through workshops and a future docket.

SWBT also disagreed with Staff on the filing of applications for price changes. It believed that applications should be filed only for new services and then become effective on ten (10) day's notice. SWBT proposed to file a price floor for new services and then allow the market to select the price. Further, SWBT opposed provisions of Staff's proposal that would allow flexible pricing applications to be suspended for review, preferring instead to allow further analysis that would result, after analysis, in any changes being ordered as prospective. SWBT also disagreed with Staff's prohibition against rate de-averaging and customer specific pricing. It pointed out that individual case

basis (ICB) and special service arrangements (SSAs) are allowed by Rule 5(b) of the Telephone Rules, but that SWBT does not intend to price most services to each customer differently.

The AG generally supported the criteria for determining when a service should be given rate flexibility and the guidelines proposed by Staff. The AG described rate flexibility as a phase-in approach towards eventually giving SWBT's markets complete freedom. At the present time, workable competition does not exist and therefore the AG recommended that price-listed services already approved should continue to be provided under existing guidelines.

In response to SWBT, Staff cited a specific example of how a flexible pricing plan nearly identical to this proposal is working well for the interexchange carrier (IXC) interLATA long distance market in Oklahoma. Staff also cited an example of how SWBT responded under its version of flexible pricing. In that example, SWBT unilaterally applied the SSA tariff to 900 call restriction resulting in charges to customers in excess of rates eventually approved by the Commission. Staff stated that 63 customers were charged SSA rates for 900 call restriction between June and October, 1991, and that Staff became aware of the SSA charges in November, 1991 after a customer inquiry was brought to its attention.

The ALJ found that while it is likely that some form of pricing flexibility may be appropriate for some SWBT services, a blanket application of a Pricing Flexibility Program to all nonbasic services is overly broad and not supported by the evidence. He noted that Staff's support for its Pricing Flexibility Plan was based on the similarity of the plan with the system of "streamline regulation" currently in place for certificated IXCs for interLATA long distance services. Staff did not propose its Pricing Flexibility Plan on the basis of the existence of competition for SWBT's nonbasic services, but instead, on the grounds that such a system is more streamlined than current practice.

The ALJ also found the granting of pricing flexibility should be related to the existence and level of competition for particular SWBT services. One of the primary purposes of regulation is to insure that a utility's rates are just and reasonable under circumstances where competitive market forces cannot accomplish that task. Thus, sound public policy requires that regulatory scrutiny over SWBT's services be reduced only where the evidence establishes that market forces will operate sufficiently to insure reasonable rates notwithstanding reduced regulatory scrutiny.

The ALJ found that the decision whether to permit pricing flexibility must also take into account SWBT's unique position as a provider of both monopoly and competitive, or at least potentially competitive, services and the fact that SWBT controls the exchange access facilities which its competitors may require for provision of their services. SWBT's unique position creates concerns regarding the potential for: (1) cross-subsidization of competitive, or potentially competitive services, by revenues from monopoly services, and; (2) below-cost pricing; or, (3) other practices for exchange access facilities which may disadvantage firms which attempt to compete with SWBT. Because of these factors, a well-defined costing method and other appropriate safeguards should be in place prior to the granting of pricing flexibility for specific SWBT services. The ALJ recommended that the implementation of pricing flexibility for SWBT should await investigation and implementation of these safeguards.

The ALJ found that SWBT's incremental cost studies were subject to a wide variety of checks and balances and a significant amount of scrutiny which renders them reliable for providing cost information to support a price floor for nonbasic services in Oklahoma. The ALJ recommended that embedded cost, the building-block approach and fully-distributed cost methods be deemed inadequate to provide the proper cost information for the setting of prices of nonbasic services in Oklahoma and recommended

that the Commission continue to utilize SWBT's incremental cost studies for setting rates.

We note that the record reveals that SWBT has a form of flexible pricing today for a limited number of its services. An example includes Plexar Custom Service, which SWBT prices on an ICB and SSAs utilized for unique services which have not been tariffed. Further, an investigation of SWBT's tariffs reveals a limited number of services which are priced according to "price lists". All of the above flexible pricing procedures can be exercised by SWBT without making further application to this Commission for an Order approving the specific prices.

Regarding the ALJ's finding that the granting of pricing flexibility should be related to the existence and level of competition for particular SWBT services, the Commission agrees with the ALJ. However, the Commission finds that it is reasonable to also explore any possible reductions in administrative expense related to tariff approvals. The Commission further finds that any flexible pricing procedure must balance the desire to decrease administrative expense with appropriate protection for SWBT's customers.

In this regard, the Commission notes with concern Staff's testimony regarding SWBT's use of the SSA flexible pricing procedure to provide 900 Call Blocker Service to a large number of SWBT customers, while at the same time, SWBT was negotiating with Staff for approval of its proposed charges for 900 Call Blocker Service. The record indicates SWBT charged its customers more than the rates ultimately approved by the Commission, and Staff's witness indicated he was not aware that SWBT provided refunds. The Commission finds that a more appropriate procedure to implement 900 Call Blocker pricing would have been to ask for interim authority. This would have given the Commission an opportunity to approve interim rates subject to refund.

It appears that such a situation as described above might have been avoided had Staff been aware earlier of SWBT's application of the SSA procedure to 900 Call Blocker Service. The Commission finds that the SSA procedures adopted elsewhere in this Order shall safeguard against this situation reoccurring and that SWBT shall provide the Director, Public Utility Division, quarterly reports on its ICB pricing activity in a form agreeable to Staff and SWBT.

With regard to additional pricing flexibility for SWBT, the Commission finds that there appears to have been considerable disagreement among the parties about issues such as which services should be flexibly priced and which methods and cost studies should be utilized. The Commission determines the issue of flexible pricing merits additional review and investigation at such time as specific attention can be focused on this topic. Thus, the Commission finds that the ALJ's recommendations regarding the need for further investigation before implementing flexible pricing for SWBT shall be adopted.

Further, the Commission finds that it is not necessary to adopt the ALJ's findings regarding cost studies or other specific findings regarding flexible pricing at this time. Rather, the Commission believes these issues might be better resolved in a generic proceeding initiated by Staff with all local exchange carriers to establish rules and set flexible pricing procedures and directs Staff to initiate such a proceeding at its earliest opportunity. The Commission further finds that the parties need not be restricted to cost study methods previously adopted by the Commission. The Commission believes the best result shall be achieved with a full review of costing and pricing methodologies.

H. ACCELERATED NETWORK MODERNIZATION

Staff proposed a total of 91 central offices being replaced in advance of when they would be replaced in SWBT's "business-as-usual"

plan. Regarding the transmission system, Staff witness Schroeder recommended upgrades which, when taken together with central office upgrades, would result in a statewide digital transmission network for SWBT. Not all new services would be immediately available to all customers with Staff's proposal, but the network resulting from Staff's proposal provides the platform from which to provide most new optional nonbasic services.

SWBT stated through testimony of witnesses in this proceeding that SWBT was meeting the Commission's quality of service rules and that the upgrades proposed by Staff would not be made by SWBT under its "business-as-usual" plan because they are not economic at this time. Yet, the Commission finds from reviewing the filings made in Cause No. PUD 000837 that SWBT filed an amended application for its TeleState/21 proposal in Cause No. PUD 000837 on November 20, 1990. This amended application consisted of several proposals by SWBT pertaining to its TeleState/21 application including network modernization, flexible pricing of certain services and price-cap regulation. In support of its proposal for accelerated investment in network modernization SWBT stated the following in the amended application to this Commission in Cause No. PUD 000837.

> "Just as 19th century Oklahoma businesses found it essential to be connected to roadways, railways and waterways, so must 1990 and 21st century Oklahoma businesses be connected to the digital highways that carry all forms of telecommunications efficiently. To be connected technically is to be connected economically. Those Oklahoma communities without access to digital connectivity may find themselves among the technical and economic have-nots. This liability can be rapidly overcome with an immediate, added investment in Oklahoma's telecommunications infrastructure. Without that investment, several communities will not keep pace with communities with which they desire to remain competitive for business and related purposes.
>
> With that investment, however, comes the full range of technological opportunities that have brought economic advancement to communities throughout the nation. Digital connectivity, for example, brings the capability for the accurate, high-speed data transmission needed by satellite plants and branch offices that must communicate with out-of-state corporate headquarters. Also, computerized switching offices can provide communities rapid expansion capabilities required by growing businesses and

telemarketing-based firms. In addition to these incentives for economic growth, these network upgrades provide communications conveniences for both home and commercial customers. With digital switching comes the capacity for present and future generations of Custom Calling Services, as well as the inclusive community safety net afforded by enhanced 911 services."

Staff provided a detailed explanation of the network upgrades it has proposed, including references to SWBT's TeleState/21 proposals filed in Cause No. PUD 000837 and data request responses from SWBT. A listing of central offices to be upgraded and future transmission system projects was provided. The lists were provided by SWBT in response to Staff data requests and were available to interested parties to the Cause.

The ALJ found that Staff had proposed both a network modernization implementation plan and a funding mechanism. The capital investment required to implement Staff's proposed network modernization plan is approximately $84 million. The ALJ found that the five-year annuity amount of $7,800,000 per year as a funding mechanism for the recommended upgrades would be appropriate. He further recommended that this annual amount, if adopted, should be a reduction to the revenue excess recommended by the ALJ on a prospective basis from the date the final Order is issued in this Cause.

The ALJ further found that the upgrade program proposed by Staff would result in a statewide digital network for SWBT. The network would provide the platform for provision of optional services on an equal statewide basis for SWBT customers, eliminating service disparities which exist today, and allowing greater optional service availability to SWBT customers. The ALJ further found that the upgrades will provide improved service quality and ultimately will result in benefits to society through providing a network capable of delivering an enhanced level of health and education services.

The ALJ noted that due to the capital-intensive nature of utility investments and the public service nature of the business, it is not

always true that investments in a utility's system will be cost-effective from an economic perspective, as demonstrated by numerous instances where averaged utility rates support investment which otherwise may not be economical.

The ALJ further noted that the Commission has broad power and authority in regulating public utilities doing business within the State of Oklahoma. SWBT filed its application in Cause No. PUD 000837 requesting in part that the Commission approve its network modernization proposals, referred to as TeleState/21. Cause No. PUD 000837 had been consolidated with this Cause until SWBT requested withdrawal of Cause No. PUD 000837. However, before granting SWBT's motion to withdraw, the ALJ determined that under the Commission Rules of Practice, all parties who had requested affirmative relief relating to the TeleState/21 proposals would have their affirmative relief considered. SWBT could not dismiss its application as to that affirmative relief. The ALJ also recognized that Exhibit 260 contains numerous letters from the people of the State of Oklahoma requesting modern telecommunications technology and relief from the antiquated switches and equipment currently in use to provide service to much of rural Oklahoma.

