IN THE MATTER OF THE SCHEDULES FILED BY NEW JERSEY BELL TELEPHONE COMPANY INCREASING BASIC EXCHANGE TELEPHONE RATES AND INCREASING OR RESTRUCTURING THE RATES AND CHARGES FOR VARIOUS OTHER SERVICE OFFERINGS AND ASSOCIATED EQUIPMENT AND FACILITIES IN THE STATE OF NEW JERSEY

and

IN THE MATTER OF FILING BY NEW JERSEY BELL TELEPHONE COMPANY OF A REVISION OF TARIFF P.U.C.-N.J.-No. 1, PERTAINING TO NEW RATE SCHEDULES ASSOCIATED WITH HOTEL/MOTEL TELECOMMUNICATIONS SERVICE

Decided December 5, 1980

Initial Decision

SYNOPSIS

New Jersey Bell Telephone filed a petition with the Board of Public Utilities requesting approval of an increase in basic exchange telephone rates and increasing or restructuring the rates and charges for various service offerings and associated equipment.

The administrative law judge assigned to the case determined that the parties had by stipulation resolved a number of issues including rate base, rate of return and earnings issues. The judge determined that the petitioner required additional annual earnings to produce a reasonable rate of return and approved a rate design to earn an allowed rate of return of 9.44 percent.

Bernard M. Hartnett, Jr., Esq., for petitioner
Patrick F. Walsh, Esq., for petitioner
Copeland G. Bertsche, Esq., for petitioner
Daniel P. Behuniak, Esq., for petitioner
Roger L. Camacho, Esq., for respondent
Robert T. Genovesi, Esq., for respondent
MC GILL, ALJ:

On February 28, 1980, New Jersey Bell Telephone Company (hereinafter the "petitioner," "New Jersey Bell" or the "company") filed a petition with the Board of Public Utilities (hereinafter the "Board") requesting approval of an increase in basic exchange telephone rates and increasing or restructuring the rates and charges for various service offerings and associated equipment and facilities in the State of New Jersey. The proposed tariff changes were designed to produce approximately $207,300,000 in additional annual intrastate revenues. The matter was transmitted to the Office of Administrative Law for a determination as a contested case, pursuant to N.J.S.A. 52:14F-1 et seq.

Hearings were conducted on 34 days beginning with a publicly noticed hearing on April 25, 1980. Intervenor status was granted to the General Services Administration (hereinafter "GSA") appearing on behalf of the federal executive agencies, the New Jersey Telephone Company and Supreme Security Systems, Inc. (hereinafter the "alarm companies") and the Asbury Park Board of Education. With the exception of the GSA, the intervenors focused entirely on rate design issues. The Board’s Staff participated throughout the hearings. The petitioner and the Department of the Public Advocate, Division of Rate Counsel (hereinafter "Rate Counsel") submitted prefiled testimony directed to all aspects of the case.

On June 26, 1980, the petitioner filed a petition to increase certain rates for Hotel/Motel Telecommunications Service pursuant to the Stipulation Concerning Reprice Procedures approved by the Board in the petitioner’s last general rate proceeding, BPU Docket No. 7711-1136, et al. This matter (hereinafter the "Hotel/Motel proceeding") was also transmitted to the Office of Administrative Law for a determination as a contested case, pursuant to N.J.S.A. 52:14F-1 et seq. On November 14, 1980, and prior to a scheduled prehearing conference in that matter, the petitioner filed a Motion to Consolidate that proceeding with the general rate proceeding. Attached to the Motion for Consolidation was a Stipulation providing for implementation of certain tariff changes for Hotel/Motel Telecommunications Service resulting in a net revenue increase of $77,811 in the context of the general rate proceeding. The Motion to Consolidate, which was unopposed, was granted on November 26, 1980.

Subsequent to the completion of the cross-examination of the petitioner’s case, the petitioner, Rate Counsel, the Staff and the GSA submitted a stipulation resolving a substantial number of revenue
requirement issues. The stipulation was approved by the Board on September 3, 1980. As a result of the stipulation and the substitution of actual data for forecast data in the test year, the petitioner now requests an increase of $106,110,000. In its briefs, Rate Counsel recommended no increase in rates, and its position, reflecting a full twelve months of actual data, is a decrease in revenues of $10,002,000. The Staff's position is to allow an increase of $58,328,000.

Test Year

The test year proposed for this proceeding by the petitioner is the twelve month period ended September 30, 1980. No party opposed this test year. At the outset of the proceeding, the test year consisted partially of historic data and partially of forecast data. During the course of the proceeding, actual data was provided as it became available. A test year consisting entirely of actual data now provides the basis for the decision in this matter.

OPERATING INCOME

Year-End Level of Revenues

Rate Counsel proposes an adjustment increasing pro forma operating income by $13,833,000 to reflect the earnings impact of the year-end level of revenues. The purpose of this adjustment is to match year-end level of revenues and year-end rate base. Rate Counsel argues that the use of year-end rate base with test year revenues results in a mismatch since in a normal year relationship, average rate base would correspond to the test year level of revenues and expenses.

The adjustment is based on a projection of revenues for a period six months beyond the test year on the basis of a trend line analysis. To obtain the appropriate earnings effect of the adjustment, expenses for which pro forma adjustments have not been made are calculated by means of an operating ratio. The difference between the revenues and expenses so calculated provides the earnings effect. The total adjustment is divided into an added customer portion and an increased usage portion. The added customer portion is calculated directly by estimating the increase in the number of customers. The

1Unless otherwise indicated, the figures contained in the revenue requirement sections of the decision are based on the update containing a full 12 months of actual data.
increased usage portion is the difference between the total adjustment and the added customer adjustment.

The petitioner argues that the use of an end-of-period rate base is an intentional and appropriate mismatch to provide an allowance for attrition and requests that it be allowed the use of an end-of-period rate base without a revenue adjustment in order to provide such an allowance. The petitioner notes that other major utilities have adjustment clauses to help offset the effects of attrition. In addition, the petitioner attacks the accuracy of the proposed adjustment.

The Staff would make an adjustment for year-end revenues but would limit the amount of the adjustment to the benefit of using an end-of-period rate base rather than an average rate base. The adjustment as recommended by the Staff was approved by the Board in the petitioner's last general rate proceeding.

In determining the revenue requirement, it is appropriate to consider adjustments which bear on any component of the determination of the utility's earnings, and revenues constitute such a component. The Board has consistently recognized growth in revenues where such growth has been shown to exist. Here, Rate Counsel has demonstrated that significant growth in revenues will occur beyond the end of the test period, and it is evident that such revenue growth will affect the petitioner's earnings during the life of the new rates. With respect to the petitioner's argument that it requires an allowance for attrition, it is questionable whether the petitioner needs such an allowance where the earnings impact of its revenue growth exceeds the impact on earnings of the use of end-of-period rate base. Further, the petitioner's surveillance reports since its last general rate proceeding do not indicate a need for an allowance for attrition.

While recognition of growth in revenues is appropriate, Rate Counsel's proposed adjustment goes too far. As the Staff appropriately notes, Rate Counsel's adjustment exceeds the earnings effect of the use of an end-of-period rate base. Since the rationale for the adjustment, i.e., to match year-end level of revenues with year-end rate base, is quantitatively exhausted at the level of the impact on earnings from use of end-of-period rate base, it would be inappropriate to make a larger adjustment because to do so would extend the quantititative effect of the adjustment beyond the rationale which supports it. With regard to the petitioner's argument that the calculation of the adjustment is inaccurate, Rate Counsel's witness, Jamshed K. Madan, demonstrated with actual results that the same adjustment proposed by him in the petitioner's last rate proceeding was reasonably accurate.
Further, the method proposed in this proceeding is the same one as the Board approved, limited as noted above, in the petitioner's last general rate proceeding. In any event, some leeway exists for possible inaccuracy since the total adjustment proposed by Rate Counsel is not being approved. The amount of the adjustment as limited herein is $9,637,000.

Accordingly, an adjustment increasing pro forma operating income by $9,637,000 should be approved.

*August 1981 Wage Increase*

The petitioner proposes an adjustment decreasing pro forma operating income by $14,176,000 to reflect a nonmanagement wage increase which will become effective in August 1981. The proposed adjustment reflects the full annual value of the wage increase. The petitioner's main argument in favor of the increase is that it represents an expense that the petitioner will have to bear during the life of the new rates.

Rate Counsel argues that this wage increase, coming as it does ten months after the end of the test year, is too far beyond the end of the test year and should not be permitted. The Staff recommends an adjustment corresponding to five-twelfths of the increase.

The wage increase in question will occur ten months after the end of the test year and approximately seven months after the new rates will be in effect. In view of the magnitude of the proposed increase, it is evident that this wage increase must be reflected to some extent in the determination of the revenue requirement if the new rates are to provide adequate earnings for any significant period of time. The fraction of five-twelfths of the total increase proposed by the Staff will include the entire amount of the wage increase which the petitioner must pay during the first year the new rates are in effect and appears to strike an appropriate balance for a large increase which will come into effect approximately ten months after the end of the test year. The amount of the adjustment including the wage increase, the related effect on capitalized Social Security and benefits, and a corresponding adjustment for the 1981 Directory price increase, is $5,907,000.

Accordingly, an adjustment decreasing pro forma operating income by $5,907,000 should be approved.

*Productivity*

Rate Counsel proposes a productivity offset for the wage, salary
and fringe benefit increases which have been used to adjust the test year in this proceeding. The purpose of the adjustment is to reflect only the true economic cost of the increases by taking into account productivity gains as well as the wage, salary and fringe benefit increases.

The calculation of the adjustment is somewhat different from the calculation proposed for this adjustment in the prior proceeding. Here, a specific productivity offset is calculated for each individual wage, salary or fringe benefit increase. The sum of the individual offsets for each approved pro forma adjustment then constitutes the productivity adjustment.

The rate of productivity improvement was addressed in the testimony of Rate Counsel witness Dr. Glenn Meyers. Dr. Meyers expressed the opinion that a productivity growth rate of 3.5 percent would be appropriate for application to the April 1980 management increase and the August 10, 1980 wage and wage-related fringe benefit increase. For the January 1, 1981 FICA base and rate change and for the April 1, 1981 management increase, Dr. Meyers believes that a rate of productivity improvement of 4.0 percent is reasonable. For the August 1981 wage increase, Dr. Meyers believes that an annual productivity rate of 4.5 percent would be reasonable. Dr. Meyers expressed the view that these figures are conservative. In order to compensate the petitioner for the additional capital outlays that will be required to achieve the productivity improvement and in order to permit the petitioner to retain a portion of the productivity gains, Dr. Meyers has reduced each percentage rate by 2.0 percent. The effect of this deduction is to share the benefit of the productivity gains between the petitioner and its customers.

