

**PUBLIC UTILITIES COMMISSION**505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298**FILED**09-15-09
12:17 PM

September 15, 2009

Agenda ID #8848
Ratesetting

TO PARTIES OF RECORD IN APPLICATION 07-12-026

This is the proposed decision of Administrative Law Judge (ALJ) Bushey. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the proposed decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision as provided in Article 14 of the Commission's Rules of Practice and Procedure (Rules), accessible on the Commission's website at www.cpuc.ca.gov. Pursuant to Rule 14.3, opening comments shall not exceed 15 pages.

Comments must be filed either electronically pursuant to Resolution ALJ-188 or with the Commission's Docket Office. Comments should be served on parties to this proceeding in accordance with Rules 1.9 and 1.10. Electronic and hard copies of comments should be sent to ALJ Bushey at mab@cpuc.ca.gov and the assigned Commissioner. The current service list for this proceeding is available on the Commission's website at www.cpuc.ca.gov.

/s/ KAREN V. CLOPTONKaren V. Clopton, Chief
Administrative Law Judge

KVC:tcg

Attachment

Decision **PROPOSED DECISION OF ALJ BUSHEY** (Mailed 9/15/2009)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Calaveras Telephone Company (U1004C), Cal-Ore Telephone Co. (U1006C), Ducor Telephone Company (U1007C), Happy Valley Telephone Company (U1010C), Hornitos Telephone Company (U1011C), Kerman Telephone Co. (U1012C), The Ponderosa Telephone Co. (U1014C), Sierra Telephone Company, Inc. (U1016C), The Siskiyou Telephone Company (U1017C), Volcano Telephone Company (U1019C), and Winterhaven Telephone Company (U1021C) for Ratemaking Determination regarding Dissolution of Rural Telephone Bank.

Application 07-12-026
(Filed December 20, 2007)

**DECISION DETERMINING RATEMAKING TREATMENT FOR
RURAL TELEPHONE BANK STOCK DISSOLUTION PROCEEDS**

Summary

This decision finds that ratepayers incurred the cost of acquiring stock in the recently-dissolved Rural Telephone Bank and should be credited with all stock redemption proceeds.

Background

On December 20, 2007, the applicants sought a determination of the proper ratemaking treatment for Rural Telephone Bank stock redemption proceeds that each applicant had received as a result of the dissolution of the Rural Telephone Bank. Each applicant's known proceeds are listed in Attachment A to this

decision, and the amounts range from \$12,150 for Hornitos Telephone Company to \$1,045,547 for Sierra Telephone Company and total \$3,652,356.67. The applicants proposed to share the proceeds with ratepayer based on a time in rate base analysis which resulted in ratepayers of five applicants receiving a total of \$3,037, less than one percent of the total. Applicants proposed that their shareholders would retain all remaining stock redemption proceeds, over 99 percent of the total.

Applicants explained that the Rural Telephone Bank was created by Congress in 1971 to provide loans to telephone utilities that served rural areas. Each borrower was required to purchase stock in the Rural Telephone Bank with 5% of the proceeds from each loan. In a filing dated September 18, 2008, the applicants provided further detail on their stock purchases showing that the earliest purchased was by Ducor Telephone Company in 1972 and the most recent purchase was by Sierra Telephone Company in 2004. Applicants purchase Class B stock at a par value of \$1 per share. Upon repayment of the Rural Telephone Bank loans, the applicants were able to convert 1,000 shares of Class B stock to one share of Class C stock. Cash dividends were paid on the Class C stock.¹

The applicants further stated that after a multi-year process of discussion and deliberation, along with needed Congressional approval, the Board of Directors of the Rural Telephone Bank authorized the dissolution of the bank and initiated the stock redemption process on August 4, 2005, and redemption

¹ Applicants should confirm in their compliance filing discussed below that all dividends were credited to regulated revenue requirement.

payments began on April 10, 2006. All Class C stock was redeemed at par value, i.e., \$1,000 share, and the Class B stock was redeemed at \$1.04435 per share. As of the date of the application, each applicant had redeemed its shares of the Rural Telephone Bank. Applicants explained that the dissolution process also distributed to stockholders excess Rural Telephone Bank funds, which applicants term “residual amounts,” as well as “patronage” shares.²

On April 21, 2009, and June 3, 2009, the Staff of the Commission’s Communications Division issued data requests to the applicants. The focus of the requests was further information and documentation demonstrating that shareholders had provided the purchase price of the Rural Telephone Bank stock. As discussed above, the stock was purchased with 5% of the proceeds from each applicant’s Rural Telephone Bank loans. Accordingly, the Staff data requests sought a demonstration that “no less than 5% of the loan was funded by shareholders and not included in the regulated cost of service.”