The Commission has reviewed the record and notes, that SWBT has questioned the Commission's jurisdiction to require SWBT to make upgrades to its network, in view of the fact that SWBT is currently meeting the service requirements set forth in the Commission's Telephone Rules. We find that this Commission, in Cause No. PUD 000260, required SWBT to use monies which otherwise would have been refunded to customers to eliminate party lines and to upgrade certain specific central offices. We recognized therein that the source of funds for the Cause No. PUD 000260 upgrades was a refund, as opposed to an annuity which is funded through the rate design in this Cause, but we find that to be a distinction without a difference. We note that in the Answer Brief filed by SWBT in response to the AG Brief filed with the Oklahoma Supreme Court in July, 1990, in Case No. 74,194, Robert H. Henry v.

Southwestern Bell Telephone Company and the Corporation Commission of the State of Oklahoma, 825 P.2d 1305 (Okla. 1992), SWBT argued in support of the Commission Order which required SWBT to use monies which might otherwise have been refunded to its customers to upgrade central offices and eliminate multiparty lines. SWBT, at page 15 of that Brief, cited Turpen at page 1334 in support of the fact that the Commission has wide discretion in ratemaking. Additionally, SWBT stated:

> "The Commission found an opportunity to provide upgrades in Oklahoma's telecommunication network, yet exclude the cost from SWBT's rate base and revenue requirements, and avoid additional debt-equity costs normally associated with the cost of providing upgrades. The AG is urging this Court to override the Commission's wide discretion and Order a one-time cash refund. It is very obvious the Commission's decision, supported by substantial evidence, to require the expenditure of funds for upgrades is one which is of more lasting and greater benefit to the ratepayers of Oklahoma. The Commission's decision in this regard should be affirmed."

The record in this Cause is similar to that in Cause No. PUD 000260 regarding the need for upgraded services on SWBT's network. There were numerous letters from customers requesting digital switches in the central offices which served them, explaining the difficulties they experience in communicating with computers in other parts of the state and nation because of the lack of digital switches in their central offices. Additionally, customers expressed great frustration with the lack of custom calling features due to the absence of technological capability in their central office to provide those services. We find that because SWBT would be compensated for the technological improvements required to be made in this Cause, there is no merit to any objection regarding the propriety of upgrading its network to digital switches in each central office on its system. We also note that because of the funding mechanism recommended herein, there is no taking of property without compensation. We therefore order that the network modernization program and funding mechanism recommended by Staff be approved.

In addition to our findings as outlined above, we add that the Commission has broad authority pursuant to Article IX, §18 of the Oklahoma Constitution and may require a company to establish and maintain all such public service, facilities, and conveniences as may be reasonable and just. This Cause presents a unique opportunity for the Commission to assist SWBT in bringing its telecommunications network to a state-of-the-art system, by providing the funding to upgrade central offices and transmission system projects which SWBT believes otherwise would be uneconomical to upgrade to digital switches within the next five years under a "business-as-usual" plan.

We note that the record shows that Staff witness Schroeder testified that several customer benefits would be derived from adoption of Staff's proposals. Mr. Schroeder named service quality improvements, service equality, increased service availability and societal benefits. The AARP witness Gabel also testified to improved service quality related to network modernization. The network would provide the technological capability for provision of optional services on an equal statewide basis, thereby eliminating service disparities which exist today. The Commission finds that the upgrades will provide improved service quality and ultimately will result in benefits to society through providing a network capable of delivering an enhanced level of health and education services.

With regard to the funding of the network modernization, Staff proposed two methods for compensating SWBT for the costs of this network moderization. In one option, Staff proposed funding through rates the network modernization program to be implemented by SWBT over a five-year period. Under this option, Staff stated that it projected revenues, expenses and net operating income required for the proposed network modernization program, based upon information provided by SWBT with certain Staff adjustments, on an annual basis over a five-year period. The calculations for the projected digital office revenues were based on the detailed Wire Center Planning Forecast data provided by SWBT. The

proposed recovery of the revenue requirement is based on a five-year annuity, indicating this methodology would allow recovery of the revenue requirement applicable to the five-year investment period, in equal payments of $5,361,908. This amount, which was grossed up for the income tax effect, was based upon Staff's proposed ROE of 12.20 percent. The proposed annuity amount would create the effect of a .76 percent increase in the ROE under the capital structure proposed by Staff.

Staff also proposed an alternative method to recover the network modernization investment costs which defers costs related to the network modernization for future recovery, but stated that this method would not take into account revenue requirement offsets for any increase in revenue streams or expense savings during the five-year investment period.

SWBT stated that it did not agree with Staff's recommendation to use an annuity to fund the network modernization program. SWBT stated that it could not attract the financial resources necessary to accomplish the proposed investment at a 12.20 percent ROE and with significantly lower rates than those SWBT is currently authorized to charge. In addition, SWBT disagreed with Staff's imputed digital office revenues and toll pool settlement revenues, indicating that Staff's assumptions as to availability and customer take rate of the digital services were more aggressive than those SWBT believed to be appropriate.

SWBT stated that Staff's toll pool settlement revenues were incorrectly computed for two reasons. SWBT alleged that while Staff correctly recognized that the toll pool's ROR would be reduced by SWBT's additional investment and expenses allocated to the toll pool, Staff incorrectly recognized only the additional settlements SWBT would receive because of the return paid by the toll pool on the new investments allocated to the pool. SWBT agrued that Staff did not recognize the reduction in settlements that SWBT would experience due to the lowered ROR on existing investment allocated to the toll pool and

that Staff's initial toll pool ROR was overstated by .0011 percent. SWBT stated that the additional revenue requirement necessitated by Staff's network modernization proposal would actually be approximately $7.8 million per year over at least the next five years.

Staff stated that SWBT's calculation of the pool settlement revenues was based on the assumption that the total toll pool investment, including network modernization investments, should earn a 12.4539 percent ROR for the next five years while assuming that the toll pool revenue would remain unchanged from the third quarter level of 1990. Staff argued that although the toll pool ROR would decline due to the increase in expenses and investments caused by the network modernization, the projected rates of return for toll pool investments in each of the years are at a reasonable level and would be above the 10.8576 percent Staff proposed herein as the overall ROR for SWBT.

The ALJ determined that SWBT will be given a reasonable incentive to implement the $84 million network modernization proposed by Staff over a five-year period. By using Staff's proposed five-year annuity method, SWBT will recover the revenue requirement on the proposed network modernization investment on an incremental basis as the investment is made. The ALJ further found that SWBT's projected revenue calculations of the digital office revenues and toll pool settlement revenues were reasonable. Both Staff and SWBT agree these projections are estimates, with the effect that SWBT may earn a higher ROR on their toll pool investments than the overall ROR recommended by Staff in this cause.

The Commission finds that it is of paramount importance to properly fund the network improvements. We believe the annuity mechanism as ordered herein is an extraordinary measure undertaken by a concerned utility regulatory Commission to assist a utility in meeting its responsibilities to its customers. We note that many of these rural communities have been without modern telephone service enjoyed by millions of Oklahoma urban customers for decades. We likewise believe

the funding of this improvement negates any alleged claim that this Commission has exceeded its authority. After recruiting support for SWBT's Telestate/21 proposal by talking to hundreds of civic organizations across Oklahoma and encouraging their members to write letters of support to the Commission, it is hypocritical of SWBT to suggest that the same network modernization proposed by SWBT in Telestate/21 is not necessary and that it is outside the Commission's jurisdiction to mandate.

The Commission finds that SWBT's modifications to Staff's annuity calculations are reasonable. Therefore, the Commission finds that the annuity amount shall be $7,800,000. This additional revenue requirement shall be included in SWBT's cost of service and shall have the effect of decreasing the SWBT's revenue excess by $7,800,000 on a prospective basis from the date this Order is implemented. Thus, the Commission finds that SWBT shall continue to recover the amount of the annuity through its rates until or unless rates are reestablished at some later date, because there is no automatic cancellation of the funding mechanism after year five.

The Commission recognizes that there will be continuing capital and operating costs related to this network modernization investment, after the five-year investment period. The Commission orders that all such costs, reasonably and prudently incurred, will need to be considered in determining SWBT's revenue requirements in subsequent rate proceedings before this Commission.

The Commission has reviewed the record and finds that the findings and recommendations of the ALJ regarding accelerated network modernization are supported by substantial evidence, are reasonable and are hereby adopted.

In addition, the Commission finds that it would be appropriate to have more information regarding the scheduling of the upgrades.

Therefore, the Commission finds that the Public Utility Division shall assign Staff members with accounting, economics, and engineering expertise to develop and file an implementation schedule and reporting plan for the system improvements ordered herein, specifying the criteria on which the plan is based and restricting said criteria to economic and engineering considerations. The Commission finds that this plan shall be filed within forty-five (45) days from the date of this Order.

The annual revenue requirement impact associated with Network Modernization is reflected on Line 16 of Schedule A herein as an increase to SWBT's revenue requirements in the amount of $7,800,000.

I. SUPREME COURT REMAND - PUD 000260

The Oklahoma Supreme Court issued its decision concerning the case of State ex rel. Henry v. Southwestern Bell Telephone Company et al. 825 P.2d 1305 (Okla. 1992) and the parties each submitted a late-filed Exhibit 431 to address the recommended treatment of the Supreme Court's decision involving Cause No. PUD 000260 in this Cause.

The ALJ found that the Supreme Court's decision remanded to the Commission for further consideration the issue of cash working capital, severance pay expenses, the existence of a reserve deficiency imbalance and the priority for central office upgrades which were ordered by the Commission. The ALJ found that the pending cause, Cause No. PUD 000662 is an entirely different proceeding involving an entirely different test year from that involved in Cause No. PUD 000260. The ALJ found that the purpose of Cause No. PUD 000260 was to determine, inter alia, the appropriate levels of cash working capital and severance pay for the 1987 test year. He recommended the Commission's decision in this Cause be based on substantial evidence concerning the test year ending December 31, 1989.

The Commission has reviewed the record and makes the following findings. Although the Supreme Court's Opinion remanded certain portions of the Order in Cause No. PUD 000260 for reconsideration, on the grounds of a lack of evidence, it does not require that those issues which have been mandated necessarily create a specific legal result in this Cause. The Supreme Court's decision does not remove this Commission's authority to adopt a negative cash working capital allowance in Cause No. PUD 000662 if a negative cash working capital allowance is supported by the evidence in this Cause. Additionally, the Court's decision concerning severance pay in Cause No. PUD 000260 does not change the facts which are before the Commission concerning severance pay in Cause No. PUD 000662.

We note that SWBT has objected to the continuing nature of having its revenues placed subject to refund, to the extent they exceed 11.41 percent return on equity, pending a final Order in this Cause. We find that reopening the record to address the Cause No. PUD 000260 issues remanded to the Commission, at this time, will further delay the issuance of an Order in this Cause. Such a reopening would be contrary to SWBT's stated objective of obtaining an Order in this Cause as expeditiously as possible. We note that the Interim Orders in this Cause have been extended until September 4, 1992, and that after that time, the ratepayers will not be protected from any overcollections by SWBT, unless the Commission deems it necessary to further extend the Interim Orders. To avoid further extension of the Interim Orders, we agree with the ALJ that the record should not be reopened in Cause No. PUD 000662 to consider the issues remanded from Cause No. PUD 000260, but instead, we direct Staff to schedule a hearing concerning the remanded issues as quickly as schedules permit, in order to protect SWBT.