For the stipulated wage, salary and fringe benefit adjustments, the proposed productivity offset is $6,318,000. In the event that the August 1981 wage increase is approved, the productivity offset would be $9,114,000 for that adjustment alone, or a pro rata portion thereof if a portion of that wage increase is approved.

The petitioner raises a number of arguments against the adjustment. In reliance on previous Board decisions in which a proposed productivity adjustment was denied, the petitioner cites the present high rate of inflation and argues that this rate of inflation is comparable to the rate of inflation when the Board denied the productivity adjustment in the petitioner's last general rate proceeding. The petitioner further argues that no adjustment should be made so that productivity improvement will serve as an incentive for efficiency. The petitioner
claims that there is double and triple counting in the calculation of the productivity adjustment and also that past productivity gains are reflected in the test year results. The petitioner maintains that the use of labor productivity alone is not appropriate and that total factor productivity is a more comprehensive measure of productivity and more appropriate under any circumstances. The petitioner also attacks the use of Bureau of Labor Statistics data and maintains that they represent a frail measurement of productivity improvement. Finally, the petitioner argues that non-labor inflationary costs will more than offset any gains from productivity and, hence, concludes that no productivity adjustment should be made.

The Staff takes the position that inflationary conditions today are comparable to or higher than those that existed when the Board in its decision in the petitioner's last general rate proceeding denied a productivity offset due to the high rate of inflation. On this basis, the Staff recommends that no productivity adjustment be made.

The productivity results for the year 1971 through 1979 as well as the petitioner's estimates for 1980 and 1981 were introduced into evidence. During the period 1974 to 1978, the petitioner's average productivity improvement was 9.3 percent. During 1979, the rate of productivity improvement was 2.5 percent. The petitioner's estimates for 1980 and 1981 are 3 percent and 5 percent, respectively. From these figures it is evident that productivity improvement has fallen considerably since the mid-1970's. On the other hand, it appears that productivity improvement has been achieved through all phases of the economic cycle and that productivity improvement will continue to be a source of savings to the petitioner, albeit at a lower rate than in the past. Considering all the evidence on this issue, it appears that a rate of productivity improvement on the order of 4 percent can be expected during the first year the new rates are in effect.

While it appears that there will continue to be some productivity improvement, certain of the arguments raised by the petitioner are persuasive that the adjustment should not be approved at this time. As argued by the petitioner and by the Staff, the present rate of inflation is comparable to the rate of inflation at the time of the petitioner's last general rate proceeding when the Board denied a productivity adjustment due largely to the high rate of inflation. Moreover, the 4 percent rate of productivity improvement which can be expected on a prospective basis is substantially lower than the rates of productivity improvement that existed when the Board made the productivity adjustment. In view of the present rate of productivity
improvement, it seems that it would be more appropriate to allow the petitioner to retain the benefits of the productivity improvement as an incentive for efficiency. While the customers will not presently receive the benefit of the proposed productivity adjustment, the customers will benefit from the productivity improvement as reflected in test year results in future rate proceedings. It follows that under these circumstances, the proposed productivity adjustment should not be approved.

Interest Deduction for End-of-Period Cost of Debt

Rate Counsel proposes to adjust the petitioner’s federal income tax calculation to reflect the year-end level of debt. The purpose of this adjustment is to match the end-of-period federal income tax interest deduction with the end-of-period capital structure employed in determining the rate of return. In support of the adjustment, Rate Counsel argues that the adjustment reflects current Board policy on this issue and is consistent with the treatment of other major utilities.

The petitioner argues that the adjustment ignores the actual interest and tax expense during the test year and would, therefore, result in confiscatory rates. The petitioner points out that actual results for the test year will be available for the decision in this case. Viewing this adjustment as an annualization adjustment, the petitioner argues that the calculation would represent a six-month forecast of costs beyond September 30, 1980, to match expenses to end-of-period rate base and that the higher costs applicable from September 30, 1980 to March 31, 1981, would be mitigated by the relatively lower costs of debt incurred in the six-month period from April 1, 1980 to September 30, 1980. The petitioner finally argues that the adjustment represents a disallowance of taxes actually paid by the petitioner during the test year.

In its position, the Staff groups this adjustment with the other end-of-period adjustments including the revenue annualization adjustment and the separations adjustment. The Staff would then limit the total adjustment for these items to the benefit associated with the use of an end-of-period rate base as compared to an average rate base.

The use of an end-of-period capital structure for rate of return purposes typically places upon the ratepayer the additional burden of paying for higher debt costs. Associated with the higher debt costs is a benefit in the form of a greater interest deduction for federal income tax purposes. The Board has recognized that the additional
burdens and benefits of higher debt costs should be matched and, accordingly, has generally made this adjustment.

In arguing that the adjustment ignores actual test year results, the petitioner overlooks the fact that an end-of-period capital structure typically reflects greater debt costs than were borne during the test year. The petitioner's request that the customer be burdened with the higher debt cost but not receive the benefit of the corresponding interest deduction is clearly inequitable to the ratepayer and inconsistent with Board policy. The petitioner's argument to the effect that the adjustment does not recognize the lower interest deduction during the period April 1, 1980 to September 30, 1980, as compared to the deduction for the period October 1, 1980 to March 31, 1981, unsupportedly assumes there will be no increase in total debt costs during the latter period. In fact, the company's witness, Mr. Looloian, testified on another issue that there would be a debt issuance during the first quarter of 1981. This indicates that the interest deduction for the period October 1, 1980 to March 31, 1981, would be higher than the interest deduction associated with the end-of-period level of debt.

Another difficulty with this argument is that it overemphasizes the annualization nature of this adjustment. Unlike revenue annualization corresponding to end-of-period rate base where an annual figure for revenues must be determined, it is entirely possible to use a specific end-of-period figure for the interest deduction corresponding to the end-of-period level of debt.

With respect to the petitioner's argument that the adjustment is a disallowance of the taxes actually paid in the test year by the petitioner, it must be remembered that rates are set for the future. The end-of-period level of debt provides a better indication of the level of debt which the petitioner will have to bear during the life of new rates than does the test year average level of debt. Correspondingly, the end-of-period interest deduction provides a better indication of the level of the interest deduction during the period the new rates will be in effect. Accordingly, this argument is not persuasive that the adjustment should not be made.

The Staff's position does not seem to give adequate recognition to this adjustment. The proposed adjustment is not associated with end-of-period rate base and, accordingly, should not be limited by the benefit associated with the use of an end-of-period rate base. Rather, the adjustment should be made in order to reflect the interest deduction benefit corresponding to the greater burden placed on the ratepayer because of the higher end-of-period cost of debt used by
the petitioner in the capital structure for rate of return purposes.

Based upon the above, the conclusion is justified that this adjustment should be approved. The effect of the adjustment is to increase pro forma operating income by $5,499,000.

*Consolidated Taxes*

Rate Counsel proposes to adjust the allowance for the petitioner's federal income taxes to reflect consolidated tax savings. The amount of the proposed adjustment is $7,235,000.2 As an alternative, Rate Counsel recommends the use of the NARUC methodology which has been approved by the Board in previous rate proceedings of the petitioner. The amount of the adjustment under the NARUC methodology is $4,191,000. The Staff recommends application of the NARUC methodology in this proceeding.

The petitioner claims that no "savings" exist as a result of a filing of a consolidated tax return. The petitioner maintains that this adjustment represents a hypothetical tax savings and will in no way reduce New Jersey Bell's actual federal income tax liability. In addition, the petitioner attacks Rate Counsel's calculation of the proposed adjustment.

There is a threshold problem with Rate Counsel's proposed adjustment in that the record does not reflect a convincing rationale for believing that the calculation relates to any real tax savings or other tax benefits which may be attributed to the petitioner. Rate Counsel states in its brief that this methodology was adopted by the Board for Public Service Electric and Gas Company in BPU Docket No. 794-310, but there is a clear difference factually in that New Jersey Bell is a subsidiary of a parent company whereas Public Service Electric and Gas Company is not. Absent a persuasive rationale for the calculation of the proposed adjustment, it would not be appropriate to recommend approval of such an adjustment. As an alternative, Rate Counsel recommends that the NARUC methodology be approved. The purpose of the NARUC methodology is to distribute the federal income tax benefits resulting from the corporate debt of the American Telephone and Telegraph Company ("AT&T") among the various operating companies. This is appropriate since the

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2This figure is based on Rate Counsel's proposed rate of return of 9.37 percent. The amount of the adjustment would be $8,487,000 using the petitioner's proposed rate of return of 9.44 percent.
petitioner's equity is raised by AT&T in the form of both equity and debt. Associated with the debt portion of AT&T capital structure is an interest deduction. Recognizing that New Jersey Bell's equity is raised in part as AT&T debt, there is a clear basis for attributing a portion of AT&T's interest deduction to New Jersey Bell. It follows that a portion of AT&T's debt should be recognized as a source of a tax benefit to New Jersey Bell ratepayers.

Accordingly, this adjustment, calculated on the basis of the NARUC methodology, should be approved. The effect of the adjustment is to increase pro forma operating income by $4,191,000.

Accumulated Deferred FIT Reserve Surplus

As a result of the reduction of the corporate income tax rate from 48 percent to 46 percent, the petitioner's deferred federal income tax balance contains a surplus in the amount of $11,064,000. Rate Counsel proposes to amortize the surplus amount to operating income over a three-year period. The amount of the amortization would be $3,688,000, and a corresponding adjustment would be made increasing rate base by the same amount. The Staff also recommends that the surplus amount be returned to the ratepayers but would amortize the surplus over four years. The amount of the adjustment would then be $2,766,000.

The petitioner does not dispute that the surplus exists and is presently flowing the surplus through to income over the life of the plant that gave rise to the deferral. The petitioner maintains that it would be preferable to await promulgation of guidelines by the Internal Revenue Service and that to do otherwise would pose a risk to the petitioner's eligibility for liberalized depreciation treatment under the Internal Revenue Code.

All parties are in agreement that a surplus exists in the petitioner's accumulated deferred federal income tax reserve and differ only as to the time and circumstances under which it should be returned to the ratepayers. A relatively rapid amortization has the advantage of being more likely to return the surplus to the customers who provided it. With respect to the petitioner's argument that return of the surplus should be delayed until guidelines are promulgated by the Internal Revenue Service, the same argument was made two full years ago and still no guidelines have been promulgated. Rather than further delay the return of the surplus to the ratepayers, it now seems preferable to return the surplus to the ratepayers who provided that surplus, to
the greatest extent possible, and to consider such guidelines as may be promulgated by the Internal Revenue Service when they are promulgated. Such treatment would be consistent with the treatment of other utilities within the State. A four-year amortization period would provide for a reasonably prompt return of the surplus to the ratepayers.

Accordingly, an adjustment increasing pro forma operating income by $2,766,000 should be made, and a corresponding adjustment increasing rate base by $2,766,000 should also be made.

