

Decision REVISED PROPOSED DECISION OF ALJ BUSHEY (Mailed 12/17/2009)

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 AND
ORDER TO SHOW CAUSE**

Summary

This decision finds that the applicants received \$31,295,903.13 in 2006 from the Rural Telephone Bank stock dividends and redemption, and that this amount should be credited to ratepayers. Applicants are ordered to Show Cause why they should not be subject to penalties for violating Decision 91-09-042 and Rule 1 of the Commission's Rules of Practice and Procedure.

Procedural History

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. Applicants proposed to credit \$3,037 to ratepayers. No protests were filed.

In response to a request from the assigned Administrative Law Judge (ALJ), the applicants filed additional information on September 18, 2008, showing the total amount of purchased Rural Telephone Bank stock as \$3,465,017.

The Commission's Communications Division submitted its first set of data requests to applicants on April 21, 2009. Pursuant to a May 18, 2009, ruling by the assigned ALJ, the applicants filed and served their responses on May 22, 2009. The responses addressed the ratemaking treatment of the purchased shares and disclosed that the full sales price for the purchases was \$3,652,356.

The Communications Division submitted a second set of data requests to applicants on June 2, 2009, and the applicants filed and served their responses on June 24, 2009, with an amendment following on June 30, 2009. In their data requests to applicants, the Communications Division sought further information and documentation demonstrating that shareholders had provided the purchase price of the Rural Telephone Bank stock.

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 Rural Telephone Bank stock was recorded in Account 1402, a below-the-line,

non-regulated account, as required by Federal Communication Commission Accounting Rules.

On September 15, 2009, the assigned ALJ mailed her Proposed Decision. The applicants filed comments on the Proposed Decision on October 12, 2009. Also on that date, applicants moved to reopen the record for the submission of additional evidence. On October 15, 2009, the assigned ALJ granted the motion.

On November 19, 2009, the applicants filed and served their additional evidence and argument. The filing consisted of three parts: (1) legal argument, (2) financial accounting of all non-loan proceed amounts received by each applicant from the Rural Telephone Bank, and (3) expert testimony presenting a ratemaking and economic analysis of the Rural Telephone Bank stock redemption. In this filing applicants disclosed that they had received over \$31 million from the Rural Telephone Bank dissolution.

On December 8, 2009, the Division of Ratepayer Advocates requested party status in the proceeding. The ALJ granted the request for party status pursuant to Rule 11.1(g).

Background of Rural Telephone Bank and Stock Acquisition

In 1971, Congress created the Rural Telephone Bank as part of the United States Department of Agriculture. Following the tradition of the Rural Electrification Administration, the purpose of the Rural Telephone Bank was to make capital available to rural telephone providers at reasonable costs for investment in infrastructure to serve their customers.¹

¹ November 19, 2009, filing, Appendix B at 23.

California's small local exchange carriers, applicants herein, obtained substantial loans from the Rural Telephone Bank, prior to its dissolution in 2006, and from its successor entities, the Rural Utilities Service and the Federal Finance Bank.² Currently, loans from the three federal entities comprise nearly all the outstanding long-term debt held by applicants.³

Each applicant's known proceeds from the redemption of Rural Telephone Bank stock are listed below, and the amounts range from \$257,296 for Happy Valley Telephone Company to \$7,101,551 for Ponderosa Telephone Company and total \$30,283,581.⁴ The applicants proposed to allocate the proceeds from the stock sale based on a time in rate base analysis which resulted in ratepayers of five applicants receiving a total of \$3,037. Applicants proposed that their shareholders would retain the remaining over \$30 million in stock redemption proceeds.

² See, e.g., In the Matter of the Application of the Ponderosa Telephone Company, 1998 Cal. PUC LEXIS 968 (D.98-09-069), granting authorization to borrow about \$20 million from the three entities, thereby doubling long-term company debt to about \$42 million.

³ See, e.g., In the Matter of the Application of the Volcano Telephone Company, 66 CPUC2d 137 (headnote only), 1996 Cal. PUC LEXIS 627 (D.96-05-003), granting authorization to borrow almost \$23 million from the three federal entities, thereby increasing company long-term debt from about \$4 million to \$27 million.

⁴ These totals include funds distributed by the Rural Telephone Bank as residual amounts and dividends. Applicants define "residual amounts" as the funds available for distribution by the Rural Telephone Bank after complete par value redemption of all outstanding stock. See application at page 9.

The applicants' filings in response to staff's inquiries disclose that the applicants obtained stock in the Rural Telephone Bank through three mechanisms:

1. Purchasing Stock - the following four applicants purchased Class C shares in the indicated amounts: Cal-Ore Telephone Company, \$5,000; Kerman Telephone Company, \$1,126; Siskiyou Telephone Company, \$7,000; and Volcano Telephone Company, \$5,000.⁵ Shareholders of the respective applicants provided the funds for these purchases.

2. Patronage Refunds - the Rural Telephone Bank would periodically issue patronage refunds to borrowers when the Bank's interest income exceeded its expenses, reserve requirements, and obligatory shareholder payments.⁶ This refund was in the form of shares of Class B stock with a par value of \$1 per share and each borrower's allocation was based on the amount of interest that the borrower paid that year.⁷

Rural Telephone Bank stock obtained as patronage refunds comprise the largest share of stock redeemed by the applicants.⁸ Of the total \$30 million in

⁵ See November 19, 2009, filing at Attachment B, at 44, and accounting data.

⁶ 7 U.S.C. § 946(g).

⁷ *Id.* at 24.

⁸ The accounting data applicants presented on November 19, 2009, did not aggregate the data based on origin. Applicants have previously acknowledged that \$3,652,356 of the stock redemption proceeds originated as loan purchased Rural Telephone Bank stock. Thus, subtracting that amount from the total and excluding dividends yields \$24,291,471: \$30,283,581 (total) - \$2,339,754 (dividends) - \$3,652,356 (loan proceeds) = \$24,291,471).

realized redemption proceeds, over \$24 million originated as patronage refunds. The amounts vary among the applicants.

3. Mandatory Stock Purchase with Loan Proceeds – Rural Telephone bank loan regulations required each borrower to purchase stock in the Rural Telephone Bank with 5% of the proceeds of each Rural Telephone Bank loan. In their filing dated September 18, 2008, the applicants showed that the earliest purchase was by Ducor Telephone Company in 1972 and the most recent purchase was by Sierra Telephone Company in 2004. Applicants purchased Class B stock at a par value of \$1 per share, and the total redeemed value of all stock purchased in this manner for all applicants was \$3,652,356.

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.

Commission Approval of Rural Telephone Bank Loans for Public Utility Purposes

Pursuant to Public Utilities Code⁹ § 818, a public utility must obtain authorization from the Commission prior to issuing any “evidence of indebtedness payable at periods of more than 12 months after the date thereof.” The Commission may only authorize such evidence of indebtedness for the specific purposes listed in § 817, which include acquiring property, constructing or extending facilities, improving or maintaining its services, and for certain adjustments to its debt or capitalization. The Commission is prohibited from

⁹ All citations are to the Public Utilities Code unless otherwise indicated.

authorizing any evidence of indebtedness for any other purpose, and has specifically determined that the public utility's property may not be encumbered for the private purposes of the public utility's owners.¹⁰

Consistent with the requirement found in §§ 817 and 818, the applicants sought and received Commission authorization to enter into the loan agreements and issue mortgage notes secured by public utility property to obtain loans from the Rural Telephone Bank. For example, in Application (A.) 91-10-023 and A.93-05-053, the Ponderosa Telephone Company obtained Commission authorization to enter into two loan contracts with the Rural Telephone Bank in the amounts of \$8,607,900 and \$2,623,950. As part of its presentation in those applications, Ponderosa explained that 5% of the proceeds from each loan, \$409,900 and \$124,950, would be used to purchase stock in the Rural Telephone Bank. In the decisions approving the loans, the Commission specifically listed the stock purchase amounts as line items in the allocation of proceeds from each loan.

The Commission approved these loan contracts notwithstanding its staff's finding that Ponderosa's "balance sheet is exceptionally strong and that it is well capable of financing its proposed construction program through internally generated funds and reserves."¹¹ The Commission found that because the

¹⁰ In the Matter of the Application of Jesse S. Harker and Edma M. Harker to Sell and Convey, and of E. A. Perkiss to Mortgage the Melvin Place Water Plant, 19 CRC 667 (1921)(D. 8845).

¹¹ In the Matter of the Application of Ponderosa Telephone Company, 50 CPUC2d 734 (headnote only) 1993 Cal. PUC LEXIS 639 at *6 (D.93-09-047).

borrowings from the Rural Telephone Bank represent such a low cost of capital it was to the company's "great advantage" to obtain these loans, and that "under cost of service ratemaking, the benefits of Ponderosa's lower cost of capital would eventually flow through to its subscribers."¹²

In 1998, the Commission approved Ponderosa's request to increase its borrowings to \$20,445,000 and to add two additional U.S. Government entities, the Rural Utilities Service and the Federal Finance Bank, to the Rural Telephone Bank as loan providers. The Commission found that the offerings of the Federal Finance Bank are "less costly" than the other entities due to the "cost of capital involved, for example, in the mandatory 5% [Rural Telephone Bank] stock purchase."¹³

In 2008, Ponderosa obtained authorization to increase its borrowings from the Rural Utilities Service to \$27,288,000. In that application, Ponderosa stated that its outstanding debt to the Rural Utilities Service and the Rural Telephone Bank totaled \$19,509,542.