The Commission specifically finds that contrary to SWBT's apparent position, the Court's opinion in the Henry decision, supra, especially in light of the reconsideration decision, does not provide controlling

legal authority for the treatment of the cash working capital or severance pay issues in this pending Cause No. PUD 000662. The Supreme Court opinion remanded those issues for additional consideration, including the taking of additional evidence if necessary, in the context of Cause No. PUD 000260. The pending PUD 000662 Cause is an entirely different proceeding, in which testimony and evidence was taken on the appropriate levels of cash working capital and severance pay for the 1989 test year. While any finding by the Commission in Cause No. PUD 000662 must be based on substantial evidence, the Court's opinion which remanded certain portions of a previous Order on evidentiary grounds, does not mandate any specific legal result in the pending Cause.

The Commission finds there are two additional issues addressed in the Court's Henry decision, which could conceivably result in a rate adjustment in the future. The Court's holding on neither of these issues, however, requires that the Commission base its PUD 000662 Order on anything but the present evidentiary record of Cause No. PUD 000662.

First, the Court held that there was not substantial evidence in the record to support the use of ratepayer funds for upgrades to fourteen selected central offices. (Henry at p. 1313.) The Court found the record inadequate because it contained no specific information which could provide a basis for upgrading the specifically selected central offices. (Id. at 1313.) The Court remanded this issue, directing the Commission to determine specifically which central offices are most in need of improvement or modernization.

Because ratepayers, not shareholders, supplied the funds used for the service improvement program, costs for upgrading the 14 central offices should be excluded from rate base and cost of service. The Court's opinion remanding this issue, however, does not automatically mean that these upgrades should now be included in cost of service and rate base. At this moment, we do not know whether any of the selected

offices will survive scrutiny in the remand proceeding. But even if the remand proceeding does not support the use of ratepayer-supplied funds for these particular central office upgrades, it does not necessarily follow that SWBT will be entitled to include the cost of these upgrades in rate base, particularly in light of the fact that the remaining central offices in Oklahoma are being ordered upgraded herein.

Second, the Court remanded the issue of whether there is adequate proof to support a finding of a depreciation reserve deficiency in Cause No. PUD 000260. All the parties to this Cause, reflected the revenue requirement effect from the expiration of the RDA on June 30, 1991. Because we do not yet know whether the RDA will survive scrutiny in the remand proceeding, and there is a possibility that sufficient evidence will be introduced to support the existence of the RDA, we do not need to address the effect in this Cause of a determination on remand that there was no RDA.

The Commission issues this Order assuming the expiration of the reserve deficiency on June 30, 1991. The evidentiary basis of that reserve deficiency shall be determined at the future remand proceeding. If, on the basis of that proceeding, this Commission finds that there is not an adequate evidentiary basis for the RDA, we can, at that time, order the necessary refunds with interest and adjust rates to recognize any appropriate adjustments to rate base and operating expense for SWBT on a prospective basis. Thus, any increase in revenue requirements resulting from a disallowance of the RDA in the remand hearing can be reflected in that rate proceeding involving SWBT. For these reasons, the Commission declines to reopen this record to consider the remand of Cause No. PUD 000260 and directs Staff to schedule a hearing on Cause No. PUD 000260 as quickly as the schedules of the parties and the ALJ permit.

J. ALJ REPORT - GENERAL CAUSE NO. 29321

The ALJ issued his report in General Cause No. 29321 on April 8, 1992. Herein, the ALJ directs SWBT to refund the sum of $2,395,018 to its Oklahoma ratepayers as a result of the reimbursements it received from AT&T in 1983 and 1984. That ALJ Report further recommends that interest at the level of "SWBT's authorized cost of capital during the periods for which these refunds have been retained by SWBT" be applied to the refund amount and that this total be "incorporated as a reduction in revenue requirements in Cause No. PUD 000662, by amortizing this amount over the number of years that the resulting tariffs are expected to remain in effect, with the unamortized balance reflected as a reduction to rate base."

The Commission has been requested to review the record and consider the recommendations of the ALJ in his report in General Cause No. 29321. We have reviewed this record, including the late-filed exhibits, and issue a separate order in General Cause No. 29321, concurrently with this Order, which adopts the ALJ's recommendations.

The revenue impact of our Order in General Cause No. 29321 is reflected on Line 14 of Schedule A herein as a decrease to SWBT's revenue requirements in the amount of $1,997,576.

K. REVENUE REQUIREMENT

The Commission finds that a revenue requirement for SWBT needs to be determined in order to allow the Commission to establish rates for SWBT prospectively. In establishing the revenue requirement for SWBT, the Commission must determine pro forma rate base, pro forma operating revenues, pro forma operating expenses, pro forma income taxes and the authorized weighted cost of capital.

The Commission further finds that these components of the revenue requirement shall be determined by using the findings and conclusions as set forth previously in this Order. A numerical quantification of these findings and conclusions related to the revenue requirement is attached to this Order as Schedule A. Line 3 of Schedule A reflects the pro forma rate base of $796,422,702. Line 9 of Schedule A reflects pro forma operating revenues of $638,390,046. This pro forma operating revenue level is also reflected on Line 18 of Schedule A. Line 7 of Schedule A reflects pro forma operating expenses of $434,505,752 and Line 5 of Schedule A reflects pro forma income taxes of $20,242,074. Line 2 of Schedule A reflects the weighted cost of capital of 10.823 percent. The Commission, based upon the above findings regarding pro forma rate base, pro forma operating revenue, pro forma operating expenses, pro forma income tax and the authorized weighted cost of capital, determines SWBT's revenue requirement to be $454,769,519. This revenue requirement level is calculated by subtracting the revenue excess and nontariffed service sources of test year revenues, shown on Lines 19 through 21 of Schedule A, from the present pro forma operating revenue level reflected on Line 18. Therefore, the Commission finds that SWBT's rates shall be set to recover $454,769,519 prospectively.

L. REFUND

Interim Order No. 356271 issued by the Commission April 19, 1991, placed the revenues of SWBT subject to refund to the extent that they exceed 11.41 percent return on equity (ROE). This Interim Order also indicated that the Commission would consider the end of the reserve deficiency amortization, which occurred July 1, 1991, in establishing any refund liability of SWBT. Accordingly, Staff prepared its schedules in three parts, with Part I addressing the revenue requirements for SWBT which should be used to establish rates prospectively from the date of this order; Part II addressing the revenue requirements for SWBT for the period April 19, 1991, through June 30, 1991; and Part III addressing the revenue requirements of SWBT for the time period July 1, 1991, to the date of an Order in this Cause.

The Interim Order also states that consideration shall be given to SWBT's actual capital structure, and final determination of rate base, revenues and expenses, adjusted for items which are prospective in nature or which occur during the refund period.

Schedule A, attached to this Order, reflects development of SWBT's rates prospectively, the Commission's final determination of rate base, revenues, and expenses as discussed in this order; Schedule B addresses the revenue requirements for SWBT for the period April 19, 1991 through June 30, 1991; Schedule C addresses the revenue requirements of SWBT for the time period July 1, 1991, to the date of this Order.

The Commission has reviewed the record and makes the following findings and conclusions:

a. Interest Rate

In Order No. 356271, this Commission placed SWBT's earnings subject to refund, effective April 19, 1991, to the extent those earnings exceed an 11.41 percent ROE. In determining the interest to be used in the calculation of this refund amount, we reject the ALJ's recommendation to use a 5 percent rate and adopt the authorized ROE interim rate of 11.41 percent to be used, for the following reasons described by Staff witness Glen Gregory: (1) the revenue excess during the interim period is a source of funds available for reinvestment or distribution to the stockholders, and as such, will have a cost equal to the ROE; (2) the return of the excess earnings to the ratepayers at the ROE rate will place stockholders in a neutral position when the refunding is completed; (3) use of the utility's ROE provides a more workable standard than attempting to determine ratepayers' marginal borrowing costs, which vary tremendously; and, (4) use of ROE reflects the logical conclusion that once all allowed expenses and debt coverages are allowed, the excess earnings accumulate to the retained earnings, or stockholders' equity account.

We note SWBT's argument that the interest rate of SWBT's refund obligations should be limited to the six-month treasury bill rate. We find that although the ALJ indicated that SWBT's refund obligation is relatively risk-free to its customers, the ALJ ignored other very important factors which needed to be considered in establishing an interest rate on any refund obligation. These factors include:

a. The interest rate should reflect the cost of money for SWBT in order to avoid SWBT receiving a windfall as a result of not making refunds in a timely manner.

b. A five percent (5 percent) interest rate is inconsistent with other refund interest recommendations made by the ALJ in other causes.

c. A time value of money needs to be considered in light of the fact that money available to customers in the present is more valuable than the same amount of money received by customers in the future.

d. Customers do, in fact, bear a risk in any refund situation.

We find that the 5 percent rate recommended by the ALJ would produce a significant financial incentive for SWBT to appeal this Order. SWBT will have the opportunity to actually earn their authorized ROE on any monies they hold pending an appeal to the Supreme Court. If the Oklahoma Supreme Court upholds this Order finding that refunds are appropriate and the utility is only required to pay customers a 5 percent interest rate on the refund obligation, SWBT will realize a profit on the withheld refund in an amount equal to the difference between 5 percent and any ROE actually earned by SWBT. This difference constitutes a windfall to SWBT and acts as an incentive to encourage SWBT to delay making any refunds for as long as possible. The Commission is mindful of SWBT's repeated promises, including those made to the Commission in oral argument and in the media, to appeal any order of this Commission. We note that with an interest rate of 5 percent on the refund, SWBT lacks any incentive to carefully consider this action.

Additionally, we find that a recommendation of 5 percent interest is inconsistent with the ALJ's recommendation regarding the interest

assessed on AT&T reimbursements in General Cause No. 29321. In that Cause as discussed herein in Section J, the ALJ found that it was appropriate to calculate interest on said reimbursement in an amount equal to SWBT's overall authorized ROR, for the period of time between the receipt of the AT&T reimbursements and the date of the final Commission Order in this Cause.

The ALJ's recommendation of a 5 percent interest rate also ignores the time value of money. Staff presented evidence that ratepayers should be compensated for their cost of money and that to many customers of SWBT, this value may be as high as 25 percent if the customer could have used those funds paid to SWBT to reduce their personal debt. Additionally, the ALJ's recommendation ignores the fact that customers bear a risk in any refund situation because, to the extent that a utility overearns its authorized ROE, the customer is deprived of the discretionary use of the excess levels of money paid to the utility.