*Separations Factors*

Jurisdictional separations is a procedure by which total company expenses and plant investment are separated between intrastate and interstate expenses and plant investment. The detailed separations procedure is set forth in the NARUC-FCC Separations Manual published in February 1971. The portion of the expenses and plant investment assigned to intrastate service provides the basis for the revenue requirement to be determined in this proceeding.

Rate Counsel maintains that there is a downward trend in separations factors resulting in a smaller portion of expenses and plant investment being assigned to intrastate service. Based on this trend, Rate Counsel proposes to use end-of-period separations factors for determining the petitioner's expenses and rate base. The rationale for the proposed adjustment is that it matches the end-of-period separations factors with the end-of-period rate base.

In order to determine the end-of-period figure for the separations factors, Rate Counsel witness William W. Dunkel employed a trend line analysis based on the downward trend that has existed in separations factors for approximately two years to project specific numbers for the end-of-period separations factors. Based on this analysis, Rate Counsel would increase pro forma operating income by $4,064,000 and would reduce rate base by $22,114,000.

The petitioner, in its presentation, used average monthly separations factors and maintains that these factors are more representative of the conditions that existed during the test year. The petitioner attacks the reliability of the trend line analysis and characterizes the adjustment as a reverse mismatch since it serves to reduce test year expenses below those that were actually incurred at the separations levels that existed at the time the expenses were incurred. The petitioner also maintains that the recent decline in separations factors is unrepresentative of the long-term trend in separations factors.
Another criticism made by the petitioner is that Rate Counsel's witness did not attempt to ascertain the causes of the downward trend so as to be able to determine whether the trend is likely to continue. Yet another criticism by the petitioner is that Rate Counsel applies the separations factors to all expense and tax items regardless of whether the items are adjusted to the end-of-period level. Finally, the petitioner maintains that successive updates of the test year with actual results have substantially reduced the difference between the average separations factors and the end-of-period separations factors.

The Staff groups this adjustment with the other end-of-period adjustments and would then limit the total effect of the end-of-period adjustments proposed by Rate Counsel to the benefit of using an end-of-period rate base as opposed to an average rate base.

As recognized by the petitioner and the Staff, this is another end-of-period adjustment for which the rationale is to match with the end-of-period rate base. While this rationale is a sound one to the extent of the benefit of using an end-of-period rate base, it must be recognized that there is a quantitative limit to this rationale and further that the rationale was quantitatively exhausted by making the revenue annualization adjustment. Accordingly, the rationale of matching with end-of-period rate base cannot provide a basis for making both the revenue annualization adjustment and the separations adjustment. While it would be possible to make a separations adjustment and to reduce the revenue annualization adjustment is one that has been approved by the Board in the past, it follows that this adjustment should not be made. Another concern is that the trend upon which the adjustment is based has existed for only two years. To make a projection based on such a relatively short trend seems unduly speculative. Accordingly, the end-of-period separations adjustment should not be made.

Another separations adjustment proposed by Rate Counsel concerns other common carriers (OCC). The petitioner and Rate Counsel are in agreement that OCC items should be excluded from the intrastate rate-making determination on the basis of the fact that they constitute an interstate service. The petitioner and Rate Counsel differ, however, as to the appropriate revenue figure to be used for these items. Rate Counsel's figure is based on data provided by the petitioner, which data the petitioner later claimed was in error. Ultimately, the petitioner provided revised data which showed a substantially larger revenue figure than was originally provided. At this point, there does not appear to be any reason to doubt the petitioner's figure other
than that there was previously an error in the data. Under these circumstances, it is reasonable to accept the petitioner's figure for revenues.

RATE BASE

The only proposed adjustments to rate base concern the accumulated deferred FIT reserve surplus and the separations factors. Both of these adjustments correspond to operating income adjustments and were treated in the Operating Income section. The determination there was to increase the petitioner's rate base by $2,766,000 due to the surplus in the petitioner's deferred FIT reserve and not to make the separations adjustment. Accordingly, the petitioner's intrastate rate base is $1,597,822,000.

RATE OF RETURN

Cost of Debt

The issue here is whether the Bell System consolidated cost of debt or the New Jersey Bell embedded cost of debt should be used in the determination of the rate of return have been based upon the Bell System consolidated capital structure. The petitioner maintains that the Bell System consolidated cost of debt of 7.86 percent should be employed, while Rate Counsel maintains that the New Jersey Bell embedded cost of debt of 7.23 percent should be used.

The petitioner argues that it is improper to intermix both subsidiary and Bell System costs for various components of the capital structure because it is the consolidated Bell System capital structure, at its level and costs, which investors consider in making a market judgment as to the cost of AT&T equity. Rate Counsel maintains that it is proper to mix the New Jersey Bell cost of debt with the Bell System capital structure and claims that to employ the higher Bell System consolidated cost of debt rather than the New Jersey Bell cost of debt would result in cost subsidization of subsidiaries with higher debt costs. In response to this argument, the petitioner maintains that the difference results only from timing of debt issues. New Jersey Bell has deferred a debt issuance because of high interest rates which have existed during 1980. The petitioner anticipates the issuance of debt in the first quarter of 1981 and maintains that the debt issuance will result in the cost of New Jersey Bell debt coming back in line with the Bell System consolidated capital structure and, accordingly, would
use the Bell System consolidated cost of debt in determining the overall rate of return.

One difficulty with Rate Counsel's argument is that the record is not persuasive that the use of the Bell System consolidated cost of debt would result in cost subsidization of other Bell System operating companies. Mr. Looloian's testimony that the New Jersey Bell cost of debt is lower than the Bell System cost of debt because of the deferral of a debt issuance until the first quarter of 1981 is the most persuasive explanation of the difference between the Bell System cost of debt and the New Jersey Bell cost of debt in the record. Further, this explanation provides reason to believe that the New Jersey Bell cost of debt will soon approximate the Bell System consolidated cost of debt. Moreover, Rate Counsel's claim that it is appropriate to mix the New Jersey Bell cost of debt with the Bell System consolidated capital structure is not entirely persuasive, particularly where short-term debt is concerned. Use of the Bell System consolidated cost of debt seems more consistent with the determination of the other components of the rate of return, and no persuasive reason has been advanced for use of the New Jersey Bell cost of debt.

RATE DESIGN

Channel Services

The petitioner proposes to increase the rates for channel services and assigns these increases a priority second only to its proposal to charge for Directory Assistance. The requested increase is based on cost studies which indicate that the current costs of providing channel services are $113,000,000 and that the embedded costs of providing channel services are $74,000,000, compared to revenues from present rates of only $34,000,000. The petitioner originally proposed to increase rates to the embedded cost level in this proceeding. In its brief, the petitioner suggests raising rates approximately halfway to the embedded cost level in this proceeding and in a subsequent proceeding increase the rates to the embedded cost level with a corresponding decrease in message toll service rates. Such a proceeding would occur approximately one year after the decision in this matter and would have a zero net revenue effect.

Prior to the filing of the petition in this matter, the Board instituted a generic proceeding to investigate channel service rates under BPU Docket No. 801-48, OAL Docket No. PUC 632-80. The record in that proceeding was incorporated into the record of this proceeding. A
primary purpose of the generic proceeding was to consider a restructure of channel service rates. While some parties have addressed changes in rates for specific services in their briefs, it would not be appropriate to consider such issues again in this proceeding. Accordingly, this decision will be addressed to the appropriate revenue/cost relationship for the channel service category.

While no party to this proceeding disputes that a revenue/cost disparity exists for channel services, several arguments must be addressed. The alarm company intervenors argue that they have been denied due process of law because certain translators used in the cost studies for channel services were provided by AT&T and no witness of the petitioner could verify their accuracy. The translators are used in the conversion of current costs to indicated embedded direct costs. The essence of the alarm companies' argument is that any decision based upon the translators would be arbitrary since there is no adequate basis in the record for determining the accuracy of the translators. The alarm companies also couch their argument in terms of the residuum rule and argue that there is no residuum of legally competent evidence upon which to base a finding with respect to the translators and in turn with respect to the indicated embedded direct costs. In large measure, this argument bears on the rates for individual services which should be considered in the generic proceeding, but it also reflects on the total embedded cost level. The argument is undercut, however, by the fact that there is another source in the record for determining the embedded cost level for the channel services category. This other source is the 1979 Embedded Direct Analysis (EDA) which indicates that channel services have embedded costs of $71,500,000 and revenues of only $32,800,000. This study is based directly on embedded costs and produces essentially the same results as the channel service cost studies. This being so, the alarm companies' argument provides no basis for not raising rates for the channel service category to the embedded cost level. To the extent that the argument relates for individual services, it should be considered in the channel service generic proceeding.

Rate Counsel, the Staff, NJTAS, and the Asbury Park Board of Education would make smaller increases than those proposed by the petitioner on the basis of the impact of a large increase on the customers. Rate Counsel, focusing on customer impact, would limit the increase to 25 percent to 33 percent. Rate Counsel points out that some customers on the basis of the petitioner's cost studies would receive increases in channel service rates well in excess of 100 percent.
Rate Counsel also argues that channel services do not constitute a homogeneous category, since some services are subject to competition while others are not. NJTAS and the Asbury Park Board of Education ask for recognition of the impact while the proposed increases will have on the customers. NJTAS points out that telephone answering services are users of vertical services which were increased by 25 percent in the last proceeding and that vertical services are proposed to be increased in this proceeding along with channel services. The Asbury Park Board of Education points to the impact the proposed increases will have on its educational program, particularly in light of budget caps. The Staff would divide channel services into two categories, local loops which the Staff considers to be a monopoly service, and inter-exchange mileage, which is subject to competition. The Staff would increase the first category by approximately one-third of what the petitioner proposes in this proceeding and would increase the second category to the embedded cost level immediately. The total increase for channel services under the Staff's proposal would be $16,900,000.

No party disputes that in theory channel services should cover at least their embedded direct costs. Absent a strong public policy reason to the contrary, every service should, at the very minimum, cover its embedded direct costs. It follows that raising channel service rates to the embedded cost level is clearly an appropriate goal. With respect to the petitioner's argument that current costs are the appropriate costs for determining channel service rates, the petitioner itself recognizes that an increase to the current cost level, that is a 200 percent increase, would be too much for one proceeding. Accordingly, embedded direct costs appear to be the appropriate costs for purposes of setting channel service rates at this time.