The Commission issued similar decisions for other applicants. In 1986, Hornitos Telephone Company obtained authorization for a loan contract with the Rural Telephone Bank "to pay for improvements, modifications, replacements and additions to its plant plus the required purchase of class B stock of the Telephone Bank representing 5% of the above costs, or \$20,150, for a

¹² *Id.* at *7.

¹³ In the Matter of the Application of Ponderosa Telephone Company, 1998 Cal. PUC LEXIS 968 at *6 (D. 98-09-069).

total loan of \$423,150.”¹⁴ Calaveras Telephone Company received authorization for a \$7,006,750 loan from the Rural Telephone Bank in 2003 and explained that the proceeds would be used “to pay for the following improvements to plant (including the purchase, associated with the proposed financing, of shares of the Class ‘B’ stock of the Rural Telephone Bank).”¹⁵

A detailed list of the Commission decisions approving the applicants’ Rural Telephone Bank loan contracts and mortgage of public utility property as consistent with the Public Utilities Code requirements is set out in Attachment A to today’s decision. These decisions confirm the Commission’s approval of the Rural Telephone Bank loans and 5% stock purchases for public utility purposes and not private investment by shareholders.

Rural Telephone Bank Dissolution and Stock Redemption

The applicants 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 payments began on April 10, 2006.

All Class B and Class C stock was redeemed at par value, i.e., \$1 a share for Class B and \$1,000 a share for Class C. The applicants received their redemption payments totaling over \$30 million on April 11, 2006.

¹⁴ In the Matter of the Application of Hornitos Telephone Company, 20 CPUC2d 595 (headnote only) 1986 Cal. PUC LEXIS 120, *3 (D.86-03-009).

¹⁵ In the Matter of the Application of Calaveras Telephone Company, 2003 Cal. PUC LEXIS 550, *10 (D.03-09-013).

On November 13, 2007, the Rural Telephone Bank distributed its remaining funds as “residual amounts” to all Class B shareholders at a rate of \$0.04435 per share of Class B stock. The applicants received an additional \$634,176 as residual amounts in this way.

Applicants’ Disclosure of Rural Telephone Bank Stock Transactions

On December 20, 2007, applicants sought Commission authorization to distribute \$3,037 to their customers from the Rural Telephone Bank stock redemption. The applicants did not disclose, either as part of this application or in the annual requests for subsidies from the California High Cost Fund A,¹⁶ that the applicants had received over \$30 million in proceeds from the Rural Telephone Bank stock redemption the previous year.

Obtaining full disclosure of these unexpected redemption proceeds required repeated inquiry by Commission staff over a two-year period, as described above, with the following ultimate results:

¹⁶ Pursuant to the California High Cost Fund A Implementation Rules, found in the Appendix to D. 91-09-042, each applicant was required to submit “at least seven months of recorded financial data” in its October 1 advice letter requesting support from the Fund. The Commission records show that the applicants failed to disclose the revenue from the Rural Telephone Bank in the recorded financial data submitted for seven months in 2006.

Telephone Company	Amounts Proposed to Allocate to Ratepayers in Application	Proceed Amounts Disclosed in May 22, 2009, Data Response	Amounts Disclosed on November 19, 2009, in "verified accounting of all amounts"
Calaveras	\$47.00	\$31,330.50	\$655,087.57
Cal-Ore	\$190.00	\$144,590.26	\$1,470,151.00
Ducor	\$42.00	\$41,862.00	\$534,076.99
Happy Valley	\$0	\$37,700.00	\$1,268,896.00
Hornitos	\$0	\$12,150.00	\$319,920.00
Kerman	\$0	\$243,450.00	\$1,507,000.00
Ponderosa	\$2,558.00	\$617,315.00	\$7,101,551.31
Sierra	\$0	\$1,045,547.00	\$3,471,574.00
Siskiyou	\$200.00	\$503,104.89	\$6,121,109.07
Volcano	\$0	\$865,837.52	\$6,918,837.19
Winterhaven	\$0	\$140,800.00	\$1,926,978.00
TOTAL	\$3,037.00	\$3,652,356.67	\$31,295,903.13

The initial application disclosed no Rural Telephone Bank stock redemption proceeds for six of the 12 applicants. The subsequent repeated inquiries finally revealed, however, that these six applicants had actually received over \$15 million in Rural Telephone Bank stock redemption proceeds.

Specifically, the Communications Division Staff asked each applicant on April 21, 2009: "what was the purchase price of the stock and how many shares were acquired by your company." In response, Volcano Telephone Company,

for example, stated that it had “purchased” 837,438 shares, with a “total selling price for all shares purchased” of \$865,837.52.

The initial proposed decision observed that applicants had referenced but not quantified the value of “residual amounts” as well as “patronage shares” and directed the applicants to submit 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.”¹⁷ This requirement was subsequently included in the ruling reopening the record, which provided for the November 19, 2009, filing.

In the November filing, the applicants revealed the value of the patronage shares, about \$24 million, which they had not disclosed until ordered, far exceeded the approximately \$3.6 million in “purchased” stock redemption proceeds. Using Volcano Telephone Company again as an illustrative example, that company revealed that it had received almost \$7 million from the Rural Telephone Bank.

Applicants, having received over \$30 million in stock redemption proceeds, nevertheless filed an application proposing to credit about \$3,000 to ratepayers, and omitted the total amount received. Upon subsequent inquiry from the Commission’s staff regarding “purchased” Rural Telephone Bank stock, the applicants disclosed only the Rural Telephone Bank stock obtained with 5% of loan proceeds, and again omitted the far larger stock proceed amount received from the sale of the patronage refund stock.

¹⁷ September 15, 2009, Proposed Decision at Ordering Paragraph 1.

High Cost Fund A

We next turn to the role of the California High Cost Fund A and loans from the Rural Telephone Bank. The California High Cost Fund A 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.¹⁸ 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 loans was a component of revenue requirement and was included in the costs recovered from the California High Cost Fund A.

The Commission calculates annually each applicant's support from the Fund based on the applicant's actual earnings during the previous year. Specifically, the Commission calculates annually each applicant's support from the Fund starting with the carrier's revenue requirement from the previous year, adjusted for regulatory changes as ordered by the Commission or the Federal Communications Commission. The next adjustment is the Universal Service

¹⁸ The California High Cost Fund A is funded by a surcharge assessed against the end user intrastate billings of all telecommunications service providers in California. As one of the Commission's telecommunications universal service programs, this fund's purpose is to provide subsidies to telephone companies with rural and otherwise high-cost service territories, where the actual costs of providing service may prohibit the charging of reasonable rates. The Commission has concluded that, absent these subsidies, its goal of ensuring affordable telephone service for all California residents would be at risk. See generally Re Alternative Regulatory Framework for Local Exchange Carriers, 41 CPUC2d 326, 330 (D.91-09-042 *modifying* D.91-05-016).

Fund¹⁹ estimated support amount used in the prior year's resolution less the estimate for the upcoming year to arrive at the carrier's revenue requirement.

The carrier's revenue requirement is then subject to a means test, except for the year following a general rate case, based on seven months actual data annualized, to ensure the rate of return does not exceed 10%. The carrier's revenue requirement is further subject to a schedule whereby the carrier will receive 100% for three years following a general rate case and then receive 80%, 50% and finally zero unless the carrier initiates a general rate case in the third year following the test year.²⁰

In sum, recorded financial data from 2006 was an important input to calculate support paid to eligible recipients in 2007. As described above, during 2006 the applicants received over \$30 million in stock redemption proceeds from the Rural Telephone Bank which were not disclosed to the Commission. During 2007, eligible applicants sought and received California High Cost Fund A subsidy payments from the California High Cost Fund A based on this omitted data as set out below:

¹⁹ A federal program providing support for rural telephone carriers.

²⁰ Re Alternative Regulatory Frameworks for Local Exchange Carriers, 41 CPUC2d 326, 331 (D.91-09-042).

Telephone Company	Rural Telephone Bank Proceeds Received in 2006	Subsidy Payment from California High Cost Fund A in 2007 (Resolution T-17064, December 14, 2006)
Calaveras	\$655,087.57	\$746,455.73
Cal-Ore	\$1,470,151.00	\$886,297.09
Ducor	\$534,076.99	\$1,746,281.38
Happy Valley	\$257,296.00	\$0
Hornitos	\$319,920.00	\$0
Kerman	\$1,507,000.00	\$1,637,920.18
Ponderosa	\$7,101,551.31	\$2,802,055.25
Sierra	\$3,471,574.00	\$13,160,139.41
Siskiyou	\$6,121,109.07	\$4,825,151.00
Volcano	\$6,918,837.19	\$2,423,859.36
Winterhaven	\$1,926,978.00	\$0

Position of the Applicants

The applicants argue that the only Rural Telephone Bank stock redemption funds subject to sharing with ratepayers are gains over par value, i.e., the residual amounts, of shares held in rate base. Because the Rural Telephone Bank stock was held in rate base only for a short time, the total amount applicants propose to allocate to ratepayers is \$3,037.

Applicants present separate rationales for the different methods under which they acquired Rural Telephone Bank stock. The applicants contend that Class C shares purchased by Cal-Ore Telephone Company, \$5,000; Kerman Telephone Company, \$1,126; Siskiyou Telephone Company, \$7,000; and Volcano Telephone Company, \$5,000 are “voluntary investments made by the companies

without any connection to RTB loan requirements.”²¹ As such, the applicants conclude that shareholders should retain all the redemption proceeds from shares acquired in this way.