In summary, we find that by adopting the ROE as the appropriate refund interest rate, customers are not required to fund the overcollection without consideration as to whether their funds could be more economically and better utilized through investing or reducing individual debt. Moreover, on the other hand, SWBT will not receive a windfall from any overcollection by investing the retained funds at its opportunity cost of capital (ROE) of 12.2 percent financed by the ratepayers at a cost to SWBT of 5 percent. We do not believe it appropriate to make such a financial incentive available to SWBT.

We likewise find little justification in SWBT's testimony for the use of the customer refund rate, but note SWBT's efforts to analyze the risk in the context of the 6.5 percent interest rate paid on customer deposits. This Commission finds that the value of customer deposits to SWBT is actually far greater than 6.5 percent. Because we have required that customer deposits be subtracted from rate base, revenue requirements are reduced by the corresponding ROR, with a provision for

income taxes. Staff witness Glen Gregory calculated the return requirement attributable to customer deposits at 14.2 percent, which exceeds the 11.41 percent interest rate that we adopt today.

In Henry, supra, the Oklahoma Supreme Court affirmed the Commission's power to require that interest be paid on excessive earnings accumulated during a period when utility rates are subject to refund. The Court recognized that "the presumption in the business world . . . and [in] equity is that the use of money calls for the payment of interest." Henry at p. 1312, (citations omitted).

SWBT has argued that 17 O.S. 1991, § 121 precludes the Commission from authorizing the payment of interest on the accrued refunds. We find 17 O.S. 1991, § 121 inapplicable to this Cause. Nothing in Section 121 limits this Commission's power to order a refund, plus interest, when it has imposed the equitable remedy of placing a utility's rates subject to refund to protect ratepayers from regulatory lag.

For these reasons, we find that the refunds ordered herein shall bear interest at the authorized ROE of 11.41 percent, compounded annually, during the interim period from April 19, 1991 until this Order is issued in Cause No. PUD 000662. We further find that any refunds ordered herein withheld by SWBT subsequent to the issuance of this Order in this Cause shall bear interest at the permanently authorized ROE of 12.2 percent, compounded annually, until paid.

b. Refund methodology

The Commission has reviewed the record and adopts the refund methodology recommended by Staff witness Glen Gregory. Under this methodology, the entire amount of the refunds shall be returned directly to ratepayers, based upon the pro rata share of the dollars paid to SWBT by individual customers. Once a refund to which each customer is

entitled is quantified, it shall be flowed back to the customer as a credit to the bill. The credit shall be carried forward until used.

We further find that the amounts to be refunded by SWBT shall be refunded as a credit on customer's bills over a twelve-month period of time. We recognize that there may be customers who are no longer on SWBT's network, but who were receiving service from SWBT during the time frame of April 19, 1991, through the refund period. Accordingly, we find that SWBT shall set aside the sum of $500,000 to refund to customers who may no longer be on SWBT's network and that payment to those former customers shall be made by check upon request by the customer. The amount of the refund to such customers shall be their proportionate share calculated from their last three-month's billing excluding the final bill, unless the former customer is able to produce bills for the period of time they were on the system during this refund period which would reflect a higher amount of refund due them. Former customers shall have until one year from the date of a final Order in this Cause to present their claim for a refund pursuant to the criteria set forth herein. Any refund amount with interest calculated at 12.2 percent, compounded annually, not claimed by former customers shall be returned to existing customers.

c. Quantification of refund

The Commission recognizes that during the refund period, April 19, 1991, through the date of this Order, the depreciation reserve deficiency amortization authorized in Order No. 341630 expired. Consistent with the prior directive of Interim Order No. 356271, the pro forma impact of the full amortization of the depreciation reserve imbalance effective July 1, 1991, shall be taken into account in the quantification of the refund amount. In addition, all the other adjustments which we deem appropriate for determining permanent rates, based on the 1989 test year, (with the exception of ROE, already fixed by Commission Order at 11.41 percent for the interim period) shall be

taken into account for determining the refund amounts. The Commission rejects the ALJ's recommendation that 1991 results should be used to determine SWBT's refund obligation, because this rate investigation uses a 1989 historical test year which would not incorporate the inclusion of attrition adjustments unless they satisfy the criteria established in this Order, supra. We find that the 1991 results do not meet these criteria.

SWBT claims that we do not have the power to order SWBT's rates to be interim subject to refund. We find that this Commission is constitutionally required to protect SWBT's ratepayers from excessive rates. Under Article IX, Section 18, of the Oklahoma Constitution, this Commission is charged with the broad "duty of supervising, regulating, and controlling all transportation and transmission companies doing business in the State, in all matters relating to the performance of their public duties and their charges therefor, and of correcting abuses and preventing unjust discrimination and extortion by such companies."

In the landmark Turpen decision, the Oklahoma Supreme Court recognized that the Commission's constitutional duty is not just intended to permit a utility to earn a fair return on its investment, but includes the duty "to prevent a public utility from making excess monopoly profits and to assure fair prices and adequate service to . . . consumers." Turpen v. Corporation Com'n., 769 P.2d 1309, 1316 (Okla. 1988). We recognized this duty in our Interim Order dated April 19, 1991.

We do not believe this power is limited to prescribing permanent rate schedules. Rather, this Commission's powers may be exercised as the "exigencies of the times and changing conditions demand." Long Star Gas Co. v. Corporation Commission, 39 P.2d 547, 550 (Okla. 1935). The Courts have recognized that the Commission should be guided by "broad equitable principles" in the discharge of its duties, and that the Constitution has invested the Commission with broad legislative,

administrative, and judicial powers so that it can structure appropriate remedies to meet the needs of particular situations. Id; Community Natural Gas Co. v. Corporation Com'n, 76 P.2d 393 (Okla. 1938).

The Supreme Court has recognized that we have an affirmative duty to protect utility shareholders when they suffer as a result of delay. Southwestern Bell Telephone Co. v. State, 214 P.2d 715 (Okla. 1949) (interim rate increases). In this Cause, the "exigencies of the times" require that this Commission invoke its broad equitable powers and structure a remedy to protect ratepayers from the harmful effect of delay. Other courts have held that a public utility commission's powers to prescribe just and reasonable rates include by necessity the power to declare rates "interim and subject to decrease" where necessary to protect a utility's customers. Pueblo Del Sol Water v. Arizona Corporation Com'n, 772 P.2d 1131 (Ariz. App. 1988).

We also reject SWBT's claims that an order placing its earnings subject to refund from the date of that order constitutes retroactive ratemaking. This Commission has not sought to retroactively adjust SWBT's authorized rates due to any mistake in Order No. 341630, Cause No. PUD 000260 (the "Tax Docket"), or any other previous orders. The Interim Order in Cause No. PUD 000662 issued April 19, 1991, placing SWBT's earnings subject to refund, insures that prospectively, from the date of that Order, SWBT's ratepayers are not deprived of rate reductions due to regulatory lag.

In fact, we believe the Oklahoma Supreme Court has explicitly recognized the retroactivity problem that would arise if the interim remedy were not available. In Southwestern Bell Telephone Co. v. State, 214 P.2d 715, 728 (Okla. 1949), the Court stated:

> "Under such arrangements [an interim rate increase] the patrons of the company will not eventually suffer if it be ultimately determined that the increase in rates was erroneously granted, for without expense to them all such increased charges will be refunded. On the other hand, if it be eventually determined by the court that the company was entitled to such increase, there is no way by which the court can make the order

> of increase of rates so effectively retroactive as to relieve the company of the burden of the loss unjustly inflicted upon it, and to require the company's patrons to pay the deficiency for past service which they have been able to unjustly avoid." (parentheticals added).

For these reasons, we find that this Commission had the jurisdiction to place the revenues of SWBT subject to refund to the extent they exceed 11.41 percent ROE, when we issued our Interim Order April 19, 1991. We further find that the Commission had the jurisdiction to extend Order Nos. 362281, 364631 and 367460 issued on December 27, 1991, April 10, 1992, and August 6, 1992, respectively.

Therefore, the Commission finds that the refund liability with interest, compounded annually, for the period of April 19, 1991 through August 26, 1992 is $148,393,959 (Schedule D) before taking into account the timing differences associated with the WACP implementation as described in Section G, Part 1 of this Order and before taking into account the time period between the issuance of this Order and the implementation of permanent rates. The Commission finds that refunds required by this Order shall be adjusted accordingly as set forth herein to account for the impact on such refunds from implementing the WACPs and permanent rates as required herein.

M. MISCELLANEOUS ISSUES

The Commission notes that SWBT has appealed several procedural rulings issued by the ALJ during the course of the trial of this Cause. The first, generally concerns the denial of SWBT's objections to the acceptance of testimony from certain witnesses, who in SWBT's opinion, were not experts. The second, generally concerns the ALJ's acceptance of testimony, over SWBT's objection, from a Staff witness who adopted and sponsored the testimony of another Staff witness who was no longer employed with the Commission. Another concern was that the ALJ improperly struck certain SWBT testimony.

The Commission has reviewed the record and transcript and finds the ALJ correctly denied SWBT's objections for the reasons stated therein. We likewise find the contested testimony proferred and accepted by the ALJ to be credible, persuasive, relevant and competent in all respects.

ORDER

IT IS THEREFORE THE ORDER OF THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA that the findings and conclusions set forth above in Sections A through M, and as summarized by the Schedules A, B, C, D and E, attached hereto and incorporated herein, are hereby adopted as the Order of this Commission.

IT IS FURTHER ORDERED that SWBT file tariffs with the Commission which conform to this Order within 30 days from the date of the issuance of this Order. Said tariffs to be effective immediately upon approval by the Director, Public Utility Division.

IT IS FURTHER ORDERED that the refund ordered herein shall continue to accrue, with interest as set forth herein, until such time as new rates become effective.