The remaining question is how quickly to proceed in eliminating the revenue/cost disparity for channel services. Some difference in treatment has been recommended on the basis of whether the services are subject to competition. It should be noted, however, that embedded direct costs should be the minimum level for services which are not subject to competition, and clearly the rate level should not be set lower for services which are subject to competition. The difficulty with the arguments based on customer impact is that to the extent that channel service rates are priced below cost, other customers must bear the cost of providing channel services. Clearly it is preferable for the customers using a service to bear the cost of that service. No reason has been advanced for holding channel service rates below
costs on a sustained basis. Under these circumstances, it seems appropriate either to increase channel service rates to the embedded direct cost level in this proceeding or to establish a procedure which contemplates increasing channel service rates to the embedded direct cost level within a short time after the completion of this proceeding.

The company's proposal as set forth in its brief constitutes such a plan. By increasing rates halfway to the embedded direct cost level at this time and the rest of the way within one year, some consideration is given to the impact of the increases on the channel service customers while other customers are not called upon to subsidize channel service rates for an unacceptable period of time. Consideration will be given to the message toll service aspect of the proposal below.

Accordingly, channel services rates should be increased halfway to the embedded direct cost level in this proceeding. The revenue effect of this increase would be $19,000,000.

**Disaggregation**

The petitioner proposes to separate or disaggregate traditional basic exchange service into two components: one component for the provision of the station set and the other component for the provision of network access, excluding the telephone instrument. Under this proposal, a customer who subscribes to telephone service from New Jersey Bell but provides his own telephone instrument would pay only the network access charge. This contrasts with the present arrangement where the customer pays for both access to the network and the telephone instrument in the basic exchange charge and receives a credit of 75 cents for providing his own telephone instrument. While the petitioner maintains that it is presently in compliance with the FCC Registration Program, this proposal is consistent with the registration environment.

The proposal has the effect of transferring revenues and costs from the basic exchange category to the vertical services category. The net effect of the change is a revenue loss of $5,270,000 per year. This revenue loss has not been netted out of the petitioner's vertical services proposals. No party to this proceeding opposes this proposal which properly separates the telephone instrument charge from the network access charge.

Rate Counsel would go a step further, however, and disaggregate inside writing from the network access charge. The basis for this
proposal is the view that the provision of inside writing is not a natural monopoly and that customers in general would be likely to benefit from the additional flexibility and freedom in choosing the suppliers for inside wiring. Both the petitioner and the Staff view this proposal as premature. Rate Counsel in fact acknowledges that certain rules and regulations governing the installation and provision of inside writing will be necessary before a program of this type can be instituted. Under these circumstances, it seems evident that disaggregation of inside wiring should not be ordered at this time. Rather, the petitioner should be directed to address the problem of inside wiring no later than its next general rate proceeding.

Based upon the above, the proposal to disaggregate the telephone instrument charge from the network access charge should be approved, while the proposal to disaggregate inside wiring from the network access charge should not be approved at this time. The revenue effect of disaggregation is a negative $5,270,000.

Vertical Services

The fundamental dispute in the vertical services area pertains to the priority of this category relative to the basic exchange category. The petitioner assigns basic exchange a priority ahead of vertical services and would derive roughly equal amounts of revenue from these two categories. The petitioner stresses the impact on the customers in observing that vertical services rates were increased by 2.5 percent in the last proceeding while basic exchange rates have not been increased since 1975 when they were increased by approximately 5 percent. The petitioner points to the revenue/cost disparity for basic exchange service for which the 1979 EDA shows revenues of $413,300,000 and costs of $724,500,000. Vertical services rates by contrast provide revenues approximately equal to their embedded direct costs. The petitioner continues to recognize the residual pricing concept and, accordingly, would not urge that basic exchange rates be raised to the embedded cost level.

Rate Counsel interprets the residual pricing concept to mean that basic exchange rates will not be increased so long as other services may be increased to produce the revenue requirement. In this proceeding, Rate Counsel would not increase basic exchange at all for a revenue increase below $90,000,000. Rate Counsel further argues that there are sound reasons for increasing vertical services. First, vertical services are presently recovering their embedded direct costs but are
not producing any significant contribution to the common costs of the company. On the basis of an allocation of common costs to the vertical services category, Rate Counsel finds a revenue deficiency of $38,600,000. Second, Rate Counsel maintains that current costs are the appropriate costs for the vertical services category and that the use of these costs would produce an even greater revenue deficiency for this category.

The petitioner argues against assigning any portion of common costs to the vertical services category on the theory that such an assignment is arbitrary. The petitioner further argues that Rate Counsel's approach lacks balance since it would assign the bulk of the revenue requirement to the vertical services category for a second consecutive case.

The Staff views the petitioner's assignment of zero percent of common costs to the vertical services category as no less arbitrary than assigning a pro rata share of common costs. At the same time, the Staff would not accept Rate Counsel's interpretation of the residual pricing concept but rather would allow reasonable increases in basic exchange rates even if other rates could be increased.

With respect to the arguments concerning common costs, it seems appropriate that relatively discretionary services such as vertical services should provide a contribution to the common costs of the firm. A pro rata allocation such as that proposed by Rate Counsel seems preferable to no allocation at all as proposed by the petitioner. At the same time, it must be recognized that any assignment of common costs is to a degree arbitrary. Accordingly, Rate Counsel's allocation of common costs should not be viewed as revenue deficiency which must be eliminated immediately.

With regard to the residual pricing concept, Rate Counsel's interpretation is logical, but the consequences of such an interpretation seem undesirable. Considering vertical services as an example, a 25 percent increase was imposed on these services in the petitioner's last general rate proceeding, and a fairly large increase could be permitted in this proceeding. Assuming, however, that there is an upper limit to the revenues which may be derived from the vertical services category in a competitive environment, the case must come when vertical services can no longer be increased, and when other services are exhausted as well, the bulk of the increase will have to be placed upon the basic exchange category. Rather than burden the various service categories with relatively large percentage increases on a sequential basis, it seems preferable in general to increase each category gradually
and maintain continuity of rates for all service categories, that is absent a showing of a serious revenue deficiency for a given category. Under the circumstances of this case, it seems that some increase in basic exchange rates is warranted with a view to long-term continuity in both vertical service and basic exchange rates consistent with the residual pricing concept. Rate Counsel and the Staff have found that an increase in rates of $38,600,000 for the vertical services category is warranted. In the interest of continuity in rates, it seems appropriate for the revenue level recommended herein to increase revenues for the vertical services category to recover approximately one-third of the pro rata allocation of common costs recommended by Rate Counsel. This results in an increase for the vertical services category of $13,000,000, aside from items discussed individually below.

The Staff has specifically mentioned two vertical services to be treated differently. One is the Rotary 500 telephone set. Prior to the disaggregation recommended herein, a 75 cent credit was allowed where the customer provided his own telephone which could replace a Rotary 500 set provided by the petitioner. The petitioner requests that subsequent to disaggregation, the charge for this telephone set be raised to 90 cents, which increase constitutes a 20 percent increase relative to the present 75 cent credit. The Staff endorses this proposal on the basis of embedded costs of 85 cents for this service. No party opposes this proposal, and since the increase is justified on a cost basis, it should be approved. The revenue effect of this increase is $3,400,000.

A second vertical service separately identified is the Public Announcement Service (PAS) pertaining to weather ("Weather"). When the "Weather" announcement was transmitted only from Newark, a differential of 5 cents or 10 cents was instituted in order to reflect the caller's distance from Newark. The "Weather" announcement is now provided on a company-wide PAS network, and distance is no longer a factor. Accordingly, the petitioner proposes to apply a single standard rate of 10 cents for all calls to "Weather" for the report in the caller's home Numbering Plan Area (NPA) when originated from non-coin flat rate telephones. No party opposes this proposal which eliminates a charge differential which no longer serves any purpose. Accordingly, this proposal, which has a revenue effect of $90,000, should be approved.

NJTAS argues, as it did in the petitioner's last general rate proceeding, that the equipment used by telephone answering services, primarily the 557B switchboard and the concentrator-identifier system, is
relatively old vintage equipment and should not be subject to another large percentage increase as they were in the last proceeding. NJTAS points out that no cost studies have been performed with respect to this equipment.

The general arguments of NJTAS have been taken into account in the discussion of vertical service rates and basic exchange rates above. With respect to the argument that no cost study was performed, absent a cost study, it seems more appropriate to treat this equipment as part of the vertical services category than to apply no increase at all. In view of the challenge to these rates from NJTAS for the second consecutive case, it seems that it is now time that these rates be supported by cost studies. It is recommended that the Board require the petitioner to submit cost studies for this equipment in its next general rate proceeding.

Based on the above, vertical services rates should be increased by $13,000,000 plus $3,400,000 for the Rotary 500 telephone set, and $90,000 for the "Weather" announcement.

**Basic Exchange Service**

In its original filing, the petitioner proposed to increase residential basic exchange rates by $1.79 and business basic exchange rates by $2.66 per month. The primary basis for the request is the revenue/cost disparity for these services with current costs at approximately $23.00 per month contrasted with a composite rate of $7.25 per month. The petitioner maintains that even after the proposed increase, basic exchange will continue to benefit from revenue flowback from more compensatory services consistent with the residual pricing concept. Finally, the petitioner emphasizes that the rates for basic exchange service have not been increased since 1975 while costs have continued to rise contributing to further deterioration of the revenue/cost relationship.

Rate Counsel opposes any increase in basic exchange rates for a revenue requirement below $90,000,000 while the Staff would allow an increase for a revenue requirement above the $63,000,000 level.

On the basis of the discussion in the previous section and applying the residual pricing concept as interpreted therein, basic exchange rates should be increased to produce the revenue requirement. Subtracting the other increases recommended herein from the revenue requirement found herein produces an increase of $8,720,000 in basic exchange rates which should be applied across-the-board to the basic exchange category.
The petitioner has made several other proposals with regard to basic exchange rates, one of which concerns the regrouping of exchanges. Regrouping involves moving an exchange from one rate group to another and is proposed only when two consecutive annual reviews indicate that the local calling area of an exchange is outside the limits of its current rate group by at least 1 percent. The purpose of regrouping is to ensure uniform rate treatment for exchanges with local calling areas having comparable numbers of customers. It is estimated that regrouping will produce additional net revenues of $3,300,000 at test year levels, subject to such other changes as may be approved for the basic exchange category. Both Rate Counsel and the Staff would approve the proposed regrouping. Since there is no opposition to this proposal which results in uniform rate treatment of similarly situated customers, it should be approved.

Rate Counsel recommends two changes pertaining to future regroupings. First, Rate Counsel maintains that the customer count done once a year on July 1 may produce false grouping. Rate Counsel seems to raise a legitimate concern with respect to the count accuracy for shore communities where the count is made once a year. It seems desirable that the count for shore communities occur at least twice a year and be averaged. Rate Counsel, however, has not shown any adequate basis to believe that its latter concern produces inaccurate results, and accordingly, this change should not be approved.