For Rural Telephone Bank stock obtained as patronage refunds, the applicants contend that because the shares were obtained as interest refunds and not dividends, the redemption proceeds are not subject to sharing under the gain-on-sale decision.²² The applicants also argue that the rule against retroactive ratemaking precludes the Commission from allocating the stock redemption proceeds to ratepayers because to do so would, in effect, retroactively lower the applicants’ rate of return.²³

For the Rural Telephone Bank stock obtained with 5% of loan proceeds, applicants state these shares were purchased “entirely with shareholder funds.”²⁴ Applicants reason that because shareholders were “wholly responsible for repayment of RTB loans, and ratepayers bore no responsibility for such repayment, there is no doubt that funds derived from RTB loans were owned by shareholders.”²⁵ The applicants argue that shareholders remained the owner of Rural Telephone Bank stock purchased with loan proceeds regardless of whether the Commission included the stock of in the cost of debt analysis. Moreover, applicants state that since 1997 the actual cost of debt has been irrelevant in

²¹ November 19, 2009, filing, Appendix B at 44.

²² November 19, 2009, Response at 17.

²³ *Id.*

²⁴ *Id.* at 7.

setting the cost of capital because the Commission has adopted an overall 10% rate of return without regard to actual capital costs or structure.²⁶

Applicants also point to the Federal Communications Commission's 1989 decision determining that Rural Telephone Bank stock purchased with 5% of loan proceeds should (1) be included in rate base as an operating investment, and (2) any profit on the stock or dividends should be recorded for the benefit of ratepayers.²⁷ Applicants explained that the Federal Communications Commission has not issued a similar decision on the treatment of patronage share refunds, but applicants offered an industry group memorandum that supported allocating patronage share gains to shareholders.

Applicants remind the Commission that its ratemaking jurisdiction extends only to intrastate operations, which comprise only a portion of each applicant's overall operations, and that any distribution of stock redemption proceeds must be done on an after-tax basis to account for state and federal income tax.

Finally, applicants explain that all California telecommunications ratepayers contribute to the California High Cost Fund A, "upon which the Applicants rely to fulfill their revenue requirements," and that this fund should be credited with any redemption proceeds allocated to ratepayers by the

²⁵ *Id.* at 9.

²⁶ *Id.* at 13.

²⁷ November 19, 2009, Response at 20-22.

Commission. The applicants also recommend that any sharing amounts should accrue interest at the 90-day commercial paper rate.

Need for a Hearing

No party intervened in this proceeding at the evidentiary stage 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 and the October ruling. 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."²⁸ 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.²⁹

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

²⁸ Pub. Util. Code §§ 451 and 454.

²⁹ See generally Application of SOUTHERN CALIFORNIA EDISON COMPANY for Authority to, Among Other Things, Increase Its Authorized Revenues For Electric Service in 2009, And to Reflect That Increase In Rates (Decision 09-03-025) (March 12, 2009) and Decisions cited therein.

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 opposed to it, has more convincing force and the greater probability of truth'"³⁰ 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.³¹ We agree with the applicants that filing this application was the procedurally proper means to resolve this question for all applicants due to the unique ratemaking issues presented by this stock redemption.

No factually similar precedent has been cited by applicants and our own research has not revealed any Commission decisions addressing the precise ratemaking issues raised by the Rural Telephone stock redemption. The Rural Telephone Bank stock was an asset of the public utilities and the 2006 redemption amounted to a sale of this asset. Therefore, we will turn to our

³⁰ 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.

³¹ Application at 4; *see also* Resolution T-16002, Hornitos Telephone Company, at Ordering Paragraph 2, at 10.

recent policy decision on allocating proceeds from the sale of utility assets for general policy guidance in resolving these issues.³²

The Commission has substantial discretion in rate setting,³³ and we begin with the long-established ratemaking standards found in the Public Utilities Code. The applicants are seeking a ratemaking determination from this Commission and pursuant to Public Utilities Code Section 454, this Commission may only authorize ratemaking changes that have been “justified” by the applicants. The resulting rates must also be “just and reasonable” as required by § 451.

Pursuant to § 817, the Commission may only authorize the encumbrance of public utility property for public utility purposes and “no others.” Accordingly, Commission decisions specifically prohibit the encumbrance of public utility property for the private interests of shareholders.

The applicants acquired Rural Telephone Bank stock through three means: (1) by direct purchase with shareholder funds, (2) as annual patronage refunds of interest paid on Rural Telephone Bank loans, and (3) as a requirement of

³²Order 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, D.06-05-041, as modified by D.06-12-043.

³³ “The fixing of rates is a legislative act. The standard is that of reasonableness. ... [The decisions have] a strong presumption of correctness of the findings and conclusions of the Commission, which may choose its own criteria or method of arriving at its decision, even if irregular, provided unreasonableness is not clearly established.” Pacific Tel. & Tel. Co. v. Public Util. Com., (1965) 62 Cal.2d 634, 647 (citations and quotations omitted.)

obtaining loans from the bank. We will address the redemption proceeds based on the method of acquisition.

Stock Purchased with Shareholder Funds

The record shows that the following applicants used shareholder funds, i.e., amounts not reflected in regulated revenue requirement, to purchase Rural Telephone Bank stock: Cal-Ore Telephone Company, \$5,000; Kerman Telephone Company, \$1,126; Siskiyou Telephone Company, \$7,000; and Volcano Telephone Company, \$5,000. As these amounts were not included in regulated revenue requirement, we agree with the applicants that the redemption proceeds and dividends from stock acquired in this manner should be credited to non-regulated accounts for the benefit of shareholders.

Stock Acquired as “Patronage Refund”

We next turn to stock acquired by the second method, that is, as an annual patronage refund. This refund was in the form of Class B stock with each borrower’s allocation based on the amount of interest paid on Rural Telephone Bank loans approved by the Commission. There is no dispute that each applicant’s regulated revenue requirement included the cost of debt.³⁴ Accordingly, the patronage refund stock was a regulated asset funded by regulated revenue requirement. As analyzed below, the ratemaking treatment of the proceeds from the redemption or sale of this regulated asset is guided by our

³⁴ For most years during the loan periods, regulated revenue requirement included the cost of capital at 10%, and the interest rate charged by the Rural Telephone Bank was about 6%. See November 19, 2009, filing at Appendix B, pages 53 -54.

2006 decision on the Allocation of Gains on Sale of Utility Assets (“Utility Assets Decision”).³⁵

In support of their proposed allocation of all \$24 million of patronage share stock redemption proceeds to shareholders, the applicants argue that the patronage refund stock is not subject to the Commission’s gain on sale rule and that the rule on retroactive ratemaking prohibits redistributing shareholder earnings from earlier periods.³⁶ Applicants state that the Rural Telephone Bank stock obtained as patronage refunds is “unrelated to the RTB purchased shares” and “cannot be viewed as ‘gains’ under the Commission’s ‘gain on sale’ doctrine.”³⁷

Applicants are small local exchange carriers subject to cost-of-service ratemaking regulation by this Commission, and recipients of substantial subsidies from all California ratepayers through the California High Cost Fund A, as demonstrated above. Accordingly, all proceeds from the sale of regulated assets are subject to our ratemaking authority. This is especially true where, as here, the loans that are the source of the asset were obtained by mortgaging public utility property for public utility purposes, as set forth above.

³⁵ 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, D.06-05-041, as modified by D.06-12-043.

³⁶ November 19, 2009, Response at 17-18.

³⁷ *Id.* at 17.

In our Utility Assets Decision, we adopted a process for allocating gains (and losses) on sale received by utilities when they sell “utility land, assets such as buildings, or other tangible or intangible assets formerly used to serve customers.”³⁸ Rural Telephone Bank stock is an intangible financial asset that arose from the Rural Telephone Bank loans approved pursuant to § 817 and used to provide public utility service to customers. Thus, we conclude that its sale or redemption is a regulated asset sale that falls within the scope of our Utility Assets Decision.

In that decision, we found that the economics of utility regulation required that “rewards should go to those that bear the actual burdens of the risks engendered by the particular economic action, such as the purchase of assets.”³⁹ Typically, utility assets are purchased by the shareholders and placed into rate base. That is not the case for the Rural Telephone Bank patronage refund stock, which was received as a distribution from the Rural Telephone Bank proportional to interest paid by borrowers.⁴⁰ Therefore, the par value redemption should not belong to shareholders, but should benefit those who bore the costs of the interest payments, i.e., the ratepayers.

As set out above, applicants state that each share of Rural Telephone Bank stock was redeemed for \$1.044, or 4.4 cents above par value. The amount above the purchase price or par value of this non-depreciable asset is the “gain” to

³⁸ D.06-05-041 *mimeo.* at 1.

³⁹ *Id.* at 27-28.

⁴⁰ 7 U.S.C. § 946(g).

which most of our Utility Asset Decision is directed. Pursuant to that decision as modified, gain on non-depreciable assets are shared 67% to ratepayers and 33% to shareholders. That sharing formula, however, is based on two factors not present with this unusual asset.

First, shareholders have not provided the capital at risk in acquiring the asset. The Rural Telephone Bank patronage refund stock resulted from interest payments on applicants' loans, and those interest payments originated from ratepayers.

Second, shareholders do not require an incentive to prudently manage Rural Telephone Bank stock.⁴¹ The shareholders were entirely passive owners of the stock, obtaining it by operation of law from the Rural Telephone Bank and selling it as part of the Bank's dissolution process.

Due to the absence of these two factors, we find that the sharing formula adopted in the Utility Asset Decision is inappropriate for the above-par amounts from the Rural Telephone Bank patronage stock redemption. We find that regulated revenue requirement should be credited with 100% of the above-par amount.