CORPORATION COMMISSION OF OKLAHOMA

Bob Anthony

BOB ANTHONY, CHAIRMAN

J. C. WATTS, JR., VICE-CHAIRMAN

Cody L. Graves

CODY L. GRAVES, COMMISSIONER

DONE AND PERFORMED this 26th day of AUGUST, 1992,

BY ORDER OF THE COMMISSION:

Charlotte W. Flanagan

CHARLOTTE W. FLANAGAN, Secretary

SCHEDULE A

SOUTHWESTERN BELL TELEPHONE COMPANY
State of Oklahoma
Part I
INTRASTATE REVENUE DEFICIENCY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

1	Southwestern Bell Hypothetical Capital Structure:				
		Weight	Cost	Weighted Cost	
	Debt	44.000%	9.070%	3.99080%	
	Equity	56.000%	12.200%	6.83200%	
2	Rate of Return				10.823%
3	Intrastate Rate Base (Schedule E, Line 100)				$796,422,702
4	Net Income Requirement (L.2 x L.3)				$86,195,236
5	Income Taxes Required				20,242,074
6	Pre Tax Operating Income Required (L.4 + L.5)				$106,437,310
7	Pro Forma Operating Expenses (Schedule E, Line 103)				434,505,752
8	Revenue Requirement (L.6 + L.7)				$540,943,062
9	Less: Pro Forma Revenues (Schedule E, Line 100)				(638,390,046)
10	Revenue Deficiency or (Excess) Before Adjustments				($97,446,984)
11	Gross-up for Gross Receipts Tax (L.10 x Factor)			0.0000000	0
12	Gross-up for Uncollectibles ((L.10 + L.11) x Factor)			0.0114189	(1,112,737)
13	Revenue Deficiency or (Excess) (L.10+L.11+L.12)				($98,559,721)
14	Revenue Requirement for AT&T Reimbursements (Cause No. 29321 Remand)				(1,997,576)
15	Sub-total				(100,557,297)
16	Revenue Requirement for Network Modernization				7,800,000
17	Total Excess Net of Network Modernization & Cause No. 29321 Remand				(92,757,297
18	Pro Forma Revenues (Schedule E, Line 100)				$638,390,046
19	Less: Yellow Pages Revenues (Schedule E, Line 22)			($60,658,850)	
20	Other Non-tariff Revenue Sources			(30,204,380)	
21	Total Excess Net of Network Modernization and Cause No. 29321 Remand (L. 17)			(92,757,297)	(183,620,527)
22	SWBT Pro Forma Revenue Requirement (L.18 - L. 21)				$454,769,519

SCHEDULE

SOUTHWESTERN BELL TELEPHONE COMPANY
State of Oklahoma
Part II
INTRASTATE REVENUE DEFICIENCY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

1	Southwestern Bell Hypothetical Capital Structure:				
		Weight	Cost	Weighted Cost	
	Debt	44.000%	9.070%	3.99080%	
	Equity	56.000%	11.410%	6.38960%	
2	Rate of Return				10.38
3	Intrastate Rate Base (Schedule E, Line 100)				$808,619,89
4	Net Income Requirement (L.2 x L.3)				$83,937,98
5	Income Taxes Required				18,579,02
6	Pre Tax Operating Income Required (L.4 + L.5)				$102,517,00
7	Pro Forma Operating Expenses (Schedule E, Line 103)				465,435,18
8	Revenue Requirement (L.6 + L.7)				$567,952,19
9	Less: Pro Forma Revenues (Schedule E, Line 100)				(642,0
10	Revenue Deficiency or (Excess) Before Adjustments				($74,128,8
11	Gross-up for Gross Receipts Tax (L.10 x Factor)			0.0000000	(
12	Gross-up for Uncollectibles ((L.10 + L.11) x Factor)			0.0114189	(846,47
13	Revenue Deficiency or (Excess) (L.10+L.11+L.12)				($74,975,36
14	Revenue Requirement for AT&T Reimbursements (Cause No. 29321 Remand)				(1,997,57
15	Revenue Deficiency or (Excess)				($76,972,938
16	Pro Forma Revenues (Schedule E, Line 100)				$642,081,08
17	Less: Yellow Pages Revenues (Schedule E, Line 22)			($60,658,850)	
18	Other Non-tariff Revenue Sources			(30,204,380)	
19	Total Excess Net of Cause No. 29321 Remand (L.15)			(76,972,938)	(167,836,168
20	SWBT Pro Forma Revenue Requirement (L.18 - L. 21)				$474,244,9

SOUTHWESTERN BELL TELEPHONE COMPANY
State of Oklahoma
Part III
INTRASTATE REVENUE DEFICIENCY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

1 Southwestern Bell Hypothetical Capital Structure:

	Weight	Cost	Weighted Cost
Debt	44.000%	9.070%	3.99080%
Equity	56.000%	11.410%	6.38960%

2	Rate of Return		10.380%
3	Intrastate Rate Base (Schedule E, Line 100)		$798,546,710
4	Net Income Requirement (L.2 x L.3)		$82,892,343
5	Income Taxes Required (Section J, Schedule 1)		18,188,946
6	Pre Tax Operating Income Required (L.4 + L.5)		$101,081,289
7	Pro Forma Operating Expenses (Schedule E, Line 103)		434,341,528
8	Revenue Requirement (L.6 + L.7)		$535,422,817
9	Less: Pro Forma Revenues (Schedule E, Line 100)		(638,390,046)
10	Revenue Deficiency or (Excess) Before Adjustments		($102,967,229)
11	Gross-up for Gross Receipts Tax (L.10 x Factor)	0.0000000	0
12	Gross-up for Uncollectibles ((L.10 + L.11) x Factor)	0.0114189	(1,175,772)
13	Revenue Deficiency or (Excess) (L.10+L.11+L.12)		($104,143,001)
14	Revenue Requirement for AT&T Reimbursements (Cause No. 29321 Remand)		(1,997,576)
15	Revenue Deficiency or (Excess)		($106,140,577)
16	Pro Forma Revenues (Schedule E, Line 100)		$642,081,086
17	Less: Yellow Pages Revenues (Schedule E, Line 22)	($60,658,850)	
18	Other Non-tariff Revenue Sources	(30,204,380)	
19	Total Excess Net of Cause No. 29321 Remand (L.15)	(106,140,577)	(197,003,807)
20	SWBT Pro Forma Revenue Requirement (L.18 - L. 21)		$445,077,279

SOUTHWESTERN BELL TELEPHONE COMPANY
COMMISSION DECISION REFUND METHODOLOGY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Days	Daily Excess Dollars (Footnotes 1 & 2)	Daily Interest (Factor of 0.0296863% Footnote 3)	Accumulated Refund Dollars
1	$210,885	$62.60	$210,948
2	210,885	125.23	421,958
3	210,885	187.87	633,031
4	210,885	250.53	844,166
5	210,885	313.21	1,055,364
6	210,885	375.90	1,266,625
7	210,885	438.62	1,477,949
8	210,885	501.35	1,689,335
9	210,885	564.11	1,900,784
10	210,885	626.88	2,112,296
11	210,885	689.67	2,323,871
12	210,885	752.48	2,535,508
13	210,885	815.30	2,747,209
14	210,885	878.15	2,958,972
15	210,885	941.01	3,170,798
16	210,885	1,003.90	3,382,687
17	210,885	1,066.80	3,594,639
18	210,885	1,129.72	3,806,653
19	210,885	1,192.66	4,018,731
20	210,885	1,255.62	4,230,872
21	210,885	1,318.59	4,443,075
22	210,885	1,381.59	4,655,342
23	210,885	1,444.60	4,867,671
24	210,885	1,507.64	5,080,064
25	210,885	1,570.69	5,292,520
26	210,885	1,633.76	5,505,038
27	210,885	1,696.85	5,717,620
28	210,885	1,759.95	5,930,265
29	210,885	1,823.08	6,142,973
30	210,885	1,886.23	6,355,745
31	210,885	1,949.39	6,568,579
32	210,885	2,012.57	6,781,477
33	210,885	2,075.77	6,994,437
34	210,885	2,138.99	7,207,461
35	210,885	2,202.23	7,420,549
36	210,885	2,265.49	7,633,699
37	210,885	2,328.77	7,846,913
38	210,885	2,392.06	8,060,190
39	210,885	2,455.38	8,273,530
40	210,885	2,518.71	8,486,934
41	210,885	2,582.06	8,700,401
42	210,885	2,645.43	8,913,931
43	210,885	2,708.82	9,127,525
44	210,885	2,772.23	9,341,182
45	210,885	2,835.66	9,554,903
46	210,885	2,899.10	9,768,687
47	210,885	2,962.57	9,982,535
48	210,885	3,026.05	10,196,446
49	210,885	3,089.55	10,410,420
50	210,885	3,153.07	10,624,458
51	210,885	3,216.61	10,838,560
52	210,885	3,280.17	11,052,725
53	210,885	3,343.75	11,266,954
54	210,885	3,407.35	11,481,246
55	210,885	3,470.96	11,695,602
56	210,885	3,534.60	11,910,022
57	210,885	3,598.25	12,124,505
58	210,885	3,661.92	12,339,052
59	210,885	3,725.61	12,553,663
60	210,885	3,789.32	12,768,337

SOUTHWESTERN BELL TELEPHONE COMPANY
COMMISSION DECISION REFUND METHODOLOGY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Days	Daily Excess Dollars (Footnotes 1 & 2)	Daily Interest (Factor of 0.0296863% Footnote 3)	Accumulated Refund Dollars
61	$210,885	$3,853.05	$12,983,075
62	210,885	3,916.80	13,197,877
63	210,885	3,980.57	13,412,742
64	210,885	4,044.35	13,627,672
65	210,885	4,108.16	13,842,665
66	210,885	4,171.98	14,057,722
67	210,885	4,235.82	14,272,843
68	210,885	4,299.68	14,488,027
69	210,885	4,363.56	14,703,276
70	210,885	4,427.46	14,918,588
71	210,885	4,491.38	15,133,965
72	210,885	4,555.32	15,349,405
73	210,885	4,619.27	15,564,909
74	290,796	4,706.97	15,860,412
75	290,796	4,794.70	16,156,003
76	290,796	4,882.45	16,451,682
77	290,796	4,970.22	16,747,448
78	290,796	5,058.02	17,043,302
79	290,796	5,145.85	17,339,244
80	290,796	5,233.71	17,635,273
81	290,796	5,321.59	17,931,391
82	290,796	5,409.49	18,227,596
83	290,796	5,497.43	18,523,890
84	290,796	5,585.38	18,820,271
85	290,796	5,673.37	19,116,741
86	290,796	5,761.38	19,413,298
87	290,796	5,849.42	19,709,943
88	290,796	5,937.48	20,006,677
89	290,796	6,025.57	20,303,498
90	290,796	6,113.68	20,600,408
91	290,796	6,201.83	20,897,406
92	290,796	6,289.99	21,194,492
93	290,796	6,378.19	21,491,666
94	290,796	6,466.41	21,788,929
95	290,796	6,554.65	22,086,279
96	290,796	6,642.93	22,383,718
97	290,796	6,731.22	22,681,245
98	290,796	6,819.55	22,978,861
99	290,796	6,907.90	23,276,565
100	290,796	6,996.28	23,574,357
101	290,796	7,084.68	23,872,238
102	290,796	7,173.11	24,170,207
103	290,796	7,261.57	24,468,264
104	290,796	7,350.05	24,766,410
105	290,796	7,438.56	25,064,645
106	290,796	7,527.09	25,362,968
107	290,796	7,615.65	25,661,380
108	290,796	7,704.24	25,959,880
109	290,796	7,792.85	26,258,469
110	290,796	7,881.49	26,557,146
111	290,796	7,970.16	26,855,913
112	290,796	8,058.85	27,154,767
113	290,796	8,147.57	27,453,711
114	290,796	8,236.32	27,752,743
115	290,796	8,325.09	28,051,864
116	290,796	8,413.89	28,351,074
117	290,796	8,502.71	28,650,373
118	290,796	8,591.56	28,949,760
119	290,796	8,680.44	29,249,237
120	290,796	8,769.34	29,548,802