The petitioner proposes to enhance its existing low use measured rate option 1MV-20 and to introduce a second measured rate option 1MR-75 to be made available on a state-wide basis as facilities permit. The petitioner maintains that half of the company's residential customers could benefit through subscription to one of the proposed measured rate options relative to the proposed rates for the higher-priced flat rate option. Rate Counsel would have these proposals approved but with the following modifications: (1) the call allowance would be stated in dollars and cents instead of number of calls in order to accommodate the introduction of peak/off-peak pricing; (2) the measured rate option would be introduced at a single uniform rate instead of at a rate that increases according to the number of customers in the local exchange; and (3) the low use measured rate option would contain no call allowance.

The Staff endorses the concept of measured rate service but was unwilling to endorse the proposal absent the corresponding increase in basic exchange rates since one purpose of the measured rate options is to provide an alternative to higher basic exchange rates. In its reply
brief, however, the petitioner notes that it favors implementation of these proposals even absent an increase in basic exchange rates. In the event that the proposals are approved, the Staff favors peak/off-peak pricing for the period 11:00 p.m. to 8:00 a.m.

These proposals offer additional options to the basic exchange customer including the opportunity to achieve a savings relative to flat rate basic exchange service. The petitioner has indicated that it favors implementation of these proposals regardless of whether basic exchange rates are increased. Under these circumstances, the benefits of the options to the basic exchange customer warrant approval of the proposals.

With respect to Rate Counsel's proposed modifications, it is noteworthy that the petitioner's proposals parallel the existing 1MV-20 service, while Rate Counsel's proposals seem to cause measured basic exchange service to take on the characteristics of message toll service. Rate Counsel's proposals seem to cause measured basic exchange service to take on the characteristics of message toll service. Rate Counsel's proposals seem to result in too much change and are likely to cause customer confusion. It follows that the measured rate options should be implemented at this time as proposed by the petitioner.

The petitioner also proposed certain changes with respect to two-party service. First, two-party flat rate service, 2FR, would be continued on its "obsolete" basis. Approximately 68,000 customers presently subscribe to this service. In a given year there are approximately 2,000 new subscribers while approximately 10,000 subscribers move out of this service for a net reduction of about 10% per year. Second, the petitioner proposes to eliminate the currently obsolete two-party measured rate service, 2MR-55, which presently has approximately 2,100 subscribers.

No party opposes elimination of 2MR-55 service, while Rate Counsel objects to the provision of 2FR service on an obsolete basis. Rate Counsel sees no reason for denying customers this option. The record shows, however, that there are only approximately 2,000 new subscribers to this service annually. With the introduction of 1MR-75 and the enhancement of 1MV-20, it is reasonable to assume that interest in 2FR service could only decline. Under these circumstances, the petitioner's proposals with respect to two-party service should be approved.
Directory Assistance Credit Plan

The petitioner proposes to implement a Directory Assistance Credit Plan in this proceeding and assigns such implementation its first priority in the rate design area. Under the proposed plan, a 30 cent per month credit would be applied to each central office line. In addition, each central office line will receive a three-call allowance for which no charge would be imposed. Two numbers could be requested per call to Directory Assistance. A 10 cent charge would be imposed for each call to Directory Assistance after the third call with the fourth, fifth and sixth calls applied against the 30 cent credit. Exemptions from the charge for Directory Assistance would be provided as follows: handicapped persons unable to use a telephone directory, interstate calls, hotel and motel guests, certain hospital patients, independent telephone operating company territories coin telephones, and mobile telephones.

The purpose of the plan is to prevent excessive use of Directory Assistance for which the annual cost now exceeds $50,000,000. The petitioner has attempted to limit calls to Directory Assistance by other means such as the Volume Control Program, but results of such efforts have not been sufficient to prevent excessive use.

In support of the proposed plan, the petitioner notes that the Directory Assistance charge would more equitably apportion the costs of Directory Assistance among the customers. The record indicates that 39 percent of all customers do not make any calls to Directory Assistance in a given month. Sixty-nine percent of all customers make either no calls, or three calls or less, to Directory Assistance in a given month. Eighty percent of all customers make either no Directory Assistance calls, or six calls or less, to Directory Assistance in a given month. Three percent of all customers make 31 or more calls to Directory Assistance in a given month and account for 38 percent of the total intrastate Directory Assistance calls. Twelve and one-half percent of all customers make 69 percent of the intrastate non-coin Directory Assistance calls. From a study of heavy users of Directory Assistance it was determined that most heavy users are business customers or residence customers apparently engaged in business activities, such as sales from the home. The petitioner estimates that as a result of the plan, approximately 90 percent of all customers will receive the benefit of some part of the credit, while 8 percent of all customers will receive higher bills due to the plan, with 2 percent of
all customers unaffected. The Staff would approve the plan, while Rate Counsel opposes the plan on the basis of previous Board rejections of proposed Directory Assistance charge plans.

The trend in telephone rates seems to favor a Directory Assistance charge plan. Telephone rates including basic exchange rates are becoming increasingly usage sensitive. At the same time, with continued inflation the opportunity to save by means of efficient location of telephone numbers becomes increasingly important, both for the petitioner and for the customers. Moreover, the plan is basically a sound one. The plan allocates costs to the cost-causers and is expected to result in a reduction in rates for 90 percent of all customers. The three-call allowance and the 30 cent credit will be more than adequate to accommodate the needs of the average customer with only the heavy, primarily business users experiencing a net increase. Under these circumstances, it appears that the proposed plan should be approved.

Three issues concerning the revenue effect of this proposal must be resolved. One issue concerns the estimated expenses of $310,119 associated with the costs of transferring Directory Assistance operators and other non-management employees from Directory Assistance bureaus to other positions. Rate Counsel and the Staff argue for a five year amortization of this expense. Since these costs constitute a one time expense, which will occur only during the first year the new rates are in effect, a five year amortization seems appropriate. The net benefit of this change is $248,000.

The second item concerns the Volume Control Program. The petitioner would include costs which were previously associated with the Volume Control Program as part of the costs of the Directory Assistance Credit Plan based on the fact that the items that gave rise to these costs will now be used for the benefit of the Directory Assistance Credit Plan. Rate Counsel and the Staff opposes this item because the costs are attributed to the Directory Assistance Credit Plan or the Volume Control Program, expenses included in the test year results should not be counted again in determining the revenue effect of the proposed rate change. It follows that this expense should not be considered in calculating the revenue effect of the Directory Assistance Credit Plan. The net benefit of this change is $862,000.

The third item concerns the cost of additional directories. The petitioner estimates an annual cost of $1,147,600 during the first year the plan is in effect and an annual expense of $57,400 during subsequent years. The petitioner would amortize the first year amount over five years and add this to the annual figure of $57,400 for each
subsequent year. The petitioner would then subtract a portion of the expenses attributable to the Volume Control Program to produce a net result of $264,000. Rate Counsel maintains that the petitioner overstates these costs by adding the amortization figure from the first year to the costs for subsequent years. The petitioner is entitled, however, to reflect in the revenue effect of the plan its increased costs including an amortization of the relatively large one time expense which will occur during the first year the plan is in effect. While the calculation could be improved marginally, there does not seem to be any consequential deficiency in the petitioner's calculation. Accordingly, this modification of the revenue effect calculation should not be approved. The net effect of the three items in issue is to increase the revenue benefit from the proposed plan by $924,000.

Based upon the above, the proposed Directory Assistance Credit Plan should be approved with a net revenue benefit of $4,800,000.

Local Coin Telephone Service

The petitioner originally proposed to increase the rate for a local coin call from 10 cents to 25 cents based upon the current costs of such a call which the petitioner claims are 29 cents. In its reply brief, the petitioner submitted a revised Appendix J. The revised Appendix J does not provide for an increase in the local coin rate.

Rate Counsel opposes the proposed increase for the following reasons. First, the petitioner has assigned all non-traffic sensitive costs such as the access wire, station, and telephone booth to local coin service, while Rate Counsel maintains that these costs should be apportioned among local coin service, intrastate toll service, and interstate toll service. Second, the petitioner has not drawn a distinction between local coin service and semi-public coin service. Third, the 11 percent rate of return used by the petitioner to determine the costs of this service is excessive.

Rate Counsel acknowledges that local coin telephone service is not covering its cost at the 10 cent rate but maintains that the proposed increase is unwarranted. The Staff for the same reasons as set forth above would not allow the proposed increase.

Rate Counsel and the Staff have raised significant arguments against the proposed increase, while the petitioner now assigns the proposed increase a priority such that the increase would not be made for any revenue requirement that could approved in this proceeding. Under these circumstances, the proposed increase should not be approved.
Semi-Public Telephone Service

Semi-public telephone service is an exchange service available for business customers where the telephone service requirement and the coin revenue do not show the need for public telephone service. This service is provided upon the request of the customer and meets the telephone needs of both the customer and the transient public. The rate for this service is presently $2.00 per month in addition to the daily guarantee which must be met by the customer. The daily guarantee in rate group D, for example, is $.52. The daily guarantee may be offset by coin box revenues. The petitioner proposed to increase the monthly rate from $2.00 to $6.00 and to increase the daily guarantee by 25 percent. This proposed increase is not reflected on the petitioner's revised Appendix J.

Rate Counsel based its analysis of this proposed increase on a comparison to business exchange service and maintains that the costs of providing this service are $9.89 above the present business auxiliary monthly rate for which Rate Counsel identifies a composite rate of $6.14. The total cost of $16.03 compares to the present monthly rate of $2.00 for semi-public telephone service. On the basis of this cost analysis, Rate Counsel endorses the proposed increase in the monthly rate from $2.00 to $6.00. To produce additional revenue from this service Rate Counsel would withdraw the tariff provisions which allow the use of coin box collections as offsets against the daily guarantee. The basis for this position is the view that the usage charges reflected in coin box collections presently, and contrary to what was once the case, do little more than offset their own costs and, accordingly, should not be viewed as an offset against the costs of providing the basic service. Rate Counsel opposes an increase in the daily guarantee because it would disproportionately impact the 30 percent of subscribers whose coin box collections do not cover the daily guarantee. By comparison, Rate Counsel's proposal to withdraw the offsets would impact 70 percent of the subscribers. The increase in the monthly rate would produce $1,375,000 in additional revenues while the changes in the guarantee provisions can produce up to $4,250,000 in addition revenues annually. In addition, Rate Counsel recommends the institution of a $20.00 nonrecurring installation charge because of the high level of "churning" in the semi-public telephone service category. Such a charge would produce approximately $100,000 annually in additional revenues. The Staff endorses the increase in the monthly rate from $2.00 to $6.00 and the installation charge rec-
ommended by Rate Counsel. The Staff opposes the 25 percent increase in the daily guarantee because of the disproportionate impact such a charge would have on customers who did not satisfy their daily guarantee.