⁴¹ "We noted in the OIR that it was our goal to encourage prudent investment in and continued ownership of property that is necessary for utility service, to ensure that utilities dispose of properties that have been rendered unnecessary by change of circumstances, and to encourage utility management to negotiate a reasonably high sale price for their property. We cannot quantify an allocation with exact precision, but given the record, a 67% - 33% allocation is a fair and reasonable outcome for shareholders, partly to compensate for some financial risk borne by the utility, and partly as an incentive to manage assets wisely." D.06-12-043, Ordering Paragraph 1 (i).

This is consistent with previous Commission treatment of ratepayer-funded efforts. The Commission has determined that when ratepayers, and not shareholders, fund an endeavor, any revenue realized from the endeavor should be credited to ratepayers because to do otherwise would result in a windfall for shareholders. In Re Pacific Bell, 45 CPUC2d 109, 130-33, (D.92-07-072)(July 22, 1992), the Commission determined that where “there is no evidence that any funds besides ratepayer-provided funds were used,” allowing shareholders to keep the value created would “confer a windfall profits on the shareholders.” See also Southern California Water Company, *mimeo.* at pp. 30 36 (D.04-03-039) (Shareholders would receive a “windfall” if revenue from balancing account was not shared with water ratepayers, who provided a portion of interim funding.) (March 16, 2004).

Applicants contend that the Commission cannot allocate the proceeds to benefit ratepayers due to the rule against retroactive ratemaking. More specifically, applicants argue that the prior decisions adopting rates for their operations “were issued after review of a record where all the information that was available about the Applicant, its operations, its services, its financing and plant and equipment was open for consideration.”⁴² However, applicants never showed the patronage refunds as a reduction in interest expense at any time. Thus, applicants’ current contention that by allocating the redemption proceeds the Commission would be re-deciding its prior conclusions about reasonable revenue and expenses is at odds with their own prior treatment of the receipt of

⁴² November 19, 2009, Response at 18.

the stock as not constituting revenue or a reduction in interest expense. Accordingly, applicants' retroactive ratemaking argument relies on a supposed set of facts that is inconsistent with their own prior presentations to the Commission.

We, therefore, conclude that all proceeds from the redemption of Rural Telephone Bank stock obtained as patronage refunds should be allocated so as to benefit ratepayers.

Stock Acquired by Mandatory Purchase with Loan Proceeds

We turn next to the third method of acquiring stock – the mandatory purchase with 5% of Rural Telephone Bank loan funds. As required by § 817, these Rural Telephone Bank loans and the mandatory 5% stock purchase were approved by the Commission for public utility purposes.

As discussed above, the Utility Assets Decision provides a process for allocating proceeds received by utilities when they sell “utility land, assets such as buildings, or other tangible or intangible assets formerly used to serve customers.”⁴³ Rural Telephone Bank stock is an intangible public utility financial asset that was obtained with 5% of the proceeds from each applicant's Rural Telephone Bank loans which were used to provide public utility service to customers as required by § 817. Thus, we conclude that the sale or redemption of Rural Telephone Bank stock obtained with 5% of the loan proceeds is a public utility asset sale that falls within the scope of our Utility Assets Decision.

⁴³ D.06-05-041 *mimeo.* at 1.

The origin of the capital used to purchase the “5% stock” is not immediately obvious.

As explained by each applicant in response to Question 5 of Data Request RTB-1 from the Commission’s Communication Division, Rural Telephone Bank stock acquisition was funded from Rural Telephone Bank loans proceeds:

[The applicant] was required by the terms of the applicable Rural Telephone Bank loan documents to allocate five percent (5%) of each Rural Telephone Bank loan to the purchase of Rural Telephone Bank stock. Accordingly, the source of the funds used to purchase Rural Telephone Bank stock was the money loaned by the Rural Telephone Bank.⁴⁴

In this way, 5% of the proceeds from each Rural Telephone Bank loan went back to the Bank and the borrower obtained stock in the Bank. The borrower, however, was responsible for paying back the entire amount of the loan, including the portion used to fund the stock purchase. As set out above, the applicants obtained Commission authorization to mortgage their *public utility assets* to secure repayment of these loans and the Commission acknowledged that a portion of the proceeds would be used to purchase Rural Telephone Bank stock.

The record of this proceeding shows that each applicant stated that the full amount of all Rural Telephone Bank loans, including the portion used to purchase Rural Telephone Bank stock, was reflected in the long-term debt tabulation used in rate cases: “[each applicant] included its Rural Telephone

⁴⁴ See Responses to Question 5 of RTB-1 Data Requests from each applicant which reflect substantially identical text (May 22, 2009).

Bank loan amount in its long-term cost of debt calculation submitted in its previous rate case filings.”⁴⁵

Applicants also stated in their June 2009 data 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 data in arriving at a rate of return.⁴⁶ Applicants contend that in adopting an overall cost of capital and then leaving the utility to manage its debt and equity components, “the Commission did not specifically consider specific costs of acquiring debt for Applicants . . . and cannot now construe the RTB stock purchases as subject to offset from Applicants’ revenue requirements.”⁴⁷

The Commission, however, was well aware of the mandatory 5% purchase at issue here. As demonstrated above, the Commission approved each Rural Telephone Bank loan and accompanying mortgage of public utility property. In those decisions, the Commission explicitly stated and approved the stock purchase as consistent with the purposes set forth in § 817 for which public utility property may be mortgaged.⁴⁸ The Commission also knew that Rural Telephone Bank borrowings were increasing in amount and for most applicants

⁴⁵ See Responses to Question 1 of RTB-3 Data Requests from each applicant which reflect substantially identical text (June 24, 2009).

⁴⁶ See Responses to Question 1.

⁴⁷ Opening Comments on First Proposed Decision at 15.

⁴⁸ See, e.g., In the Matter of the Application of Kerman Telephone Company, 2002 Cal. PUC LEXIS 550 at *7, listing “Rural Telephone Bank shares” as first use of proceeds from nearly \$7 million loan and describing such use as “purchase of additional Class B shares of RTB (a condition to the loan)” (D.02-09-019).

comprised most or all of their company debt.⁴⁹ Finally, the Commission knew that the actual interest rate on these loans was about 6%, far lower than the adopted 10% overall cost of capital.

Applicants contend that as the obligors on the Rural Telephone Bank loans, shareholders were responsible for repaying the entire amount of the loan, including the portion used to fund the stock acquisition, and that this portion of the loan was never reflected in regulated revenue requirement. Applicants thus conclude that shareholders provided the capital to acquire the 5% stock and are entitled to return of this capital upon sale or redemption of the stock.⁵⁰

Applicants' analysis, however, fails to explain the ratemaking treatment of this stock over several decades. Applicants began obtaining the loans in the 1970's, with the majority being entered into prior to 1997. We start with the proposition that traditional ratemaking principles, as reflected in the Utility Assets Decision, would indicate that an asset, such as shares of stock, purchased with loan proceeds secured by mortgages on public utility property as a requirement for Commission-approved loans would be used and useful public utility property that would properly be carried in a public utility's rate base. Applicants admit, however, that only a small share of the total amount of Rural Telephone Bank stock obtained as the mandatory 5% purchase has ever been in rate base, and only since 2003.⁵¹

⁴⁹ See, e.g., In the Matter of the Application of Volcano Telephone Company, 66 CPUC2d 137 (headnote only) 1996 Cal PUC LEXIS 627 (D.96-05-003).

⁵⁰ November 19, 2009, Response at 7.

⁵¹ Application at 8, Attachment 1.

The Commission did not explicitly address the appropriate ratemaking treatment of the Rural Telephone Bank stock until 25 years after the applicants' initial loans when, in 1997, it conducted general rate cases for most of the applicants. This is the first direct Commission action on the appropriate ratemaking treatment for this stock.

We begin with the history leading up to the mass general rate case filings. In 1994, the Commission ordered all small local exchange carriers to file general rate cases in one of the decisions creating the Alternative Regulatory Framework for Local Exchange Carriers, which opened up additional local telecommunication services to competition.⁵² The changes adopted in that decision focused primarily on the two large local exchange carriers, then called Pacific Bell Telephone and GTE California, Inc. and their implementation of the New Regulatory Framework, but the proceeding also had ancillary impacts on the small local exchange carriers. Most notably, the small carriers expected their toll and access revenues and intercompany settlement revenues to decline.⁵³

The Commission also needed to set a base year for California High Cost Fund A purposes.⁵⁴ In considering this issue, the Commission observed: "In recent years many of the [small and medium sized local exchange carriers] have earned returns that exceed, some significantly, their authorized return."⁵⁵ The

⁵² In Re Alternative Regulatory Frameworks for Local Exchange Carriers, 56 CPUC2d 117 (D.94-09-064).

⁵³ *Id.* at 140.

⁵⁴ *Id.* at 250-253.

⁵⁵ *Id.* at 251.