In responses filed on May 22, 2009, and June 24, 2009 as amended on June 30, 2009, applicants stated that the Commission did not address specific debt obligations, such as outstanding loans from the Rural Telephone Bank, in adopting a capital structure for ratemaking purposes and that the value of the

² The application does not quantify the residual amount received by each applicant nor the value of any patronage shares. For purposes of today’s decision, we include all amounts received from the Rural Telephone Bank, however described, as proceeds subject to this decision. To complete the record on the total proceeds of any kind received by each applicant, we will direct each applicant to make a compliance filing specifying the total proceeds received from the dissolution of the Rural Telephone Bank, as well as the historical treatment of stock dividends discussed above.

Rural Telephone Bank stock was recorded in Account 1402, a below-the-line, non-regulated account, as required by federal accounting rules.

Need for a Hearing

No party intervened in this proceeding and no disputed issues of material fact have been identified that would require an evidentiary hearing. The applicants have provided additional materials for the record in response to data requests from the Commission's Communications Division. Therefore, no hearings are necessary.

Burden of Proof

The Commission is charged with the responsibility of ensuring that all rates demanded or received by a public utility are just and reasonable: "no public utility shall change any rate ... except upon a showing before the Commission, and a finding by the Commission that the new rate is justified."³ The applicants in this ratesetting proceeding must meet the burden of proving that they are entitled to the relief sought in this proceeding, and the applicants have the burden of affirmatively establishing the reasonableness of all aspects of the application.⁴

With the burden of proof placed on the applicants, the Commission has held that the standard of proof the applicant must meet is that of a preponderance of evidence. Preponderance of the evidence usually is defined "in terms of probability of truth, e.g., 'such evidence as, when weighed with that

³ Pub. Util. Code §§ 451 and 454.

⁴ See generally Application of SOUTHERN CALIFORNIA EDISON COMPANY for Authority to, Among Other Things, Increase Its Authorized Revenues For Electric

Footnote continued on next page

opposed to it, has more convincing force and the greater probability of truth'⁵
In short, the applicants must present more evidence that supports the requested result than would support an alternative outcome.

We have analyzed the record in this proceeding within these parameters.

Discussion

As noted by the applicants, the Commission explicitly directed “some, but not all” of the applicants to file applications seeking Commission determination of the “appropriate ratemaking treatment” should any Rural Telephone Bank stock be redeemed.⁶ We agree with the applicants that filing this application was the procedurally proper means to resolve this question for all applicants, regardless of whether the direction was explicitly included in a general rate case decision or resolution.

Turning to the merits, the applicants must show by a preponderance of the evidence that their shareholders are entitled to retain over 99% of the Rural Telephone Bank stock redemption proceeds. As set forth below, applicants have not met their burden of proof.

The applicants acquired Rural Telephone Bank stock as a requirement of obtaining loans from the bank. The available Commission decisions and resolutions show that the stock purchase was treated for ratemaking purposes as

Service in 2009, And to Reflect That Increase In Rates (Decision 09-03-025) (March 12, 2009) and Decisions cited therein.

⁵ In the Matter of the Application of San Diego Gas & Electric Company for a Certificate of Public Convenience and Necessity for the Sunrise Powerlink Transmission Project, Decision 08-12-058, *citing* Witkin, Calif. Evidence, 4th Edition, Vol. 1, 184.

⁶ Application at page 4; *see also* Resolution T-16002, Hornitos Telephone Company, at Ordering Paragraph 2, page 10.

a component of the cost of the Rural Telephone Bank debt, and recovered from customers through rates as well as the California High Cost Fund A. The applicants have presented no evidence that shareholders provided any funds associated with the acquisition of Rural Telephone Bank stock. Accordingly, as discussed below, we find no evidentiary support for the applicant's proposed sharing of the proceeds from the Rural Telephone Bank and we reject the proposal. The record evidence supports crediting all Rural Telephone Bank stock redemption proceeds against regulated revenue requirement.

The cost of debt is a component of the total cost of capital which the Commission includes in setting each applicant's regulated revenue requirement, which forms the basis for rates charged to customers. The revenue requirement is also the basis on which applicants receive supplemental revenue from the California High Cost Fund A, a subsidy program funded by a surcharge on all California consumers' intrastate telecommunications services.⁷

In responses to Communications Division staff data requests filed on May 22, 2009, and June 24, 2009 as amended on June 30, 2009, applicants stated that the Commission did not address specific debt obligations, such as outstanding loans from the Rural Telephone Bank, in "arriving at a rate of return" for ratemaking purposes.