SOUTHWESTERN BELL TELEPHONE COMPANY
COMMISSION DECISION REFUND METHODOLOGY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Days	Daily Excess Dollars (Footnotes 1 & 2)	Daily Interest (Factor of 0.0296863% Footnote 3)	Accumulated Refund Dollars
121	$290,796	$8,858.27	$29,848,457
122	290,796	8,947.23	30,148,200
123	290,796	9,036.21	30,448,032
124	290,796	9,125.22	30,747,953
125	290,796	9,214.26	31,047,963
126	290,796	9,303.32	31,348,063
127	290,796	9,392.41	31,648,251
128	290,796	9,481.52	31,948,529
129	290,796	9,570.66	32,248,895
130	290,796	9,659.83	32,549,351
131	290,796	9,749.02	32,849,896
132	290,796	9,838.25	33,150,530
133	290,796	9,927.49	33,451,254
134	290,796	10,016.77	33,752,067
135	290,796	10,106.07	34,052,969
136	290,796	10,195.39	34,353,960
137	290,796	10,284.75	34,655,041
138	290,796	10,374.13	34,956,211
139	290,796	10,463.53	35,257,471
140	290,796	10,552.97	35,558,820
141	290,796	10,642.42	35,860,258
142	290,796	10,731.91	36,161,786
143	290,796	10,821.42	36,463,403
144	290,796	10,910.96	36,765,110
145	290,796	11,000.53	37,066,907
146	290,796	11,090.12	37,368,793
147	290,796	11,179.74	37,670,769
148	290,796	11,269.38	37,972,834
149	290,796	11,359.06	38,274,989
150	290,796	11,448.75	38,577,234
151	290,796	11,538.48	38,879,568
152	290,796	11,628.23	39,181,993
153	290,796	11,718.01	39,484,507
154	290,796	11,807.82	39,787,110
155	290,796	11,897.65	40,089,804
156	290,796	11,987.51	40,392,588
157	290,796	12,077.39	40,695,461
158	290,796	12,167.30	40,998,424
159	290,796	12,257.24	41,301,477
160	290,796	12,347.21	41,604,621
161	290,796	12,437.20	41,907,854
162	290,796	12,527.22	42,211,177
163	290,796	12,617.26	42,514,590
164	290,796	12,707.34	42,818,094
165	290,796	12,797.43	43,121,687
166	290,796	12,887.56	43,425,371
167	290,796	12,977.71	43,729,144
168	290,796	13,067.89	44,033,008
169	290,796	13,158.10	44,336,962
170	290,796	13,248.33	44,641,007
171	290,796	13,338.59	44,945,141
172	290,796	13,428.88	45,249,366
173	290,796	13,519.19	45,553,681
174	290,796	13,609.53	45,858,087
175	290,796	13,699.90	46,162,583
176	290,796	13,790.29	46,467,169
177	290,796	13,880.71	46,771,846
178	290,796	13,971.16	47,076,613
179	290,796	14,061.63	47,381,471
180	290,796	14,152.13	47,686,419

SOUTHWESTERN BELL TELEPHONE COMPANY
COMMISSION DECISION REFUND METHODOLOGY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Days	Daily Excess Dollars (Footnotes 1 & 2)	Daily Interest (Factor of 0.0296863% Footnote 3)	Accumulated Refund Dollars
181	$290,796	$14,242.66	$47,991,457
182	290,796	14,333.21	48,296,587
183	290,796	14,423.80	48,601,806
184	290,796	14,514.40	48,907,117
185	290,796	14,605.04	49,212,518
186	290,796	14,695.70	49,518,010
187	290,796	14,786.39	49,823,592
188	290,796	14,877.11	50,129,265
189	290,796	14,967.85	50,435,029
190	290,796	15,058.62	50,740,884
191	290,796	15,149.42	51,046,829
192	290,796	15,240.24	51,352,865
193	290,796	15,331.09	51,658,992
194	290,796	15,421.97	51,965,210
195	290,796	15,512.87	52,271,519
196	290,796	15,603.81	52,577,919
197	290,796	15,694.77	52,884,410
198	290,796	15,785.75	53,190,991
199	290,796	15,876.76	53,497,664
200	290,796	15,967.80	53,804,428
201	290,796	16,058.87	54,111,283
202	290,796	16,149.96	54,418,229
203	290,796	16,241.09	54,725,266
204	290,796	16,332.23	55,032,394
205	290,796	16,423.41	55,339,614
206	290,796	16,514.61	55,646,924
207	290,796	16,605.84	55,954,326
208	290,796	16,697.10	56,261,819
209	290,796	16,788.38	56,569,404
210	290,796	16,879.69	56,877,079
211	290,796	16,971.03	57,184,846
212	290,796	17,062.39	57,492,705
213	290,796	17,153.78	57,800,654
214	290,796	17,245.20	58,108,696
215	290,796	17,336.65	58,416,828
216	290,796	17,428.12	58,725,052
217	290,796	17,519.62	59,033,368
218	290,796	17,611.15	59,341,775
219	290,796	17,702.70	59,650,274
220	290,796	17,794.29	59,958,864
221	290,796	17,885.89	60,267,546
222	290,796	17,977.53	60,576,320
223	290,796	18,069.19	60,885,185
224	290,796	18,160.89	61,194,142
225	290,796	18,252.60	61,503,190
226	290,796	18,344.35	61,812,331
227	290,796	18,436.12	62,121,563
228	290,796	18,527.92	62,430,887
229	290,796	18,619.75	62,740,302
230	290,796	18,711.60	63,049,810
231	290,796	18,803.48	63,359,409
232	290,796	18,895.39	63,669,101
233	290,796	18,987.33	63,978,884
234	290,796	19,079.29	64,288,759
235	290,796	19,171.28	64,598,727
236	290,796	19,263.30	64,908,786
237	290,796	19,355.34	65,218,937
238	290,796	19,447.42	65,529,181
239	290,796	19,539.52	65,839,516
240	290,796	19,631.64	66,149,944

SOUTHWESTERN BELL TELEPHONE COMPANY
COMMISSION DECISION REFUND METHODOLOGY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Days	Daily Excess Dollars (Footnotes 1 & 2)	Daily Interest (Factor of 0.0296863% Footnote 3)	Accumulated Refund Dollars
241	$290,796	$19,723.80	$66,460,464
242	290,796	19,815.98	66,771,076
243	290,796	19,908.19	67,081,780
244	290,796	20,000.43	67,392,576
245	290,796	20,092.69	67,703,465
246	290,796	20,184.98	68,014,446
247	290,796	20,277.30	68,325,519
248	290,796	20,369.65	68,636,685
249	290,796	20,462.02	68,947,943
250	290,796	20,554.42	69,259,293
251	290,796	20,646.85	69,570,736
252	290,796	20,739.30	69,882,272
253	290,796	20,831.79	70,193,899
254	290,796	20,924.30	70,505,620
255	290,796	21,016.84	70,817,432
256	290,796	21,109.40	71,129,338
257	290,796	21,202.00	71,441,336
258	290,796	21,294.62	71,753,426
259	290,796	21,387.26	72,065,610
260	290,796	21,479.94	72,377,886
261	290,796	21,572.64	72,690,254
262	290,796	21,665.37	73,002,716
263	290,796	21,758.13	73,315,270
264	290,796	21,850.92	73,627,917
265	290,796	21,943.73	73,940,656
266	290,796	22,036.57	74,253,489
267	290,796	22,129.44	74,566,414
268	290,796	22,222.34	74,879,433
269	290,796	22,315.26	75,192,544
270	290,796	22,408.21	75,505,748
271	290,796	22,501.19	75,819,045
272	290,796	22,594.20	76,132,436
273	290,796	22,687.23	76,445,919
274	290,796	22,780.29	76,759,495
275	290,796	22,873.38	77,073,165
276	290,796	22,966.50	77,386,927
277	290,796	23,059.64	77,700,783
278	290,796	23,152.81	78,014,732
279	290,796	23,246.01	78,328,774
280	290,796	23,339.24	78,642,909
281	290,796	23,432.50	78,957,137
282	290,796	23,525.78	79,271,459
283	290,796	23,619.09	79,585,874
284	290,796	23,712.43	79,900,383
285	290,796	23,805.79	80,214,984
286	290,796	23,899.19	80,529,680
287	290,796	23,992.61	80,844,468
288	290,796	24,086.06	81,159,350
289	290,796	24,179.53	81,474,326
290	290,796	24,273.04	81,789,395
291	290,796	24,366.57	82,104,557
292	290,796	24,460.13	82,419,814
293	290,796	24,553.72	82,735,163
294	290,796	24,647.34	83,050,607
295	290,796	24,740.98	83,366,144
296	290,796	24,834.65	83,681,774
297	290,796	24,928.35	83,997,499
298	290,796	25,022.08	84,313,317
299	290,796	25,115.83	84,629,228
300	290,796	25,209.61	84,945,234

SOUTHWESTERN BELL TELEPHONE COMPANY
COMMISSION DECISION REFUND METHODOLOGY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Days	Daily Excess Dollars (Footnotes 1 & 2)	Daily Interest (Factor of 0.0296863% Footnote 3)	Accumulated Refund Dollars
301	$290,796	$25,303.42	$85,261,333
302	290,796	25,397.26	85,577,527
303	290,796	25,491.13	85,893,814
304	290,796	25,585.02	86,210,195
305	290,796	25,678.94	86,526,670
306	290,796	25,772.89	86,843,239
307	290,796	25,866.87	87,159,902
308	290,796	25,960.88	87,476,658
309	290,796	26,054.91	87,793,509
310	290,796	26,148.97	88,110,454
311	290,796	26,243.06	88,427,493
312	290,796	26,337.18	88,744,627
313	290,796	26,431.32	89,061,854
314	290,796	26,525.50	89,379,175
315	290,796	26,619.70	89,696,591
316	290,796	26,713.93	90,014,101
317	290,796	26,808.18	90,331,705
318	290,796	26,902.47	90,649,404
319	290,796	26,996.78	90,967,196
320	290,796	27,091.12	91,285,084
321	290,796	27,185.49	91,603,065
322	290,796	27,279.89	91,921,141
323	290,796	27,374.31	92,239,311
324	290,796	27,468.77	92,557,576
325	290,796	27,563.25	92,875,935
326	290,796	27,657.76	93,194,389
327	290,796	27,752.29	93,512,937
328	290,796	27,846.86	93,831,580
329	290,796	27,941.45	94,150,318
330	290,796	28,036.07	94,469,150
331	290,796	28,130.72	94,788,076
332	290,796	28,225.40	95,107,098
333	290,796	28,320.10	95,426,214
334	290,796	28,414.84	95,745,425
335	290,796	28,509.60	96,064,730
336	290,796	28,604.39	96,384,131
337	290,796	28,699.21	96,703,626
338	290,796	28,794.06	97,023,216
339	290,796	28,888.93	97,342,901
340	290,796	28,983.83	97,662,681
341	290,796	29,078.76	97,982,556
342	290,796	29,173.72	98,302,525
343	290,796	29,268.71	98,622,590
344	290,796	29,363.72	98,942,750
345	290,796	29,458.77	99,263,005
346	290,796	29,553.84	99,583,354
347	290,796	29,648.94	99,903,799
348	290,796	29,744.07	100,224,339
349	290,796	29,839.22	100,544,975
350	290,796	29,934.41	100,865,705
351	290,796	30,029.62	101,186,531
352	290,796	30,124.86	101,507,451
353	290,796	30,220.13	101,828,468
354	290,796	30,315.43	102,149,579
355	290,796	30,410.76	102,470,786
356	290,796	30,506.11	102,792,088
357	290,796	30,601.49	103,113,485
358	290,796	30,696.91	103,434,978
359	290,796	30,792.34	103,756,567
360	290,796	30,887.81	104,078,250