Commission noted that in 1991 the small and medium carriers were exceeding their authorized rate of return by 67 to 1385 basis points.⁵⁶ The Commission also found that some carriers had not had general rate cases since the 1960's.⁵⁷ As a result, the Commission ordered all small local exchange carriers to file general rate cases no later than December 31, 1995.⁵⁸

Consequently, in 1997, the Commission issued general rate case decisions for five applicants, Calaveras, Cal Ore, Ducor, Foresthill, and Sierra. Informal general rate case advice letters were filed by Hornitos, Kerman, Ponderosa, and Winterhaven, which resulted in Commission Resolutions.⁵⁹

In these 1997 decisions and resolutions, the Commission addressed for the first time the appropriate ratemaking treatment for the Rural Telephone Bank stock obtained with 5% of the proceeds, some of which had been held by the applicants for over 20 years. The Commission rejected the proposed rate base treatment of the stock and instead opted for a "different treatment" for the stock. The most complete explanation of the Commission's action is found in the Hornitos resolution:

Hornitos proposes to account for holding Rural Telephone Bank (RTB) stock with an upwards adjustment to rate base. The Commission in its GRC decisions for Cal-Oregon, Calaveras, Ducor, Foresthill, and Sierra Telephone Company **adopt a**

⁵⁶ *Id.* at 252. Assuming an authorized rate of return of 13%, this means that the carriers were realizing returns of between 13.65% and 26.85%.

⁵⁷ *Id.* at 467, note 75.

⁵⁸ *Id.* at 289, Ordering Paragraph 45.

⁵⁹ Application at 3-4.

different treatment for RTB stock. The Commission excluded RTB stock from the outstanding balance of long-term debt when calculating the embedded cost of debt. [Telecommunications Division] concurs with the treatment adopted in the decisions for the other telephone companies. [Telecommunications Division's] recommendation is reasonable and should be adopted. [Telecommunications Division] recommends the same treatment for Hornitos.

Hornitos' estimated 1997 cost of debt is 3.08%. [Telecommunications Division] calculated a 3.10% cost of debt. This difference results from [Telecommunications Division] excluding Hornitos' Rural Telephone Bank Stock from its outstanding balance of long-term debt.⁶⁰

Thus, on its first opportunity to adopt ratemaking treatment for the Rural Telephone Bank stock obtained with 5% of the loan proceeds, the Commission rejected the standard rate base treatment and instead **increased** the applicant's cost of debt.

⁶⁰ Resolution T-16002, April 9, 1997 (emphasis added). See also, Re Ducor Telephone Company, 71 CPUC 2d 575, 582 (D.97-04-035), increasing Ducor's cost of debt from 4.97% to 5.11% by "excluding Rural Telephone Bank stock applicant was required to purchase as a condition of borrowing from the Rural Telephone Bank," with applicant's concurrence; Re Sierra Telephone Company, 71 CPUC2d 506, 515 (D.97-04-032), increasing Sierra's cost of debt from 4.90% to 6.36% by similarly excluding Rural Telephone Bank stock, also with applicant's concurrence.

The Commission recently changed its treatment of the stock and over the course of 2001 to 2003 authorized five applicants to include this Rural Telephone Bank stock in rate base.⁶¹

In sum, the ratemaking history of this stock shows that from the early 1970's to 1997 the stock was not addressed. During this time, applicants were presumably satisfied that their rates were covering costs and providing a reasonable return, which for some was very high. From 1997 to 2001, all applicants excluded the stock from rate base in exchange for a higher cost of debt, and some applicants continue under this structure. Five applicants moved the stock into rate base between 2001 and 2003. This recently rate-based stock is the only stock applicants contend is subject to our ratemaking disposition, as provided in the Utility Assets Decision.

This unique and complex history undermines any attempt to blindly apply any ratemaking formula. The recent inclusion of a small share of the stock in rate base is not a sufficient rationale to ignore the other, far larger share that continues to be included in the cost of debt. Similarly, the Commission's decision to adopt an overall cost of capital without specific regard to the embedded cost of debt does not negate the Commission's decision rejecting rate base treatment as appropriate for this asset.⁶²

⁶¹ Application at 4.

⁶² In light of the average 6% interest rate on Rural Telephone Bank loans, applicants had ample opportunity to more than recover interest plus the cost of the stock and still remain well below the 10% authorized rate of return.

Applicants contend that the shareholders' proposed retention of the redemption proceeds is a reasonable ratemaking treatment. Consistent with the Utility Asset Decision, this outcome would only be appropriate where the Commission has found that the shareholders provided the capital for acquiring the asset. Here, the Commission specifically rejected the applicants' proposed rate base treatment, which would have been the correct approach if the Commission thought that the shareholders had provided the capital. Instead, the Commission, with the applicants' concurrence, adopted a different treatment for the stock purchase and increased the cost of debt. This treatment is consistent with perceiving the cost of the mandatory stock purchase as a cost of obtaining the loan, not as a shareholder-funded capital purchase. The low interest rate of the loans, even including the mandatory stock purchase, tends to support the Commission's perception that these loans were sound business decisions, i.e., low-cost capital, for applicants and that the 5% stock purchase was incidental to that purpose.

For these reasons, especially due to the unique ratemaking history and nature of this asset, we find that shareholders did not provide the capital to acquire the Rural Telephone Bank stock. These capital costs were reflected in applicants' regulated revenue requirement. Accordingly, consistent with the Utility Asset Decision, proceeds from the sale or redemption of these assets should be credited to ratepayers.

Applicants dispose of the Utility Asset Decision by quoting that decision for the proposition that where property is never included in rate base, "all gains

or losses should accrue to shareholders.”⁶³ From this, the applicants conclude that “the recent gain-on-sale decision exempts the RTB stock redemption proceeds from any gain-on-sale requirements.”⁶⁴

However, the applicants have failed to demonstrate that that they have met the Commission’s underlying assumption – 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**.⁶⁵

As analyzed above, the applicants have not demonstrated that shareholders separately funded the 5% stock acquisition as an unregulated investment. The decisions approving the Rural Telephone Bank mortgages would directly preclude such a finding because § 817 limits the purposes for which public utility property may be mortgaged; that is, the property may be encumbered for public utility uses only and not the private interests of shareholders.

⁶³ Application at 8.

⁶⁴ *Id.*

⁶⁵ 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 57 (May 25, 2006) (D.06-05-041) (emphasis added).

In conclusion, consistent with our ratemaking statutes and Utility Asset decision, we conclude that the redemption of Rural Telephone Bank stock funded by loan proceeds should benefit ratepayers. The above par value should be treated the same as the patronage refund stock.

Credit to California High Cost Fund A 2010 Draw

As provided in D.91-09-041, the California High Cost Fund A Implementation regulations require that actual recorded revenue be used to calculate support payments. Consistent with those regulations, the stock redemption proceeds should be credited against otherwise authorized regulated revenue requirement currently being recovered from California High Cost Fund A.

Each applicant receiving support for 2010 should submit an advice letter providing for a credit to its California High Cost Fund A 2010 support in the jurisdictionally separated portion of the amount set out below with interest as specified in today's decision.

Telephone Company	Rural Telephone Bank Proceeds to Be Credited to California High Cost Fund A
Calaveras	\$655,087.57
Cal-Ore	\$1,470,151.00
Ducor	\$534,076.99
Happy Valley	\$1,268,896.00
Hornitos	\$319,920.00
Kerman	\$1,507,000.00
Ponderosa	\$7,101,551.31
Sierra	\$3,471,574.00
Siskiyou	\$6,121,109.07
Volcano	\$6,918,837.19
Winterhaven	\$1,926,978.00
TOTAL	\$31,295,903.73

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 stock redemption proceeds to California High Cost Fund A.

Applicants that do not receive 2010 support from the California High Cost Fund A shall file advice letters crediting the listed amount to basic service charges for 2010. We authorize the Director the Communications Division to approve efficient and effective mechanisms for crediting the listed amount to customers' basic service charges over a period not to exceed 12 months.

Interest Rate

Applicants received nearly all of the \$30 million in Rural Telephone Bank stock redemption proceeds on April 11, 2006. 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.⁶⁶ Such an interest rate is also necessary to ensure that applicants disgorge all benefits associated with their lack of diligence in bringing this significant issue forward. Interest shall be tabulated at the overall cost of capital, shall run from the date of receipt of the proceeds, and shall be compounded monthly.

In comments on the PD, applicants object to using their own adopted cost of capital as the interest rate for these amounts. Applicants contend that “a 10% interest rate is far beyond any interest rate that has been available in the market since the Rural Telephone Bank stock redemption took place.”⁶⁷ As this is the cost of capital applicants obtain from customers, applicants are in no position to object to customers obtaining the same rate.

Jurisdictional Separation

Applicants provide both intrastate telecommunications services subject to this Commission’s ratemaking jurisdiction and interstate telecommunications services subject to the ratemaking jurisdiction of the Federal Communications

⁶⁶ See, e.g., Re California American Water Company, D.08-05-036, *mimeo.* at 9.

⁶⁷ Comments on PD at 25.

Commission. The jurisdictional separation adopted in each applicant's most recent rate case should be used to separate the Rural Telephone Bank stock redemption proceeds into the intrastate portion subject to our directives.

Applicants have presented convincing evidence that the Federal Communications Commission has determined that all loan proceeds purchased Rural Telephone Bank stock included in rate base should be credited to shareholders and all dividends and residuals credited to ratepayers.⁶⁸ The Federal Communications Commission specifically found that the stock acquired with Rural Telephone Bank loan proceeds represented "investor-provided funds used as an operating investment" and should be in rate base. That Commission went on, however, to "remind carriers that any profit realized from the sale of the stock or from dividends should . . . serve to benefit ratepayers."⁶⁹

Applicants, however, have not presented any evidence on the Federal Communications Commission's treatment of Rural Telephone Bank patronage refund stock redemption proceeds but have offered an April 13, 2006, letter from National Exchange Carrier Association.⁷⁰ We note that the rationale articulated by the Federal Commission for the 5% stock is inapplicable to patronage refund stock because shareholders did not provide the funds to acquire the stock, and a

⁶⁸ November 19, 2009, Response at 20-22, *quoting* In the Matter of Amendment to Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, FCC 89-30, 54 FR 9047, 65 RR 1719, (January 30, 1989).