Applicants also stated in their June responses that although the full value of the Rural Telephone Bank loans were included in the long-term debt calculation submitted in rate case filings, the Commission did not rely on these

⁷ See Order Instituting Rulemaking into the Review of the California High Cost Fund B Program, Rulemaking 06-06-028 (June 30, 2006) at notes 11 and 12, and text surrounding.

data in arriving at a rate of return.⁸ However, the 1997 ratemaking decisions for Ducor Telephone Company,⁹ Sierra Telephone Company,¹⁰ and Calaveras Telephone Company,¹¹ clearly show that the Commission used the actual cost of debt to tabulate and evaluate the resulting return on equity and as support for its conclusion that the resulting equity return rate is “well within the reasonable range of common equity for small telephone companies.”¹² Accordingly, the Commission relied on each applicant’s actual cost of debt, including the Rural Telephone Bank stock, as part of its rate setting review.

This is consistent with the Commission’s perception of the stock acquisition cost as just another cost of obtaining the loan. When considering a request from Hornitos Telephone Company for authorization to enter into a mortgage and security agreement with the Rural Telephone Bank, the Commission simply listed the cost of “Class B Stock – Rural Telephone Bank” as a line item in the capital costs.¹³

The applicants contend that the Rural Telephone Bank stock redemption “has no bearing on the Commission’s ratemaking analysis, and such redemption,

⁸ See Responses to Question 1.

⁹ Re Ducor Telephone Company, 71 CPUC2d 574, 582 (Decision 97-04-035).

¹⁰ Re Sierra Telephone Company, Inc., 71 CPUC2d 506, 515 (Decision 97-04-032).

¹¹ Re Calaveras Telephone Company, 71 CPUC2d 552, 564 (Decision 97-04-034).

¹² See Ducor at page 587, Sierra at page 519-20, and Calaveras at page 564.

¹³ In the Matter of the Application of Hornitos Telephone Company for an Oder Authorizing it to issue a note in an amount not exceeding \$423,150 and to execute a Telephone Loan Contract Amendment and Supplemental Mortgage and Security Agreement, 20 CPUC2d 595 (headnote only) (D.86-03-009).

on its own, should not trigger ratemaking consequences.”¹⁴ The applicants reason that in adopting a set overall rate of return, the Commission has “effectively eliminated” any positive effects for shareholders. The gist of applicants’ argument is that because the cost of debt was irrelevant to the overall cost of capital determination, including the cost the stock acquisition in the cost of debt brought shareholders no real benefit. From this lack of benefit to shareholders, applicants conclude that the stock redemption should have no ratemaking implications, i.e., all proceeds should be retained by shareholders.

Applicants have not presented any evidence that shareholders incurred any of the costs of acquiring the Rural Telephone Bank stock. Applicants bear the burden of presenting a preponderance of the evidence justifying the shareholders retaining nearly all the proceeds. Applicants simply contend that because the Commission adopted the same overall rate of return for several carriers, any actual cost of debt is lost and any subsequent events related to such debt, i.e., stock redemption, is a ratemaking non-event.

We are not persuaded by applicants’ presentation that in adopting an overall rate of return the Commission intended to allocate to shareholders any unexpected income related to debt. We often adopt similar or even identical overall rates of return for similar utilities. Such a determination, however, does not address much less determine the allocation of any unforeseen stock redemption proceeds. Our own decisions described above show that where the Commission recognized the potential Rural Telephone Bank stock redemption

¹⁴ Application at page 7.

issue, we specifically reserved the matter for future resolution by requiring that it be presented for Commission consideration via the application process.

Therefore, we find that our previous decisions have not precluded our consideration of the proper ratemaking treatment for the Rural Telephone Bank stock redemption proceeds. We also find that the cost of acquiring the stock was reflected in revenue requirement which was recovered through regulated revenue requirement. Consequently, the Rural Telephone Bank stock redemption proceeds should be returned to those entities that bore the cost of acquiring the stock, namely, regulated customers.

The applicants also contend that we should analyze the question of distributing the Rural Telephone Bank stock redemption proceeds from the perspective of the amount of time such stock was recorded in some applicants' rate base. This perspective forms the analytical basis for applicants recommending that slightly less than one percent of the Rural Telephone Bank stock redemption proceeds be allocated to ratepayers.