All parties recognize that a significant revenue/cost disparity exists for this service. An increase in the monthly rate will be a step toward raising the rates for this service to the cost level, and the institution of a $20.00 installation charge will help reduce costs as well as produce additional revenues. The petitioner's proposed increase in the daily guarantee seems to impact disproportionately those customers who do not satisfy the daily guarantee, while Rate Counsel's proposal to withdraw the coin box revenues as offsets against the guarantees seems to be effectively very similar to a further increase in basic monthly charge. An increase from $2.00 to $6.00 seems to be a sufficient increase for one proceeding. It follows that withdrawal of coin box revenues as an offset against guarantees should not be approved at this time.

Accordingly, an increase in the basic monthly charge from $2.00 to $6.00 and institution of $20.00 installation charge for semi-public telephone service should be approved. The revenue effect of these changes is $1,480,000.

Nonrecurring Charges

Nonrecurring charges are one time charges applicable to connection, move or change of telephone services and facilities. The petitioner presently has a four-element multi-element non-recurring charge plan as well as other nonrecurring charges not covered by the multi-element plan. In this proceeding, the petitioner proposes to restructure the four-element nonrecurring charge plan to a six-element nonrecurring charge plan. The four elements of the present plan are the service ordering charge, the line connection charge, the premises work charge and the station handling charge. Under the six-element plan, the charges are the service ordering charge, the central office line charge, the premises wiring charge, the station handling charge, the jack charge and the premises visit charge. The prewiring charge for residence dwellings represents a new charge. The petitioner originally proposed to increase these rates by 25 percent to produce approximately $6,370,000 in additional revenues. Further, the petitioner proposed increases for other nonrecurring charges producing additional revenues of $5,470,000 net of curtailment.
In its revised Appendix J, the petitioner requests additional revenues of only $50,000 from these services for a revenue increase of up to $100,000,000. The $50,000 figure is based upon a restructure of the multi-element nonrecurring charge plan, the petitioner, Rate Counsel and the Staff all favor the restructure which will have the beneficial effects of more closely relating charges to the work function performed and creating a rate structure more readily understood by the customers. Similarly, no parties specifically oppose the increase in the maintenance of service charge which appears to be cost justified. With respect to Rate Counsel’s proposal to institute a disconnection charge, this proposal appears likely to create administrative difficulties in the form a higher incidence of uncollectibles and a discouragement on the customer’s part from notifying the telephone company to disconnect service. Accordingly, the proposed restructure of the multi-element charge plan should be approved along with the increase in the maintenance of service charge, while a disconnection charge should not be approved. The revenue effect of these changes is a positive $50,000.

Selective Calling

Selective calling is a service which provides special rate treatment for calls to nearby exchange areas outside the customer's local calling area. A customer may select individual exchanges that are normally 10 cent or 16 cent initial period toll routes. The petitioner proposes three changes with respect to this service. First, the petitioner proposes the introduction of a residence measured rate selective calling offering designed for introduction in conjunction with the proposed residence measured rate options 1MR-75 and 1MV-10. This new offering will also be available for residence customers who retain flat rate basic exchange service. The revenue impact of this offering is expected to be a negative $243,000 at test year levels. The second change is the introduction of a 20 hour limit on the existing residence selective calling offering with proposed charges for usage beyond that limit of three cents and five cents per minute for the 10 cent and 16 cent toll routes, respectively. The revenue effect of this change net of curtailment is expected to be a positive $1,113,000 at test year levels. The third change is a change in the application of the flat rate change per route from a “per line” basis to a “per account” basis. The revenue impact of this change is estimated to be a negative $666,000 at test year levels. The net effect of the three changes is a revenue increase of $204,000.
Rate Counsel does not oppose these changes while the Staff would approve the changes with the exception of the residence measured rate selective calling offering evidently because the Staff did not recommend the introduction of the other residence measured rate options.

The 20 hour limit per route on the existing residence selective calling offering is reasonably calculated to prevent excessive usage due to a flat rate, while the change in the flat rate charge per route from a "per line" basis to a "per account" basis eliminates the situation where a multi-line customer must pay a per route charge for each line with no particular rationale to support such treatment. With respect to the selective calling offering proposed for introduction with the proposed residence measured rate options, no reason has been advanced in opposition to this proposal which provides an additional option to the customers where the proposed residence measured rate options, 1MR-75 and 1MV-10, are approved as recommended herein. Accordingly, the three changes proposed by the petitioner should be approved. The revenue effect of these changes is a positive $204,000.

Message Toll Service and WATS

Rate Counsel proposes a reduction in certain short-haul initial period and overtime message toll service (MTS) rates during the evening and night periods. Rate Counsel would make a net reduction in these rates of $6,700,000 (an $8,400,000 reduction in revenues minus a $1,700,000 stimulation effect) even if no increase in revenues is approved in this proceeding. The basis for this position is that the 1979 EDA shows this service to be priced well above costs. In addition, Rate Counsel would increase the charges for flat rate WATS service in order to cause customers to shift to the more usage sensitive measured rate WATS service.

The petitioner opposes these changes on the grounds that MTS is not overpriced since it is intentionally priced above costs in order to provide contribution to basic exchange service and argues that its toll rates are lower than the toll rates in neighboring jurisdictions. Further, the petitioner objects to Rate Counsel's claim of a stimulation effect from reducing rates for MTS service when Rate Counsel refuses to recognize curtailment associated with increases in rates. The petitioner has suggested in its reply brief, however, that MTS rates could be reduced in a zero net revenue proceeding in order to increase channel service rates. With respect to WATS service, the petitioner argues that the "broad brush" statements of Rate Counsel are not sufficient to
justify rate changes for an extensive service category such as WATS.

The Staff believes that a realignment of WATS rates may be necessary but would do so in another proceeding not later than the petitioner's next general rate proceeding.

As contemplated by Rate Counsel, the reductions in MTS rates would result in a further increase in vertical service rates. While MTS is priced well above costs, in view of the increases in rates which have recently been imposed upon the vertical services category, it does not seem appropriate to reduce other rates in order to raise vertical services rates. Moreover, the contribution from MTS serves to maintain low basic exchange rates. In the event that MTS rates were to be reduced, such reduction could more appropriately be used to counter-balance increases in channel service rates which are below cost in a separate zero net revenue proceeding as proposed by the petitioner.

With respect to WATS, the record is not very extensive with regard to this issue, and Rate Counsel's argument for raising the charge for flat rate WATS is not persuasive. Under these circumstances, it seems appropriate to defer any changes in WATS rates until a general realignment of WATS rates may be considered as proposed by the Staff.

Accordingly, the proposed rate changes for MTS and WATS should not be approved at this time.

Message Units and Econo-Pak

In its original filing, the petitioner proposed an increase in message unit charges from 6.5 cents to 7.5 cents for the first five minutes or fraction thereof and an increase in Econo-Pak rates from $5.85 to $6.75 per month for residence customers and from $11.70 to $13.50 per month for business customers. The petitioner based these proposed increases on a 1979 current cost of 6.22 cents per message unit, including set up. The proposed increases in Econo-Pak rates were intended to keep those rates in balance with the proposed message unit rate increases. These proposed increases were not reflected in the petitioner's revised Appendix J as submitted in its reply brief.

Rate Counsel disputes the petitioner's cost estimate and opposes the proposed increases. In addition, Rate Counsel proposed the introduction of off-peak rates by lowering the message unit rates for usage between 11:00 p.m. and 8:00 a.m. by 60 percent. The Staff favors peak-off/off-peak pricing.
The benefits of peak/off peak pricing are that it will encourage the use of idle capacity during the off-peak hours and tend to shift usage from the peak hours to the off-peak hours. Such pricing may produce cost savings by reducing usage during hours of peak usage while reflecting the benefit of lower costs during the off-peak hours in customers' rates. Accordingly, the message unit rates for the period 11:00 p.m. to 8:00 a.m. should be reduced by 60 percent. The revenue effect of this rate reduction is a negative $1,200,000. With respect to the proposed increases in these rates, Rate Counsel opposes the rate increases for the reason set forth above while the petitioner has not reflected these increases in its revised Appendix J. Accordingly, these increases should not be approved.

Curtailment

The petitioner proposes a 1 percent curtailment factor in this proceeding for application to those services which are subject to curtailment with the exception of channel services for which a 3 percent curtailment factor based on a range of 2 percent to 4 percent is proposed. Curtailment in local coin service need not be considered since that proposed increase has not been recommended. Curtailment in the Directory Assistance area is subject to a separate analysis and likewise need not be considered here. The petitioner's estimates of curtailment are not based on studies but rather are based on expert judgment. The petitioner notes that the Board has previously approved recognition of curtailment. Rate Counsel and the Staff maintain that the petitioner has failed to prove that its requested curtailment factors are reasonable.

Curtailment is the market reaction to an increase in price. While the Board has consistently recognized this phenomenon in pricing discretionary services in the past, the percentage increase in vertical services in the petitioner's last general rate proceeding was much greater than the percentage increase recommended herein. There, the increases were on the order of 15 percent and 25 percent as compared with approximately 5 percent here. For such a modest increase in vertical services rates, a curtailment factor of 1 percent seems excessive, and the petitioner's proofs on this issue are not persuasive that curtailment at the 1 percent level will occur for the percentage increase recommended herein. With respect to channel services, the percentage increase recommended herein is substantially larger than the percentage increase for vertical services and warrants different treat-
ment. Since the petitioner's proofs on this issue are still somewhat weak, it is appropriate to accept the lower end of the range of curtailment proposed for this service. This results in a 2 percent curtailment factor for channel services.

Accordingly, curtailment should not be recognized in this proceeding for vertical services, while a 2 percent curtailment factor should be allowed for channel services.

**Flowback of Additional Contributions Generated by Repricing Procedures**

In the petitioner's last general rate proceeding, the Board approved a Stipulation Concerning Reprice Procedures. The stipulation created a contribution pool and provided in part as follows:

(b) After the effective date of any order in the next succeeding general rate case following approval of this Stipulation there shall be and hereby is established for said contribution pool a "trigger" point of twelve million ($12,000,000) dollars, which, when and if reached between pending general rate cases, shall cause the pool to be distributed or flowed back to a class or classes of ratepayers.

(c) The class or classes of ratepayers who shall be beneficiaries of such distribution of the contribution pool, as provided in the preceding subparagraph, shall be determined by the Board in the next succeeding general rate case following approval of this Stipulation.

The "next succeeding general rate case" mentioned in the above language is this proceeding.

The petitioner urges that the additional contributions be returned to the same general class of customers who generated the contribution in the first place. As a practical matter, it appears that this would generally mean that the contribution would be returned to vertical services customers. Rate Counsel bases its position on the residual pricing concept and argues that the additional contribution should flow back to the basic exchange customer. The Staff recommends that the additional contribution be used to reduce MTS rates.