⁶⁹ *Id.* at 21.

⁷⁰ November 19, 2009, filing at Attachment C. A second letter is referenced but not attached.

“rebate of interest” on the full amount of loan is similar to a dividend or profit. The New York Public Service Commission, which followed the federal treatment for Rural Telephone Bank stock purchased with loan proceeds, has held that patronage refunds are similar to dividends and “belong to the ratepayers and should be booked in rate base at cost, which was zero.”⁷¹ The New York Commission’s logic is compelling: unlike the stock obtained with the loan proceeds, shareholders provided no capital to acquire the patronage refund stock so that the appropriate accounting treatment is to place the stock in rate base with a cost basis of zero. Consistent with the Federal Commission’s approach of all amounts above cost being credited to ratepayers for the Rural Telephone Bank stock acquired with loan proceeds, the difference between the cost basis and the redeemed amount for patronage shares should be credited to ratepayers.

We expect applicants to apply that Commission’s ratemaking treatment for loan funded Rural Telephone Bank stock to patronage refund stock, with the cost basis determined as stated above by the New York Commission.

Order to Show Cause Why A Fine Should Not Be Levied For Failure to Disclose Public Utility Revenue in California High Cost Fund A Advice Letters and Rule 1

As demonstrated above, applicants are cost-of-service regulated public utilities that receive substantial cost-based subsidies from state and federal sources. Material financial changes must be disclosed to regulators to enable the proper and fair distribution of such subsidies and the consideration of potential

⁷¹ Proceeding on Motion of the Commission to Address Dissolution the Rural Telephone Bank, Case 06-C-0314, 2007 N.Y. PUC LEXIS 310 at *8 (August 24, 2007).

Commission-ordered rate review. Accordingly, this Commission requires all California High Cost Fund A recipients to submit annual earnings statements, which must account for all regulated revenue received during the recorded period. Applicants, however, did not disclose in their 2006 earnings statements the \$30 million of Rural Telephone Bank proceeds received in 2006. As set forth below, the record in this proceeding shows that applicants' conduct has violated the California High Cost Fund A Implementation Rules adopted in D.91-09-042 and, pursuant to § 2107, we find that a fine of \$20,000 may be justified for each applicant. We further find that each applicant's conduct in filing this application to distribute a trivial sum to ratepayers when applicants had in fact received over \$30 million, and then failing to be forthcoming about actual amount at issue, may have violated Rule 1 of the Commission's Rules of Practice and Procedure, which requires all persons who transact business with the Commission "never to mislead the Commission or its staff by an artifice or false statement of fact or law." We will order each applicant to show cause why a fine of up to \$20,000 for each of these two violations should not be levied.

Violations of D.91-09-042

Applicants' conduct in failing to disclose the receipt of over \$30 million directly related to their public utility function undermines the Commission's ability to discharge its duties and to competently regulate applicants.

Specifically, the California High Cost Fund A Implementation Guidelines⁷² require each applicant to submit “seven months of recorded financial data” for the Commission’s use in calculating the subsidy payment for the following year.

As shown in each applicant’s verified accounting filed on November 19, 2009, each applicant received substantial amounts of Rural Telephone Bank stock redemption proceeds during the seven month period for which recorded financial data was included in the 2006 California High Cost Fund A Advice Letter. Applicants state in their accountings that they did not include the amounts received from the Rural Telephone Bank for ratemaking treatment in the California High Cost Fund A, and review of our records confirm this statement.

The Rural Telephone Bank stock redemption is directly related to public utility operations because the loans from which the stock originated, either as direct purchases or patronage refunds of interest, are secured by mortgages on public utility property. As demonstrated above, § 817 precludes mortgaging public utility property for private shareholder purposes.⁷³ The amounts are material. The windfall received from the Rural Telephone Bank is highly

⁷² Re Alternative Regulatory Frameworks for Local Exchange Carriers, 41 CPUC2d 326, 331 (D.91-09-042).

⁷³ Even if we were to accept that applicants had a good faith, albeit erroneous, belief that the relatively small portion of the redemption funds that came from stock purchased with 5% of loan proceeds was the unregulated property of shareholders, applicants have presented no substantive arguments reasonably justifying their decision to exclude the far larger amount of patronage refund stock redemption funds from disclosure in the Advice Letter for California High Cost Fund A.

relevant to the Commission's determination of each applicant's draw from the California High Cost Fund A because recorded financial data affects the amount an applicant could obtain from the Fund.

As a result of omitting the recorded financial data showing the Rural Telephone Bank stock redemption proceeds in Advice Letters seeking High Cost Fund A support, the applicants misrepresented to the Commission their actual financial position. Based on the misrepresented information, the Commission authorized transfers of public funds to applicants to which they do not appear to have been entitled.

Therefore, we find that D.91-09-042 required applicants to disclose recorded financial data from public utility operations in their advice letters filed in 2006 for California High Cost Fund A, and that each applicant failed to do so. Any public utility that fails to comply with a Commission decision is subject to a penalty of between \$500 and \$20,000 as provided in § 2107.

Violations of Rule 1 of the Commission's Rules of Practice and Procedure

Applicants' belated decision to file this application and to decline to be forthcoming with a full accounting of all amounts received similarly undermines this Commission's ability to efficiently and effectively regulate public utilities. Filing an application seeking authorization to distribute an immaterial sum to ratepayers without disclosing the far larger amount actually received substantially interferes with this Commission's duties. Repeated inquiries should not be necessary to obtain basic factual information, and purposely omitting the existence of closely related, larger amounts is simply inexcusable. The applicants are in no position to rely on the limited wording of staff's data request seeking information only on "purchased" shares when the applicants

had withheld disclosure of the existence of non-purchased or patronage refund shares of far greater value.

We further find that each applicant's conduct in filing this application with incomplete disclosures and then failing to be forthcoming about the actual amount at issue appears to have violated Rule 1 of the Commission's Rules of Practice and Procedure, which requires all persons who transact business with the Commission "never to mislead the Commission or its staff by an artifice or false statement of fact or law." The 2006 filings that omitted the Rural Telephone Bank stock redemption proceeds materially misstated applicants' actual financial position, which was highly relevant to calculating California High Cost Fund A support payments.

Potential Penalty to be Imposed for Each Violation

Based on the Commission's guidelines for setting fines,⁷⁴ we find that the failure of each applicant to comply with D.91-09-042 and Rule 1 is severe because the violations undermine the entire regulatory process. This Commission makes significant financial decisions based on factual representations by applicants. These representations must be made with the highest commitment to accuracy and completeness. The recalcitrant conduct of each applicant which necessitated repeated inquiries is an aggravating factor. The amount at issue, over \$30 million, tends to support the maximum fine level. Thus, we conclude that each applicant should show cause why it should not be subject to an order of this

⁷⁴ Re Standards of Conduct Governing Relationships Between Energy Utilities and their Affiliates, 84 CPUC2d 155, 188 Appendix B. (D.98-12-075).

Commission to pay a fine of up to \$20,000 to the State of California's General Fund for each violation.

Order to Show Cause

Applicants are ordered to show cause why the above stated fine should not be levied on each applicant for (1) its failure to comply with D.91-09-042 and disclose the Rural Telephone Bank stock proceeds in its California High Cost Fund A advice letter for 2007 subsidy payments, and (2) violating Rule 1 of the Commission's Rules of Practice by filing an application to distribute a trivial sum to ratepayers when over \$30 million was at issue and for failing to be forthcoming about the actual amount at issue.

No later than 30 days after the effective date of this decision, the applicants may file and serve any factual evidence or legal argument bearing on these violations. This proceeding shall remain open to resolve this Show Cause Order. With this issuance of this Show Cause Order, this proceeding will be recategorized as adjudicatory, as provided in Rule 1.3 of the Commission's Rules of Practice and Procedure. Ex parte contacts are prohibited in adjudicatory proceedings pursuant to Rule 8.2 of the Commission's Rules of Practice and Procedure.

Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Maribeth A. Bushey is the assigned ALJ in this proceeding.

Comments on Proposed Decision

The first 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. The applicants filed comments on October 12, 2009.

The revised proposed decision of the ALJ in this matter was mailed to the parties. Comments were filed on January 21, 2010, and reply comments on January 28, 2010, by applicants and DRA.

DRA's comments supported the revised proposed decision as written, and offered additional legal analysis disputing the applicants' claim that the rule against retroactive ratemaking prevented the Commission from determining that ratepayers should receive the benefit of patronage stock redemption proceeds.

The applicants commented that the revised proposed decision was as "deeply flawed" as the original proposed decision, and reiterated many previously presented and addressed arguments.

The applicants support the revised proposed decision's treatment of the Rural Telephone Bank stock purchased by shareholders of Cal-Ore Telephone Company, Kerman Telephone Company, Siskiyou Telephone Company, and Volanco Telephone Company, but seek clarification that the shareholders should also retain dividends on the stock purchased in this manner. Today's decision has been clarified to allow shareholders to retain the dividends on the stock purchased directly with shareholder funds.

Applicants contend that the Commission is legally precluded from distributing to ratepayers the approximately \$24 million in redemption proceeds from Rural Telephone Bank stock obtained as patronage refunds of interest because the patronage refund stock is not a dividend and thus not subject to the Utility Assets Decision.⁷⁵

⁷⁵ Applicants' Comments on Revised Proposed Decision at 8.