The evidence presented by the applicants consists of citations to the Commission's decision establishing guidelines for the sharing of gains on the sale of assets held by regulated utilities. Applicants quote the Commission's decision for the proposition that where property is never included in rate base, "all gains or losses should accrue to shareholders."¹⁵ From this, the applicants conclude that "the recent gain-on-sale decision exempts the RTB stock redemption proceeds from any gain-on-sale requirements."

¹⁵ Application at page 8.

However, the applicants have failed to demonstrate that that they have met the Commission's prerequisite to that conclusion – a showing that the property was funded entirely by shareholders. The full quotation from the Commission's decision is set out below:

Thus, where property is never in rate base, all gains or losses should accrue to shareholders. This includes property used for speculative or unregulated activities **funded entirely by shareholders**.¹⁶

In the June 3, 2009, data request, Communications Division Staff sought a demonstration from each applicant that “repayment of no less than 5% of the [Rural Telephone Bank] loan was exclusively funded by shareholders and not included in the regulated cost of service.” The applicants' response did not include any documents or accounting entries showing any participation by shareholders in funding the acquisition of the Rural Telephone Bank stock. We, therefore, find that the applicants have not met their burden of proving that shareholders funded the Rural Telephone Bank stock purchases. Accordingly, this finding obviates any need for consideration of whether or not our decision in the gain-on-sale proceeding applies to the Rural Telephone Bank stock redemption proceeds. In addition, the redemption of stock was for par value, or slightly above par value, and thus there were nominal, if any, “gains” on sale.

We next turn to the role of the California High Cost Fund A in recovering the costs of acquiring the Rural Telephone Bank stock. With the exception of

¹⁶ Order Instituting Rulemaking on the Commission's own motion for the purpose of considering policies and guidelines regarding the allocation of gains from sales of energy, telecommunications, and water utility assets, *mimeo.* at page 57 (May 25, 2006) (D.06-05-041) (emphasis added).

Hornitos Telephone Company, all applicants received support from the California High Cost Fund A during the time the Rural Telephone Bank stock was acquired and held. That Fund paid the eligible applicants the difference between their local exchange revenue requirement and the amount that could be recovered from customers with rates set at 150% of comparable California urban areas.¹⁷ In this way, applicants' customers paid rates limited to 150% of urban area rates, with state-wide customers supplying subsidy payments to applicants to make up the difference. The cost of the Rural Telephone Bank stock was a component of the cost of debt reflected in the revenue requirement, which then formed the basis on which the High Cost Fund A payment to shareholders was calculated. Accordingly, the costs of the Rural Telephone Bank stock acquisition were included in the costs recovered from the California High Cost Fund A.

Applicants' have failed to present adequate evidence to support their request to allocate nearly all of the Rural Telephone Bank stock redemption proceeds to shareholders, and we deny the request. The stock redemption proceeds should be credited against otherwise authorized regulated revenue requirement currently being recovered from ratepayers through recurring monthly charges for basic telephone service.

Each applicant should implement the credit for Rural Telephone Bank dissolution proceeds in an administratively efficient manner that minimizes rate changes and customer confusion. We direct each applicant to file revised basic telephone service tariffs for calendar year 2010 that show a monthly per line

¹⁷ Re Alternative Regulatory Framework for Local Exchange Carriers, 41 CPUC2d 326, 330 (D.91-09-042 *modifying* D.91-05-016).

credit sufficient to amortize the Rural Telephone Bank proceeds over the 12-month period. We authorize the Director of the Communications Division to approve deviations from this directive where the Director finds that the applicant has proposed a more efficient or effective mechanism for crediting the Rural Telephone Bank proceeds to all customers on a per-line basis.

The application shows that the Rural Telephone Bank stock redemption process began on April 11, 2006, and is concluded but does not specify when and in what amount applicants received payments.¹⁸ We infer that applicants may have received payments as early as 2006 and are holding all such amounts awaiting this decision. Accordingly, the total proceeds amount to be credited to ratepayers should include provision for interest on the amount held by each applicant. Due to the certainty of those amounts and the regulatory policy of matching actual accruals with costs, we will authorize interest to be calculated at the adopted rate of return.¹⁹ Interest shall be tabulated at the overall cost of capital and shall run from the date of receipt of the proceeds. Each applicant should include this tabulation in its compliance filing showing the total Rural Telephone Bank proceeds realized.

In summary, we find that the purchase price of the Rural Telephone Bank stock was a cost of obtaining a loan from the Bank, which was included in evaluating the cost of capital adopted by this Commission in setting the applicants' revenue requirement to be recovered from customers. We conclude that applicants have not met their burden of proving that shareholders funded

¹⁸ Application at page 2.