SOUTHWESTERN BELL TELEPHONE COMPANY
COMMISSION DECISION REFUND METHODOLOGY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Days	Daily Excess Dollars (Footnotes 1 & 2)	Daily Interest (Factor of 0.0296863% Footnote 3)	Accumulated Refund Dollars
361	$290,796	$30,983.31	$104,400,030
362	290,796	31,078.83	104,721,905
363	290,796	31,174.39	105,043,875
364	290,796	31,269.97	105,365,941
365	290,796	31,365.58	105,688,103
366	290,796	31,461.21	106,010,360
367	290,796	31,556.88	106,332,713
368	290,796	31,652.57	106,655,161
369	290,796	31,748.30	106,977,705
370	290,796	31,844.05	107,300,346
371	290,796	31,939.83	107,623,081
372	290,796	32,035.64	107,945,913
373	290,796	32,131.47	108,268,840
374	290,796	32,227.34	108,591,864
375	290,796	32,323.23	108,914,983
376	290,796	32,419.16	109,238,198
377	290,796	32,515.11	109,561,509
378	290,796	32,611.08	109,884,916
379	290,796	32,707.09	110,208,419
380	290,796	32,803.13	110,532,019
381	290,796	32,899.19	110,855,714
382	290,796	32,995.29	111,179,505
383	290,796	33,091.41	111,503,393
384	290,796	33,187.56	111,827,376
385	290,796	33,283.74	112,151,456
386	290,796	33,379.94	112,475,632
387	290,796	33,476.18	112,799,904
388	290,796	33,572.44	113,124,272
389	290,796	33,668.74	113,448,737
390	290,796	33,765.06	113,773,298
391	290,796	33,861.41	114,097,956
392	290,796	33,957.79	114,422,709
393	290,796	34,054.20	114,747,560
394	290,796	34,150.63	115,072,506
395	290,796	34,247.10	115,397,549
396	290,796	34,343.59	115,722,689
397	290,796	34,440.11	116,047,925
398	290,796	34,536.66	116,373,258
399	290,796	34,633.24	116,698,687
400	290,796	34,729.85	117,024,213
401	290,796	34,826.49	117,349,835
402	290,796	34,923.15	117,675,554
403	290,796	35,019.84	118,001,370
404	290,796	35,116.57	118,327,283
405	290,796	35,213.32	118,653,292
406	290,796	35,310.10	118,979,398
407	290,796	35,406.91	119,305,601
408	290,796	35,503.75	119,631,901
409	290,796	35,600.61	119,958,297
410	290,796	35,697.51	120,284,791
411	290,796	35,794.43	120,611,381
412	290,796	35,891.38	120,938,069
413	290,796	35,988.36	121,264,853
414	290,796	36,085.37	121,591,735
415	290,796	36,182.41	121,918,713
416	290,796	36,279.48	122,245,788
417	290,796	36,376.58	122,572,961
418	290,796	36,473.70	122,900,231
419	290,796	36,570.86	123,227,598
420	290,796	36,668.04	123,555,062

SOUTHWESTERN BELL TELEPHONE COMPANY
COMMISSION DECISION REFUND METHODOLOGY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Days	Daily Excess Dollars (Footnotes 1 & 2)	Daily Interest (Factor of 0.0296863% Footnote 3)	Accumulated Refund Dollars
421	$290,796	$36,765.25	$123,882,623
422	290,796	36,862.49	124,210,281
423	290,796	36,959.76	124,538,037
424	290,796	37,057.06	124,865,890
425	290,796	37,154.39	125,193,841
426	290,796	37,251.75	125,521,888
427	290,796	37,349.13	125,850,033
428	290,796	37,446.55	126,178,276
429	290,796	37,543.99	126,506,616
430	290,796	37,641.46	126,835,053
431	290,796	37,738.96	127,163,588
432	290,796	37,836.49	127,492,221
433	290,796	37,934.05	127,820,951
434	290,796	38,031.64	128,149,779
435	290,796	38,129.25	128,478,704
436	290,796	38,226.90	128,807,727
437	290,796	38,324.57	129,136,847
438	290,796	38,422.28	129,466,066
439	290,796	38,520.01	129,795,382
440	290,796	38,617.77	130,124,795
441	290,796	38,715.56	130,454,307
442	290,796	38,813.38	130,783,916
443	290,796	38,911.23	131,113,624
444	290,796	39,009.11	131,443,429
445	290,796	39,107.02	131,773,332
446	290,796	39,204.95	132,103,333
447	290,796	39,302.92	132,433,432
448	290,796	39,400.91	132,763,628
449	290,796	39,498.94	133,093,923
450	290,796	39,596.99	133,424,316
451	290,796	39,695.07	133,754,807
452	290,796	39,793.18	134,085,397
453	290,796	39,891.32	134,416,084
454	290,796	39,989.49	134,746,869
455	290,796	40,087.69	135,077,753
456	290,796	40,185.91	135,408,735
457	290,796	40,284.17	135,739,815
458	290,796	40,382.46	136,070,994
459	290,796	40,480.77	136,402,270
460	290,796	40,579.11	136,733,646
461	290,796	40,677.49	137,065,119
462	290,796	40,775.89	137,396,691
463	290,796	40,874.32	137,728,361
464	290,796	40,972.78	138,060,130
465	290,796	41,071.27	138,391,997
466	290,796	41,169.79	138,723,963
467	290,796	41,268.34	139,056,027
468	290,796	41,366.92	139,388,190
469	290,796	41,465.52	139,720,452
470	290,796	41,564.16	140,052,812
471	290,796	41,662.82	140,385,271
472	290,796	41,761.52	140,717,828
473	290,796	41,860.24	141,050,485
474	290,796	41,959.00	141,383,240
475	290,796	42,057.78	141,716,093
476	290,796	42,156.59	142,049,046
477	290,796	42,255.43	142,382,097
478	290,796	42,354.30	142,715,248
479	290,796	42,453.20	143,048,497
480	290,796	42,552.13	143,381,845

SOUTHWESTERN BELL TELEPHONE COMPANY
COMMISSION DECISION REFUND METHODOLOGY
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Days	Daily Excess Dollars (Footnotes 1 & 2)	Daily Interest (Factor of 0.0296863% Footnote 3)	Accumulated Refund Dollars
481	$290,796	$42,651.09	$143,715,292
482	290,796	42,750.08	144,048,838
483	290,796	42,849.10	144,382,483
484	290,796	42,948.14	144,716,227
485	290,796	43,047.22	145,050,071
486	290,796	43,146.33	145,384,013
487	290,796	43,245.46	145,718,054
488	290,796	43,344.63	146,052,195
489	290,796	43,443.82	146,386,435
490	290,796	43,543.04	146,720,774
491	290,796	43,642.30	147,055,212
492	290,796	43,741.58	147,389,750
493	290,796	43,840.89	147,724,387
494	290,796	43,940.23	148,059,123
495	290,796	44,039.60	148,393,959
TOTAL REFUND DOLLARS AS OF AUGUST 26, 1992			$148,393,959

Footnote 1: Daily excess dollars to day 73 are calculated from Period II ending June 30, 1991. The amount was calculated by dividing the Period II annual excess revenues of $76,972,938 by the 365 days in a calendar year.

Footnote 2: Daily excess dollars subsequent to day 73 are calculated from Period III ending on day 495 or August 26, 1992. The amount was calculated by dividing the Period III annual excess revenues of $106,140,577 by the 365 days in a calendar year.

Footnote 3: The interest on the refund is based upon the 11.41% return on equity allowance as ordered by the Commission. To allow for interest to accumulate at an annually compounded rate of 11.41% and to compute interest on daily refund balances the equivalent daily compounded rate of .000296863 was used for determining interest accruals.

SOUTHWESTERN BELL TELEPHONE COMPANY
REVENUE, EXPENSE AND RATE BASE ADJUSTMENTS
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Line No.	Adjustment Description	COMMISSION DECISION Revenues	Expenses	Rate Base
1	1989 Actual Results (Footnote 1)	$568,394,327	$444,830,039	$857,678,021
2	Year-end Revenues:			
3	Local	$997,777		
4	Toll	2,829,707		
5	Access	(1,047,135)		
6	Other	1,341,984		
7	Year-end Wage & Nonwage:			
8	Management Survey		0	
9	Non-management Survey		0	
10	Signing Bonus		(414,652)	
11	Other Wages		(2,833,214)	
12	Annualize Wages & Salaries	(133,575)	777,316	
13	Annualize Non-Wage Expense	0	0	
14	Payroll Taxes	0	332,043	
15	Pro Forma 1990 Non-Management wages	0	0	
16	Pro Forma 1990 Management Salaries	0	0	
17	Year-end Depreciation & Represcription	(522,735)	(4,496,324)	
18	Year-end Gross Receipts Tax		(13,145)	
19	Exclusion of Lobbying Expense		(624,128)	
20	Inclusion of Nonregulated Services	9,425,000	8,564,000	5,759,000
21	Maintenance of Service Charge (MSC)	0	0	0
22	Imputation of Yellow Page Operations	60,658,850	31,481,361	(Footnote 2)
23	Improved Mobile Telephone Service (IMTS)	(1,149,858)	(506,051)	(1,510,604)
24	Bellcore Dividends and Investment:			
25	Dividend/Investment		(369,318)	
26	ROE		0	
27	Project Disallowances		(1,669,000)	
28	Technology Resources Project Disallowances		(445,000)	
29	Prepayments/Materials and Supplies			(803,174)
30	Adjustment for Reciprocity Service	989,835	785,221	1,854,704
31	Exclusion of Aircraft Expense		(1,094,784)	
32	Amortization of Embedded $200-$500 Invest.	12,846	110,497	
33	1/2% State Sales Tax Increase	10,060	88,301	
34	End of Reserve Deficiency Amortization	(4,580,877)	(24,858,556)	(28,644,244)
35	1990 Basic Alloc. Factor (BAF) Phase-down		2,405,677	6,112,000
36	Optional Toll Calling Plan	0		
	1990 Step of the COE CAT 3 Transition	226,578	1,408,292	3,182,353
	7-1-90 CCL Rate Reduction	0		
39	1990 Impact of Toll Pool Stipulation	1,200,000		
40	End of Inside Wire Amortization	(1,123,675)	(8,578,903)	(6,408,066)
41	Uncollectible	(60,112)		