Applicants' notion that because the patronage stock is not a dividend, it belongs to shareholders is fundamentally at odds with long-standing Commission ratemaking and public utility property precedents. Rural Telephone Bank stock obtained as annual patronage refunds based on interest paid, for public utility loans which were reflected in regulated revenue requirement and secured by public utility assets, is public utility property subject to the ratemaking jurisdiction of this Commission. Applicants have provided no rationale justifying their extraordinary conclusion that the proceeds from the sale of this regulated asset could properly and unilaterally be characterized as shareholder funds.

Applicants fail to cite any authority for the proposition that the rule against retroactive ratemaking prohibits the Commission from allocating regulated asset sale proceeds, such as the patronage refund stock, to ratepayers. DRA supports the revised proposed decision and explains that the rule against retroactive ratemaking requires first that there be general ratemaking.⁷⁶ The California Supreme Court has defined general ratemaking as a Commission decision "where many variables are taken into account and broad policies are formulated" and not a "narrowly restricted" decision.⁷⁷ Here, the Commission is not engaged in general ratemaking because it is only addressing the narrow issue of the disposition of asset sale proceeds, not taking into account many variables. Moreover, that same California Supreme Court decision also recognizes that this

⁷⁶ DRA Reply Comments at 2.

⁷⁷ *Southern California Edison v. Public Utilities Commission*, (1978) 20 Cal.3d 813, 828.

Commission may “mitigate the windfall” of past over-collections by reducing future collections and that such mitigation does not violate the rule against retroactive ratemaking.⁷⁸

Applicants offered extensive comments on the revised proposed decision’s treatment of approximately \$3.6 million in redemption proceeds from Rural Telephone Bank stock obtained as a mandatory purchase with 5% of loan amounts. Relying on testimony in the record, applicants explain that the Commission did not increase applicants’ rates to provide funds for the cost of the stock, so therefore only shareholder funds could have been used to purchase the 5% stock.⁷⁹

The 5% purchased stock, like the patronage stock, arose from public utility loans included in revenue requirement and secured by public utility property. This stock, like the patronage stock, is therefore a public utility asset subject to the ratemaking jurisdiction of this Commission. As discussed above, the Utility Asset Decision directs that the redemption proceeds should be allocated based on the source of the purchase capital. The source of the purchase capital,

⁷⁸ In their Comments at 16, applicants reargue that the rule against retroactive ratemaking precludes the Commission from allocating the patronage stock proceeds to ratepayers by contending that the stock was received in previous ratemaking periods, albeit in an “illiquid and uncertain” form. Applicants’ own accounting, however, did not reflect the value of Rural Telephone Bank stock obtained as patronage refunds in the revenue requirement presented to the Commission during those prior periods, a fact which substantially undermines their argument that today’s asset sale decision would retroactively adjust applicants’ rates for those prior periods.

⁷⁹ November 19, 2009, Filing Attachment B at 39-68.

however, for the 5% stock is not immediately obvious and applicants' ratemaking history is unique and complex.

The two sources of Commission direction are the 1997 general rate case decisions and the series of decisions authorizing public utility property to be encumbered for the Rural Telephone Bank loans with 5% of those loan proceeds used to purchase stock. This limited history illustrates the Commission's perception of the mandatory 5% stock purchase as a cost of obtaining the public utility loan, and demonstrates ratemaking treatment consistent with this perception. Applicants' testimony does not reconcile its conclusions with the Commission's 1997 rate case decisions specifically rejecting applicants' position that shareholders provided the capital to purchase the 5% stock, nor does the testimony address the series of Commission decisions authorizing public utility property to be encumbered to purchase these shares for public utility purposes and not the private investment interests of shareholders. These Commission decisions directly contradict the assertions in the testimony; consequently, the testimony has limited persuasive value.

State and Federal Income Tax

Applicants argue that the Rural Telephone Bank redemption proceeds amount to be credited to ratepayers should be reduced to account for state and federal income tax consequences. Applicants cite to the Utility Assets Decision for the proposition that sharing applies only to the "after-tax" gain on asset sales.⁸⁰ However, as explained above, the par value stock redemption proceeds,

⁸⁰ Comments on Revised Proposed Decision at 24.

both the 5% purchase and patronage, originated with ratepayers and, pursuant to today's decision, are being returned to ratepayers. The relatively minor residual amounts, or the over par value, may perhaps meet the definition of "gain" for income tax purposes, however, the Rural Telephone Bank was a non-profit enterprise with only the payments of borrowers as revenue. Accordingly, it is not clear how applicants would incur income tax liability under this scenario.⁸¹ To the extent applicants may have paid income tax based on other interpretations, applicants should pursue a tax refund.

Findings of Fact

1. There are no disputed issues of material fact.
2. The Commission authorized applicants to encumber their respective public utility property as security for repayment of loans obtained from the Rural Telephone Bank, and the authorized uses for the proceeds from the loan included the mandatory purchase of Rural Telephone Bank stock.
3. Over the past 20 years, applicants have substantially increased the total amount of outstanding debt payable to the Rural Telephone Bank, Rural Utilities Service, and the Federal Finance Bank and such borrowings comprise most, and in some cases, all of an applicant's total outstanding debt.

⁸¹ Should applicants obtain an Internal Revenue Service letter ruling and/or equivalent ruling from the California Franchise Tax Board finding income tax liability on the Rural Telephone Bank stock dissolution proceeds consistent with the effects of today's decision, applicants are authorized to file a petition for modification of this decision to reduce an applicant's credit to California High Cost Fund A or basic service rates limited only to the amount an applicant can demonstrate was actually paid to the taxing authority as tax on the proceeds.

4. This proceeding is the first opportunity for the Commission to consider the appropriate ratemaking treatment for dividends, residual payments, and redemption proceeds from the sale of the Rural Telephone Bank stock.

5. Applicants acquired Rural Telephone Bank stock through three methods: (1) by direct purchase with costs not included in revenue requirement, (2) as annual patronage refunds of interest, and (3) as a requirement of obtaining loans from the Rural Telephone Bank, paid for with 5% of the proceeds from each Rural Telephone Bank loan.

6. Shareholders cost basis in the stock obtained as patronage refunds is \$0.0.

7. Applicants presented the full amount of Rural Telephone Bank loans in their cost of long term debt tabulations for general rate cases.

8. Interest on Rural Telephone Bank loans was a component of each applicant's regulated cost of service.

9. Applicants did not raise and the Commission did not address ratemaking for Rural Telephone Bank stock from the early 1970's, when applicants began acquiring it, to 1997.

10. From 1997 to 2001, the Commission, with applicants' concurrence, excluded Rural Telephone Bank stock from rate base in exchange for a higher cost of debt, and some applicants continue under this structure. Five applicants moved the stock into rate base since between 2001 and 2003.

11. The Commission considered long term debt in reviewing cost of capital and evaluating resulting return on equity.

12. Applicants received the following amounts from the Rural Telephone Bank:

Telephone Company	Rural Telephone Bank Proceeds
Calaveras	\$655,087.57
Cal-Ore	\$1,470,151.00
Ducor	\$534,076.99
Happy Valley	\$1,268,896.00
Hornitos	\$319,920.00
Kerman	\$1,507,000.00
Ponderosa	\$7,101,551.31
Sierra	\$3,471,574.00
Siskiyou	\$6,121,109.07
Volcano	\$6,918,837.19
Winterhaven	\$1,926,978.00
TOTAL	\$31,295,903.73

13. Applicants other than Happy Valley Telephone Company, Hornitoes Telephone Company, and Winterhaven Telephone Company received substantial subsidy payments in 2007 from the California High Cost Fund A.

14. Applicants were not forthcoming in disclosing the substantial proceeds from the sale of the Rural Telephone Bank stock.

Conclusions of Law

1. No hearing is necessary.
2. The Commission is prohibited from authorizing the encumbrance of public utility property for the private interests of shareholders.

3. The Commission has broad discretion in exercising its ratemaking jurisdiction and has not previously addressed the appropriate ratemaking treatment for Rural Telephone Bank dividends and stock redemption proceeds.

4. The Rural Telephone Bank stock obtained as patronage refunds was a distribution from the Rural Telephone Bank proportional to interest paid on Rural Telephone Bank loans.

5. Shareholders provided no capital to acquire the patronage refund stock.

6. Rural Telephone Bank stock obtained with 5% of the proceeds from Rural Telephone Bank loans secured by mortgages on public utility property and included in revenue requirement is public utility property subject to the ratemaking jurisdiction of this Commission.

7. The ratemaking history for the Rural Telephone Bank stock is unique and complex and requires detailed and sophisticated analysis rather than unthinkingly applying a ratemaking formula.

8. The Commission's 1997 general rate case decisions authorized applicants to recover from ratepayers the capital costs of the 5% mandatory stock purchase by an upward adjustment to the cost of debt.

9. The relatively recent inclusion of a small share of the 5% stock in rate base is not a sufficient rationale to ignore the other, far larger share that continues to be treated under the Commission's "different treatment for RTB stock," namely, as a means to increase the cost of debt.

10. The Commission's decision to adopt an overall cost of capital without specific regard to the elements of the embedded cost of debt does not negate the Commission's decision rejecting rate base treatment as appropriate for the Rural Telephone Bank stock asset.

11. The Commission's lack of specificity as to the elements of the cost of debt does not exempt those elements from Commission ratemaking jurisdiction.

12. The Commission considered all known costs, i.e., interest rates and the mandatory stock purchase, of obtaining loans from the Rural Telephone Bank in adopting an overall cost of capital for applicants.

13. Applicants have not adequately justified their proposal that shareholders should retain over \$30 million in Rural Telephone Bank stock sale proceeds and ratepayers receive about \$3,000, or that the resulting rates would be just and reasonable.