Since the flowback from the contribution pool will serve to reduce rates, it is appropriate that the flowback of revenues should be directed to a service category which warrants a rate reduction. In this regard, MTS stands out as a service priced well above its costs. Vertical services, on the other hand, should be priced to produce
contribution and may well require further increases, while basic exchange service is already a benefited service priced well below its costs. Under these circumstances, it is appropriate that the contribution pool should be used to reduce MTS rates.

Itemization

Currently the petitioner does not itemize equipment charges for residential customers on their monthly bills. Rate Counsel proposes that the petitioner include an itemization in the residential customer's bill at least once quarterly. Such itemization would make customers aware of the charges for the various equipment to which they subscribe and allow the customers to make informed choices as to whether to continue to subscribe to such equipment. The petitioner opposes this proposal on the grounds that it would be administratively costly and that such information is available to customers upon request.

It seems appropriate that residential customers should have ready access to an itemization of their monthly charges. Quarterly itemization as proposed by Rate Counsel seems unduly burdensome administratively in that the petitioner would be required to provide itemizations for customers who may have no desire for such information. Instead, an explicit statement made quarterly in the customer's bill as to how to obtain an itemization seems to be a more efficient way to provide customers who desire such information with an itemization of their monthly charges.

Hotel/Motel Telecommunications Service

The petition to increase the rates for Hotel/Motel Telecommunications Service was originally filed as a repricing pursuant to the Stipulation Concerning Reprice Procedures. Issues were raised as to whether the services were sufficiently competitive to qualify under the reprice procedures and as to the amount of the contribution. The parties were able to resolve the matter through a Stipulation which is premised upon incorporation of the Hotel/Motel proceeding with the petitioner's general rate proceeding. The Stipulation appears reasonable and should be approved. The net revenue effect of the proposed increase is $77,811.

After consideration of the entire record, I FIND:

1. New Jersey Bell Telephone Company is public utility of the
State of New Jersey, subject to the jurisdiction of the Board of Public Utilities.

2. In a stipulation approved by the Board in its Order dated September 3, 1980, the parties resolved a number of issues, including rate base, rate of return and earnings issues, thereby eliminating the need for further findings and conclusions on those specific issues.

3. Rate Counsel proposes an adjustment to increase pro forma operating income by $13,833,000 to reflect year-end level of revenues attributed to customer growth and increased usage.

4. Rate Counsel has demonstrated by means of a trend line analysis that the petitioner will experience growth in revenues beyond the end of the test year.

5. The revenue annualization adjustment matches year-end level of revenues with year-end rate base.

6. The amount of the proposed adjustment exceeds the rationale which supports it.

7. An adjustment limited to the benefit associated with year-end rate bases should be approved. Such an adjustment would increase pro forma operating income by $9,637,000.

8. The petitioner proposes an adjustment to decrease pro forma operating income by $14,176,000 to reflect a non-management wage increase which will become effective in August of 1981.

9. The wage increase represents an expense that the petitioner will have to bear during the life of the new rates.

10. The increase will take effect ten months after the end of the test year.

11. An adjustment corresponding to five-twelfths of the increase represents the portion of the increase which the petitioner will have to bear during the first year the new rates are in effect and strikes an appropriate balance for an increase which occurs ten months after end of the test year.

12. An adjustment decreasing pro forma operating income by $5,907,000 to reflect the August 1981 wage increase should be approved.

13. Rate Counsel proposes a productivity offset in the amount of $6,318,000 for the wage, salary and fringe benefit increases used to adjust the test year. The productivity offset corresponding to the August 1981 wage increase along is $9,114,000.

14. The petitioner has achieved productivity improvement during each year of the last decade.
15. In 1979, the rate of productivity improvement was 2.5 percent compared to rates of productivity improvement on the order of 9 percent during the mid-1970's.

16. The rate of productivity improvement during the first year the new rates are in effect is likely to be 4 percent.

17. The rate of inflation during the first year the new rates are in effect is likely to be on the order of 10 percent.

18. Allowing the petitioner to retain the benefits of productivity improvement will provide and incentive for efficiency.

19. The proposed productivity adjustment should not be approved.

20. Rate Counsel proposes an adjustment increasing pro forma operating income by $5,499,000 to reflect the interest deduction associated with the year-end level of debt which corresponds to the end-of-period capital structure used to determine the petitioner's overall rate of return.

21. Matching the year-end level interest deduction with the year-end level of debt properly associates the burdens and benefits of using the year-end level of debt for rate of return purposes.

22. The use of year-end rate base is unrelated to this adjustment, and it follows that this adjustment should not be limited by the benefit associated with use of year-end rate base.

23. An adjustment increasing pro forma operating income by $5,499,000 should be approved to reflect the year-end level interest deduction corresponding to the year-end level of debt used to determine the rate of return.

24. Rate Counsel proposes an adjustment related to consolidated taxes to increase pro forma operating income by $7,235,000. As an alternative, Rate Counsel proposes use of the NARUC methodology which produces an adjustment increasing pro forma operating income by $4,191,000.

25. There does not appear to be an adequate rationale in the record to support Rate Counsel's first proposal on this issue.

26. New Jersey Bell's equity is raised by AT&T in the form of equity and debt.

27. The NARUC methodology distributes the tax benefit associated with AT&T's debt among the subsidiaries.

28. Since there is a tax benefit in the form of AT&T's interest deduction associated with the debt invested in New Jersey Bell, the ratepayers should receive the benefit of that interest deduction.

29. An adjustment to reflect the benefit of AT&T's debt based
upon the NARUC methodology should be approved. The effect of such an adjustment is to increase pro forma operating income by $4,191,000.

30. As a result of the Revenue Act of 1979, which reduced the corporate income tax rate from 48 percent to 46 percent effective January 1, 1979, a surplus exists in the petitioner's deferred tax reserve.

31. The petitioner is flowing that surplus through to income over the life of the plant that gave rise to the deferral.

32. Rate Counsel proposes to return the surplus to the ratepayers over a three year period, while the Staff proposes to return the surplus to the ratepayers over a four year period.

33. The surplus should be returned to the ratepayers, and a more rapid amortization has the benefit of being more likely to return the surplus to the customers who provided it.

34. A four year amortization to return the surplus to the ratepayers is reasonable and should be approved. The effect of the adjustment is to increase pro forma operating income by $2,766,000. A corresponding adjustment should be made increasing rate base by $2,766,000.

35. Rate Counsel proposes an adjustment increasing pro forma operating income by $4,064,000 and an adjustment decreasing rate base by $22,114,000 to reflect end-of-period separations factors.

36. Rate Counsel's end-of-period separations factors were developed by trending two years of historical data which reflect a downward trend in separations factors.

37. The rationale for the adjustment is that it matches end-of-period separations factors with end-of-period rate base.

38. The rationale of matching with end-of-period rate base was quantitatively exhausted by the revenue annualization adjustment.

39. The petitioner's test year average separations factors reflect the downward trend in separations factors as it existed in the test year.

40. A projection of separations factors based on a two year trend is unduly speculative.

41. The proposed separations adjustment should not be made.

42. Rate Counsel proposes that all plant, revenues and expenses associated with the provision of certain non-ENFIA (Exchange Network Facilities for Interstate Access) exchange network
facilities to other common carriers be removed from the intrastate jurisdiction since the related services are regulated by the Federal Communications Commission.

43. The petitioner agrees to the removal of these items, arguing only that $3,500,000 in operating revenue be removed from the intrastate jurisdiction rather than the $604,000 originally proposed by Rate Counsel.

44. Rate Counsel's original position was based upon information provided by the petitioner that the petitioner later claimed contained erroneous figures.

45. The petitioner's revised revenue figure should be used to remove interstate revenues from the intrastate revenue requirement determination.

46. The petitioner proposes that all elements of the Bell System consolidated capital structure be utilized in this proceeding to determine and calculate the overall rate of return for New Jersey Bell.

47. Rate Counsel proposes that the Bell System consolidated capital structure be utilized for those same purposes except that it would incorporate the embedded cost of debt at the level experienced by New Jersey Bell rather than that experienced by the Bell System as a whole.

48. The difference in cost between the New Jersey Bell embedded cost of debt and the Bell System embedded cost of debt appears to be caused by the deferral of the issuance of debt by New Jersey Bell from the spring of 1980 when interest rates were very high to the first quarter of 1981.

49. The record is not persuasive that it is appropriate to mix two separate capital structures by simply inserting one component of one capital structure into the other capital structure.

50. The Bell System consolidated embedded cost of debt should be used to determine the petitioner's overall rate of return.

51. Based on the 1979 Embedded Direct Analysis, the embedded direct costs of providing channel services are $71,500,000.

52. The revenues from channel services at present rates are $32,800,000.

53. Channel service rates produce revenues $38,700,000 below embedded direct costs.

54. Channel services should cover their embedded direct costs.

55. Rates for channel services should be raised to their embedded direct costs promptly with a first step increase, consistent with
the restructure in channel services generic proceeding, of $19,000,000.

56. The petitioner proposes to further separate the rates and charges for station instruments or telephone sets from the rates and charges for the provision of exchange access service consistent with prior orders of the Board and the FCC Registration Program.

57. The proposal is unopposed and has a revenue effect of a negative $5,270,000.

58. Vertical services as a category are covering their embedded direct costs.

59. Based upon a pro rata allocation of common costs, to which vertical services should contribute, vertical service rates may be increased by $38,600,000.

60. Consistent with maintaining continuity of rates in the vertical services and basic exchange categories and with the revenue requirement found herein, vertical services rates should be increased by $13,000,000, which is approximately one-third of the increase justifiable on the basis of an allocation of common costs.

61. The petitioner proposes to increase the disaggregated rate for a Rotary 500 telephone set by 20 percent to 90 cents.

62. The proposed increase for the Rotary 500 telephone set is cost justified and should be approved. The revenue effect of this increase is $3,400,000.

63. The petitioner proposes to apply a single standard rate of 10 cents for the "Weather" announcement.

64. The proposed increase will eliminate a differential based upon distance that is no longer appropriate.

65. The proposed increase for the "Weather" announcement should be approved.

66. The petitioner originally proposed to increase residential basic exchange rates by $1.79 and business basic exchange rates by $2.66 per month.

67. Rate Counsel would not increase basic exchange rates for a revenue requirement of less than $90,000,000, while the Staff would not increase basic exchange rates for a revenue requirement of less than $63,000,000.

68. Basic exchange rates do not cover the embedded direct costs of providing basic exchange service.
69. Based on the residual pricing concept and consistent with continuity of rates and the revenue requirement found herein, basic exchange rates should be increased by $8,720,000.

70. The petitioner proposes to introduce a new residence measured service option, 1MR-75, and an enhanced low use measured residence service, IMV-10.

71. Since the proposed service options will provide the customers with additional choices as to service and will provide some customers the opportunity to reduce their monthly charges, these proposed service options should be approved.