SOUTHWESTERN BELL TELEPHONE COMPANY
REVENUE, EXPENSE AND RATE BASE ADJUSTMENTS
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Line No.	Adjustment Description	COMMISSION DECISION Revenues	Expenses	Rate Base
42	SBC:			
43	Salary and Wage		(819,806)	
44	Allocation Factor		(337,201)	
45	Public Issues Research		(43,755)	
46	Marketing		(354,797)	
47	5th Anniversary Expenses		(25,325)	
48	Non-business Portion of Conference		0	
49	VINCE Project		(29,520)	
50	Common Look Project		0	
51	Custom Care Projects		(25,123)	
52	Executive and Exec. Support		(1,836,000)	
53	SBC Board of Directors		(147,000)	
54	Corporate Policy/Strategic Development		(346,000)	
55	SBC Cash Management		(27,000)	
56	Advertising:			
57	Corporate		(416,964)	
58	Product		(3,383,070)	
59	Advertising Salaries		(217,928)	
60	Customer Deposits		223,593	(2,478,125,
61	Memberships and Dues		(184,679)	
62	Remove Long-Term TPUC			(5,186,972)
63	Wide Area Calling Plan (WACP)		0	0
64	Remove Artwork			(106,651)
65	Income Tax Adj. (Separation Factor Chg)			(10,594,186)
66	GAAP:			
67	Pension (FAS 87)		3,964,365	15,226,000
68	Compensated Absences		(1,448,430)	
69	1991 Basic Alloc. Factor (BAF) Phase-down		0	0
70	1991 Step of the COE CAT 3 Transition	0	0	0
71	Cash Working Capital:			
72	SWBT Formula Allowance			0
73	Staff Lead/Lag Study			(17,910,386)
74	AG Lead/Lag Study (excl. non-cash items)			0
75	7-1-91 CCL Rate Reduction	0		
76	1991 Impact of Toll Pool Stipulation	0		
77	CO-OP Taxability	(787,400)		
78	Postal Rate Increase	0	0	
79	Debt Refinancing		0	
80	Minimum Cash Balances Required			3,236,516
81	Advance Payments			0
82	Internal Audit - Marketing Non-Reg.		(1,157,110)	
83	GHQ Prorate		(1,457,093)	

SOUTHWESTERN BELL TELEPHONE COMPANY
REVENUE, EXPENSE AND RATE BASE ADJUSTMENTS
T.Y.E. 12/31/89; CAUSE NO. PUD 000662

Line No.	Adjustment Description	COMMISSION DECISION Revenues	Expenses	Rate Base
84	Net Compensation Study		(1,623,268)	
85	AT&T Reimbursements		(180,826)	(723,306)
86	Ad Valorem Taxes		0	
87	U.S. Olympic Festival		(134,162)	
88	Company Outing		(28,492)	
89	Antitrust Expenses		0	
90	Short-Term TPUC Disallowance			(11,131,832)
91	Employee Concessions	547,449		
92	CATS Revenue	0		
93	SBC Deferred Comp. Liability			(5,406,966)
94	GHQ Liabilities			(2,035,311)
95	GHQ Outstanding Drafts			(351,085)
96	Advance Payments			(29,634)
97	Service Improvement Investment		(343,505)	(3,305,349)
98	Royalties	1,161,000		
99	TOTAL ADJUSTMENTS	$69,995,719	(10,329,463)	(61,255,319)
100	1989 Adjusted Results	$638,390,046	$434,500,576	$796,422,702

101	Revenue Requirement Effect of Income Tax Difference (PLR)	$0
102	Non-361 Items	5,176
103		$434,505,752

Footnote 1: Line 1 "1989 Actual Results" Revenues includes Other Operating Income & Expense of $212,071.

Footnote 2: Line 22 "Imputation of Yellow Page Operations" - Rate Base Adjustments are incorporated into the Expense adjustment.

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF HOWARD W. MOTLEY, JR. FOR AN INQUIRY INTO THE RATES AND CHARGES OF SOUTHWESTERN BELL TELEPHONE COMPANY.	)))))	CAUSE NO. PUD 000662

CONCURRING OPINION

I am voting today to direct Southwestern Bell to reduce its rates and to refund significant sums of monies to its Oklahoma ratepayers. I believe the evidence presented at the hearings amply supports this decision. However, I do not want my vote in this matter to be construed in any fashion as an endorsement of the actions taken by some of the parties which I believe have served to create an incredibly hostile and increasingly ineffective regulatory atmosphere. I am very dismayed by these actions and believe that the people of this State deserve better.

I believe that the Commission typically reaches its best decisions when it employs an adversarial process which allows parties to a proceeding to present their best evidence and arguments and then affords others an opportunity to vigorously contest their views. Not only does this give the Commission a chance to assess the credibility of the evidence and arguments presented, but it also frequently motivates parties to resolve their differences and settle their cases. Such an adversarial system has and will continue to serve us well. Unfortunately, it is my observation that the parties in this case have gone far beyond legitimate advocacy and engaged in what at best may be described as remarkably unprofessional behavior. Some parties to this case have succeeded in creating a hostile and acrimonious regulatory environment which will ultimately prove harmful to the interest of consumers in this State and in this instance, will likely insure that deserving ratepayers won't see the directed rate reductions and refunds for some time.

From the day the Commission Staff called its press conference to accuse Southwestern Bell of "fraud", the parties to this case have engaged in public name-calling, political posturing, obstructive

maneuvering, and other vitriolic behavior which has done nothing to serve the public interest.

I acknowledge that the parties to this proceeding have the right to openly speak their minds and I expect them to forcefully advocate their respective positions. While I accept this sort of litigation will likely evoke strong emotions, I also think it is reasonable to expect that the actions of the parties will be tempered and constrained if not by professional standards, at least by notions of decency and fair play. As this case has worked its way through an incredibly tortured process for over a year, I have seen little that would demonstrate anything other than an unbridled interest in serving and protecting private interest and not the public interest.

Some, of course, will submit that I am naive and this is simply the way the adversarial system works. I respond that being a tough advocate does not require one to abdicate one's personal responsibility to be professional, fair, decent and do what's right. I endorse the decision reached today. However, if this State is to have an effective and healthy regulatory environment in the future, we must not repeat our experience in this case.

Respectfully submitted,

J. C. WATTS, JR., Vice Chairman

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF HOWARD W. MOTLEY, JR. FOR AN INQUIRY INTO THE RATES AND CHARGES OF SOUTHWESTERN BELL TELEPHONE COMPANY.	)))))	CAUSE NO. PUD 000662

SPECIAL CONCURRING AND DISSENTING OPINION

There is no doubt in my mind that the overwhelming evidence indicates that indeed SWBT has been over earning at the expense of the ratepayers of the State of Oklahoma and would continue to do so if we as Commissioners had not taken the action that we have taken today. Despite this clear result, there remain a number of inconsistencies in the positions that the Public Utility staff has advocated.

However, the most substantial problem with the Order being issued today is procedural in nature. I believe these procedural errors may have tainted the process to the extent that this cause could be remanded to the Commission by the Oklahoma Supreme Court for further action. Such a result would be catastrophic to the ratepayers of the State of Oklahoma because the benefits to be derived from this Order would not be realized by the ratepayers of Oklahoma for several more years.

This Commission has a basic duty to the people of the State of Oklahoma to conduct its hearings in such a manner as to be above reproach and to do anything less suggests that the Commission does not take its judicial duties seriously. The Oklahoma Supreme Court in Monson v. State ex rel. Oklahoma Corporation Commission, 673 P.2d 839 (Okl. 1983) declared that:

> ". . . There can be absolutely no doubt of the Commission's legitimate claim to possession of adjudicative authority. When in individual proceedings it sits to hear and decide the issues before it, it acts, pursuant to Art. 9, Section 19, Okl. Const., in the exercise of "powers and authority of a court of record . . . ."

The Court went on to state:

> ". . . The Commission's dispute-settling power clearly stands reposed in it by virtue of direct constitutional mandate. Our fundamental law exclusively charges that body with the responsibility of a "court of record". In short, the Constitution's command is that, when acting

> in an adjudicative capacity, the Commission is to be treated as the functional analogue of a court of record . . .

Further, in Turpen v. Oklahoma Corporation Com'n., 769 P.2d 1309 (Okl. 1988), the Oklahoma Supreme Court reiterated the adjudicative powers of the Commission and found that when the proceedings before the Commission are adjudicative proceedings, the Commission must adhere to stringent due process safeguards.

The failure of the Commission En Banc to hear the merits of a major rate case that extended over a 4 month period becomes a deprivation of due process rights when the Commissioners hear the appeals to the Report of the Administrative Law Judge in less than 3 days. Such a case of intricate financial and accounting processes should be heard by the Commissioners on the merits, so that the Commissioners are made fully aware of the details of the case. When an appeal is limited, as in this case, it becomes impossible for even the most knowledgeable Commissioner to fully understand the interlocking effects of all the appealed proposed adjustments. Consequently the combination of not hearing the case on the merits and limiting the time for the appeal from the Report of the Administrative Law Judge results in the fact that the Commissioners receive no more than a brief overview of the case. It then falls upon each Commissioner to reach a determination on each of the appealed issues with limited knowledge and without any ability or time to review the entire record of such a lengthy and involved proceeding.

I find myself further concerned with the issuance of this Order by the failure of the Commission's Judicial system to attempt to avoid the appearance of impropriety in its deliberation process. This process resulted in a motion filed on July 10, 1992 requesting the Commission cease and desist using Public Utility Staff witnesses and counsel, who took part in the case, to deliberate the case. The Commission failed to heed the request to prohibit the Public Utility Staff's chief witness from advising it in the deliberations. To allow this type of dual role by the witness after the extensive and aggressive publicity afforded this case by

that very same person, taints the entire Judicial process. Deliberations in this case were held in an open forum with little attempt to allow review and discussion of each of the many issues presented by the complexity of this case. Orders have been prepared and presented to the other Commissioners by members of the legal staff at the bequest of one Commissioner with little or no time for review of their contents.

And finally, although as I have said before that I believe the final results of this case are supported by the evidence, it concerns me deeply that, except for one major area, the Commissioners would have an order issued in this cause that seems in fact to mirror the original position of the Commission's own Public Utility Staff.

I specifically dissent to the failure of the Commission to grant the SWBT expenses related to the Olympic Festival. Those expenses should be allowed and be amortized over a five (5) year period.

Cody L. Graves, Commissioner
Oklahoma Corporation Commission

Dated this 26th day of August, 1992.