14. Applicants' proposed allocation of the proceeds from the sale of the Rural Telephone Bank stock should be denied.

15. The Rural Telephone Bank stock dividends and redemption proceeds should be credited against support from the California High Cost Fund A or, for applicants not receiving support from the fund, 2010 basic service charges.

16. The amount credited to the California High Cost Fund A or monthly line charges should include interest calculated at the cost of capital from the date of receipt, compounded monthly.

17. The amount each applicant credits to the California High Cost Fund A or basic service charges should be jurisdictionally separated and the interstate portion should be treated as directed by the Federal Communications Commission, i.e., all above cost components, such as dividends and profit, credited to ratepayers and only the original cost basis credited to shareholders.

18. The Director of the Communications Division should be authorized to approve more efficient mechanisms for crediting the Rural Telephone Bank dissolution proceeds.

19. Applicants should be authorized to submit a petition to modify this decision to reduce an applicant's credit to California High Cost Fund A or basic service rates by the income tax amount the applicant actually paid on the Rural Telephone Bank proceeds including the effects of today's decision, but only after applicants obtain an Internal Revenue Service letter ruling and/or equivalent ruling from the California Franchise Tax Board finding income tax liability on the Rural Telephone Bank stock dissolution proceeds consistent with the effects of today's decision.

20. Applicants should be required to show cause why they should not be fined for the following violations:

(A) failure to disclose the substantial revenue from the dissolution of the Rural Telephone Bank in their respective 2006 California High Cost Fund A advice letter filings as required by Decision 91-09-042, and

(B) failure to comply with Rule 1 of the Commission's Rules of Practice and Procedure for filing an application that did not disclose the actual amount at issue and not being forthcoming with relevant information.

O R D E R

Therefore, **IT IS ORDERED** that:

1. No later than 30 days after the effective date of this order, each applicant receiving support from the California High Cost Fund A fund in 2010 must file and serve an Advice Letter seeking approval of a revised 2010 draw that reflects a credit for the jurisdictionally separated intrastate portion of the amounts listed below, with ongoing interest compounded monthly at the approved cost of capital. Applicants that do not receive California High Cost Fund A support must file an Advice Letter, also no later than 30 days after the effective date of

this order, with revised 2010 basic service tariffs showing a credit, spread over a reasonable period of time, not to exceed 12 months, for the jurisdictionally separated intrastate portion of the amounts listed below, with ongoing interest compounded monthly at the approved cost of capital. All Advice Letters must include supporting workpapers showing the jurisdictional separation factor and a demonstration that the interstate portion of the amounts listed below have been credited in accordance with the Federal Communications Commission's directives.

Telephone Company	Rural Telephone Bank Proceeds
Calaveras	\$655,087.57
Cal-Ore	\$1,470,151.00
Ducor	\$534,076.99
Happy Valley	\$1,268,896.00
Hornitos	\$319,920.00
Kerman	\$1,507,000.00
Ponderosa	\$7,101,551.31
Sierra	\$3,471,574.00
Siskiyou	\$6,121,109.07
Volcano	\$6,918,837.19
Winterhaven	\$1,926,978.00
TOTAL	\$31,295,903.13

2. The Director of the Communications Division is authorized to approve deviations from Ordering Paragraph 1 where the Director finds that the

applicant has proposed an equally efficient mechanism for crediting the Rural Telephone Bank dissolution proceeds to California High Cost Fund A or, for applicants not receiving California High Cost Fund A support, to basic service charges.

3. Applicants are authorized to submit a petition to modify this decision to reduce an applicant's credit to California High Cost Fund A or basic service rates by the income tax amount the applicant actually paid on the Rural Telephone Bank proceeds including the effects of today's decision, provided that applicants first obtain an Internal Revenue Service letter ruling and/or equivalent ruling from the California Franchise Tax Board finding income tax liability on the Rural Telephone Bank stock dissolution proceeds consistent with the effects of today's decision.

4. Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Co., The Ponderosa Telephone Co., Sierra Telephone Company, Inc., The Siskiyou Telephone Company, Volcano Telephone Company, and Winterhaven Telephone Company must show cause why a fine of \$20,000 should not be levied on each applicant for each of the following alleged violations:

(A) failure to disclose the substantial revenue from the dissolution of the Rural Telephone Bank in their respective 2006 California High Cost Fund A advice letter filings as required by Decision 91-09-042, and

(B) failure to comply with Rule 1 of the Commission's Rules of Practice and Procedure for filing an application that did not disclose the actual amount at issue and not being forthcoming with relevant information.

5. Applicants must file and serve any additional evidence and legal argument that relates to the violations no later than 30 days after the effective date of this order.

6. Parties may file and serve comment on the applicants' subsequent filing no more than 10 days after the filing.

7. This proceeding is recategorized as adjudicatory.

Dated _____, at San Francisco, California.

ATTACHMENT A

List of Commission Decisions Authorizing Rural Telephone Bank Loans

LIST OF TELECOMMUNICATIONS UTILITIES WITH RUS/RTB LOAN								
	Utility	Decision No.	Date	Loan Amount	Amount Funded By RTB	Class B Stock of RTB	Net Amount of Loan	Class B Stock %
A	B	C	D	E	F	G	H	I
1	Cal-Ore Telephone Co.	D.87-06-023	06/15/87	\$875,700	\$875,700	\$41,700	\$834,000	5.00%
2	Cal-Ore Telephone Co.	D.02-06-040	06/27/02	\$6,711,750	\$2,472,750	\$117,750	\$2,355,000	5.00%
3	Calaveras Telephone Co.	D.03-09-013	09/04/03	\$7,006,750	\$2,577,750	\$122,750	\$2,455,000	5.00%
4	Calaveras Telephone Co.	D.05-06-023	06/16/05	\$7,762,000	<i>100% RUS funded</i>	<i>none</i>		
5	Ducor Telephone Co.	D.87-10-013	10/16/87	\$657,000	<i>REA/RTB</i>			
6	Ducor Telephone Co.	D.94-03-035	03/09/94	\$4,485,000	\$4,485,000	\$213,000	\$4,260,750	5.00%
7	Evans Telephone Co.(a)	D.90-10-030 ^(e)	10/12/90	\$725,000	<i>REA/RTB</i>			
8	Foresthill Telephone Co.	D.06-06-068 ^(e)	06/29/06	\$24,901,250	\$10,253,250	\$488,250	\$9,765,000	5.00%
9	Happy Valley Telephone Co.	D.91-01-036	01/25/91	\$956,550	\$956,550	\$45,550	\$911,000	5.00%
10	Kerman Telephone Co.(b)	D.93366	08/04/81	\$5,508,450	<i>REA/RTB</i>			
11	Kerman Telephone Co.	D.02-09-019	09/05/02	\$6,936,700	\$2,555,700	\$121,700	\$2,434,000	5.00%
12	Kerman Telephone Co.	D.08-02-026	02/28/08	\$7,677,000	<i>100% RUS funded</i>	<i>none</i>		
13	Ponderosa	D.92417	11/18/80	\$7,219,000	<i>REA/RTB</i>			

	Telephone Co.(c)							
14	Ponderosa Telephone Co.	D.98-09-069	09/17/98	\$20,445,000	\$20,445,000	\$971,000	\$19,474,000	4.99%
15	Ponderosa Telephone Co.	D.08-07-013	07/10/08	\$27,288,000	100% RUS funded	none		
16	Ponderosa Telephone Co.	D.93-09-047	09/01/93	\$2,623,950	\$2,623,950	\$124,950	\$2,499,000	5.00%
17	Ponderosa Telephone Co.	D.93-09-047	09/01/93	\$8,607,900	\$8,607,900	\$409,900	\$8,198,000	5.00%
18	Sierra Telephone Co., Inc.(d)	D.88-06-010	06/08/88	\$2,240,000	REA/RTB			
19	Sierra Telephone Co., Inc.	D.92-08-041	8/11/1992	\$3,062,850	\$3,062,850	\$145,850	\$2,917,000	5.00%
20	Sierra Telephone Co., Inc.	D.98-07-088	7/23/1998	\$35,500,000	\$35,500,000	\$1,669,387	\$33,830,613	4.93%
21	Siskiyou Telephone Co.	90-08-022	8/8/1990	\$6,998,250	\$6,998,250	\$333,250	\$6,665,000	5.00%
22	Siskiyou Telephone Co.	D.93-05-048	5/19/1993	\$10,587,150	\$10,587,150	\$504,150	\$10,083,000	5.00%
23	Winterhaven Telephone Co.	D.90-06-056	6/20/1990	\$2,956,800	\$2,956,800	\$140,800	\$2,816,000	5.00%
	TOTAL			\$201,732,050				

Notes:

- debt authorized by D.88-01-045 dated 1/28/88 assumed from Capay Valley Telephone System.
- D.87-10-063 dated 10/28/87 granted 5-yr. extension of time for loan funds to be advanced & extend repayment time.
- D.88-01-021 dated 1/13/88 granted 5-yr. extension of time for loan funds to be advanced & extend repayment time.
- debt authorized by D.88946 dated 6/13/78 assumed from Mariposa County Tel. Co., Inc.
- Although authorized by the Commission, loan has not completed and no RTB stock acquired.

In Column F, those showing REA/RTB means REA and RTB shared in the funding. However, amount funded by RTB cannot be determined.

REA - Rural Electrification Administration
RTB - Rural Telephone Bank
RUS - Rural Utilities Service (formerly REA)

(END OF ATTACHMENT A)