¹⁹ See, e.g., Re California American Water Company, D.08-05-036, *mimeo.* at page 9.

the acquisition of the Rural Telephone Bank stock. We deny applicants' request to allocate the stock redemption proceeds to shareholders and order that stock redemption proceeds be credited against regulated revenue requirement.

Assignment of Proceeding

Rachelle B. Chong is the assigned Commissioner and Maribeth A. Bushey is the assigned Administrative Law Judge (ALJ) in this proceeding.

Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____ by _____.

Findings of Fact

1. There are no disputed issues of material fact.
2. Applicants acquired Rural Telephone Bank stock as a requirement of obtaining loans from the Rural Telephone Bank, and paid for the stock with 5% of the proceeds from each Rural Telephone Bank loan.
3. For ratemaking purposes, the Commission treated the cost of Rural Telephone Bank stock acquisition as cost of obtaining the Rural Telephone Bank loan and reflected the cost in regulated revenue requirement.
4. The record is not clear on the exact amount of total stock redemption proceeds received from each applicant.
5. The Rural Telephone Bank stock redemption process began on April 11, 2006, and applicants state that the process is concluded. Applicants may have received payments as early as 2006 and are holding all such amounts awaiting this decision.

Conclusions of Law

1. No hearing is necessary.
2. The applicants should supplement the record with exact accountings of all proceeds received from the Rural Telephone Bank dissolution and stock redemption.
3. Applicants have not met their burden of proving by a preponderance of the evidence that shareholders funded the acquisition of the Rural Telephone Bank stock and are entitled to nearly all the stock redemption proceeds.
4. The stock redemption proceeds should be credited against otherwise authorized regulated revenue requirement currently being recovered from ratepayers through recurring monthly charges for basic telephone service during calendar year 2010.
5. The Director of the Communications Division should be authorized to approve deviations from the Rural Telephone Bank dissolution proceeds credit to basic service directive where the Director finds that the applicant has proposed a more efficient or effective mechanism for crediting the Rural Telephone Bank dissolution proceeds to all customers on a per-line basis.
6. Interest at each applicant's overall cost of capital should be included in the amount to be credited to ratepayers.

O R D E R

Therefore, **IT IS ORDERED** that:

1. No later than 15 days after the effective date of this order, each applicant shall file and serve a verified statement of all proceeds of any kind received by the applicant, directly or indirectly, as a result of the Rural Telephone Bank dissolution and stock redemption. Such statement shall include a tabulation of

interest equivalent to each applicant's last authorized overall cost of capital on all amounts received.

2. No later than 30 days after the effective date of this order, each applicant shall file and serve an Advice Letter seeking approval of a revised tariff for the recurring monthly charge for basic telephone service during calendar year 2010 that reflects a credit for each month sufficient to amortize the amount tabulated in Ordering Paragraph 1, with on-going interest, over per line charges to be collected in 2010.

3. The Director of the Communications Division is authorized to approve deviations from Ordering Paragraph 2 where the Director finds that the applicant has proposed a more efficient or effective mechanism for crediting the Rural Telephone Bank dissolution proceeds to applicant's customers on a per-line basis over a reasonable period of time.

4. This proceeding is closed.

Dated _____, at San Francisco, California.

ATTACHMENT A

| | Amounts Applicants Proposed to be Credited to Ratepayers | Known Proceeds |
|-----------------------------------|---|-----------------------|
| Calaveras Telephone Company | \$47.00 | \$31,330.50 |
| Cal-Ore Telephone | \$190.00 | \$144,590.26 |
| Ducor | \$42.00 | \$41,862.00 |
| Happy Valley | \$0 | \$37,700.00 |
| Hornitos | \$0 | \$12,150.00 |
| Kerman | \$0 | \$243,450.00 |
| Ponderosa | \$2,558.00 | \$617,315.00 |
| Sierra | \$0 | \$1,045,547.00 |
| Siskiyou | \$200.00 | \$503,104.89 |
| Volcano | \$0 | \$865,837.52 |
| Winterhaven | \$0 | \$140,800.00 |
| Total | \$3,037.00 | \$3,652,356.67 |

(END OF ATTACHMENT A)

INFORMATION REGARDING SERVICE

I have provided notification of filing to the electronic mail addresses on the attached service list.

Upon confirmation of this document's acceptance for filing, I will cause a Notice of Availability of the filed document to be served upon the service list to this proceeding by U.S. mail. The service list I will use to serve the Notice of Availability of the filed document is current as of today's date.

Dated September 15, 2009, at San Francisco, California.

/s/ TERESITA C. GALLARDO
Teresita C. Gallardo