72. The petitioner proposes to "obsolete" two-party flat rate service (2FR), i.e., to continue it for existing customers only.

73. There is minimal new interest in this service offering and the proposed measured rate service options will largely fill this need.

74. The petitioner's proposal to obsolete 2FR service should be approved.

75. The petitioner proposes to eliminate 2MR-55 service, which is currently in an obsolete status. No party opposes this proposal.

76. The proposal of the petitioner to terminate this service one year after implementation of the residence measured service options approved herein should be approved.

77. The petitioner proposes to implement a Directory Assistance Credit Plan as described above.

78. The Directory Assistance Credit Plan will be beneficial to most customers and will prevent excessive use of this service.

79. The Directory Assistance Credit Plan should be approved with a revenue effect of a positive $4,800,000.

80. The petitioner originally proposed to increase the rate for a local coin telephone call from 10 cents to 25 cents.

81. This proposed increase is not reflected in the petitioner's revised Appendix J.

82. Rate Counsel and the Staff oppose the proposed increase in the local coin rate.

83. The proposed increase in the local coin rate should not be approved.

84. The petitioner originally proposed to increase the monthly rate for semi-public telephone service from $2.00 to $6.00 and to increase the guarantees 25 percent. These increases are not reflected in the petitioner's revised Appendix J.
85. Rate Counsel proposes to increase the monthly rate for semi-public telephone service from $2.00 to $6.00 and to withdraw the offsets.

86. Based upon a comparison to business exchange service, the monthly cost of providing semi-public telephone service is $16.03 compared to a rate of only $2.00 per month.

87. An increase in the guarantees would disproportionately impact the 30 percent of customers who do not meet their guarantees.

88. An increase in the monthly rate for semi-public telephone service from $2.00 to $6.00 is cost justified and should be approved. The revenue effect of this increase is $1,375,000.

89. The introduction of an installation charge should tend to reduce excessive "churning" in the semipublic telephone service category. The revenue effect of the charge is a positive $100,000.

90. The petitioner proposes to introduce a six multi-element charge plan similar in concept to the four multi-element charge plan currently in existence.

91. For the revenue increase recommended herein, the restructure would occur with no revenue increase except for the implementation of a new prewiring charge for residence dwellings with a revenue effect of $40,000 and an increase in the maintenance of service charge with a revenue effect of $10,000.

92. No party opposes the petitioner's proposals which should be approved with a revenue effect of a positive $50,000.

93. Rate Counsel proposes implementation of a disconnection charge.

94. It appears that a disconnection charge would cause a higher incidence of uncollectibles as well as other administrative difficulties and should not be approved.

95. The petitioner has proposed three structural modifications to its selective calling option.

96. The three structural modifications are reasonable and should be approved. The net revenue effect of the changes is a positive $204,000.

97. Message toll service is priced above cost to provide a contribution to basic exchange service and the common costs of the company.

98. Message toll service rates should not be reduced at this time in order to increase vertical services rates.

99. The petitioner originally proposed an increase in message unit
charges from 6.5 cents to 7.5 cents and an increase in Econo-
Pak rates from 5.85 to $6.75 per month for residence customers
and from $11.70 to $13.50 per month for business customers.

100. These proposed increases are not reflected in the petitioner's
revised Appendix J.

101. Rate Counsel disputes the petitioner's cost estimates and op-
poses the increases.

102. Message unit charges and Econo-Pak rates should not be in-
creased at this time.

103. Rate Counsel proposes peak/off-peak pricing for message
units.

104. Costs of service at off-peak hours are considerably less than
costs during peak hours.

105. Message unit rates for the period 11:00 p.m. to 8:00 a.m. should
be reduced by 60 percent.

106. The petitioner has proposed a 1 percent curtailment factor for
vertical services and a 3 percent curtailment factor for channel
services.

107. The record is not persuasive that curtailment should be re-
cognized for vertical services for the level of increase approved
herein.

108. A 2 percent curtailment factor for channel services appears
reasonable and should be approved.

109. Based upon the Stipulation of the parties, the increase in rates
for Hotel/Motel Telecommunications Service appears reason-
able and should be approved.

Based upon the above, I CONCLUDE:

1. The petitioner's pro forma operating income at present rates
is $220,701,000, as per schedule A.

2. The petitioner's intrastate rate base is $2,597,822,000.

3. The petitioner's fair rate of return is 9.44 percent.

4. The petitioner's allowed operating income is $245,234,000.

5. The petitioner requires $24,533,000 in additional annual earn-
ings in order to achieve its fair rate of return.

6. The petitioner's present rates are insufficient to produce the
rate of return found herein and therefore are unreasonable.

7. The rates proposed by the petitioner would produce an annual
pro forma operating income which would result in a rate of
return on the rate base found herein which is in excess of the
rate of return found herein and therefore are unreasonable.

8. Additional annual revenues of $47,648,000 will provide the
petitioner with a reasonable opportunity to achieve its allowed rate of return.

9. The rate design approved herein will produce just and reasonable rates and will provide the petitioner a reasonable opportunity to earn its allowed rate of return of 9.44 percent on the rate base found herein.

Accordingly, it is hereby ORDERED that:
1. The rates proposed by the petitioner are DENIED.
2. The petitioner be allowed to file for the Board's consideration revisions of its tariff, consistent with the rate design approved herein, to produce additional annual revenues of $47,648,000, to become effective on a date to be determined by the Board.

After reviewing this Initial Decision,
the Board of Public Utilities on September 11, 1981
issued the following Final Decision:

By Order of February 18, 1981, the Board accepted tariff revisions permitting an increase in rates of approximately $4,000,000. We adopted the initial decision of Administrative Law Judge McGill, except as noted therein on the disputed revenue and rate design issues. Subsequently, petitioner moved for reconsideration of the Board's Order on four revenue issues identified as "separations," and of period interest, deferred income taxes and "curtailment." Also remaining at issue is the motion by Rate Counsel that the new rates be "priced out" by the "units of service" at year and test year rather than at average units of service as proposed by petitioner and permitted by the Board.

Separations Adjustment: We held as follows in the February 18th Order:

We conclude that Rate Counsel's separation adjustment is reasonable and proper. We find persuasive the testimony of Rate Counsel's expert William Dunkel based upon a two year trend-analysis of separations factors, especially since a sister company, Illinois Bell has adopted a similar methodology. We conclude that there is a downward trend in separation factors.

Under detailed separations procedures set forth in the NARUC-FCC Separations Manual, company expenses and plant investment are allocated between the intrastate and interstate service segments of New Jersey Bell. Rate Counsel has urged the Board to recognize
a downward trend in the intrastate separations factors in recent years, with a correspondingly smaller portion of petitioner's plant investment and expense being assigned to the intrastate service which provides a basis for the revenue requirement.

Rate Counsel demonstrated a downward trend in separation factors which is causing a shift in responsibility for its rate base and operating expense from the intrastate jurisdiction to the interstate jurisdiction. This downward trend was confirmed through Rate Counsel's witness, William Dunkel's analysis and through AT&T's own projections, as depicted in Schedule 2 of Mr. Dunkel's testimony. We find persuasive the testimony of Mr. Dunkel that petitioner in mismatching its test year-end level of rate base and operating expenses, with separations factors computed pursuant to a weighted average for the test period has overstated its intrastate rate base and operating expenses. petitioner has lagged its separations factors by six months behind its test year-end level of rate base and operating expenses.

Mr. Dunkel performed a sum of the least squares regression analysis for the 24 monthly data points for the two year period ended September 30, 1981. We find that Mr. Dunkel's methodology results in appropriate separations factors to be used in conjunction with petitioner's test year-end rate base and operating expenses. We find Mr. Dunkel's result based upon two years of data reasonable. petitioner argued that data from the most recent years represent an aberration with regard to the degree of downward shift in its separations factors. petitioner's figures therefore did not reflect a continuation of this shift beyond the test year. Mr. Dunkel in his deposition testified that petitioner's sister company, Illinois Bell Telephone Company, was requested to perform a regression analysis with regard to separations factors. Illinois Bell Telephone Company was given the option of performing that regression analysis based upon one, two or five years of data. The utility selected the two year data as most reasonable. We also are persuaded that the data from the prior two years constitute a reasonable base for a representative set of separations factors to be matched with petitioner's test year-end rate base and operating expenses.

Petitioner has attacked the reliability of the Dunkel trend line analysis on the grounds that the recent acceleration in the general downward trend, is unrepresentative of the longer term separations trend, is uncertain as to its cause or likely duration, and is unduly speculative. The administrative law judge agreed and adopted the Staff's revenue annualization adjustment, an adjustment which, in his
view and Staff's, precluded further end-of-period adjustments.

Nevertheless, we find Mr. Dunkel's explanation of his approach, in the course of pointed and well structured cross-examination by company counsel, to be cogent and credible. We are not prepared to reject his approach as unduly speculative. Accordingly, we affirm our acceptance of Rate Counsel's end-of-period separations factor and of its application to petitioner's rate base.

Deferred Federal Income Tax: This issue involves the accelerated amortization of the surplus created in petitioner's deferred F.I.T. reserve by the reduction in the corporate income tax rate, from 48 percent to 46 percent, effective January 1, 1979. There is no remaining dispute as to the amount of the surplus balance. Rather, the dispute centers on the timing of the amortization of that surplus.

Petitioner has argued, on reconsideration, that the surplus is now effectively and properly being amortized or returned to ratepayers over the life of the affected plant, and that this approach is consistent with applicable federal tax regulations. The acceleration proposal, according to petitioner, might jeopardize the company's continuing eligibility for the tax benefits available to it and its ratepayers through the use of accelerated depreciation. In this context, petitioner points to the Board's holding in the prior rate base, Docket No. 7711-1136, that "any attempt to address this issue should await promulgation of the appropriate IRS regulations and guidelines."

However, the IRS has not yet taken definitive action on this question despite AT&T's formal request that they do so, and we are not included to defer this issue any longer. Staff and Rate Counsel have submitted reasonable plans for amortizing this surplus, and have convinced us that such action poses minimal risk to petitioner's continuing eligibility for other important tax benefits.

Accordingly, petitioner is directed to commence in 1981, not later than the date of this opinion, the amortization over a four-year period of the surplus in the deferred federal income tax reserve, with leave to bring before us any contrary or inconsistent regulation or guidelines as may be promulgated by the Internal Revenue Service.

End of Period Debt Costs: The administrative law judge adopted Rate Counsel's proposal to adjust the petitioner's federal income tax calculation to reflect the year-end level of debt. This adjustment is intended to match the end-of-period federal income tax deduction with the end-of-period capital structure used to determine rate of return.

Staff had urged that since this adjustment amounted to another end-
of-period adjustment, it was "absorbed" in Staff's revenue annualization adjustment. The administrative law judge distinguished this item from the annualization adjustment on the ground that it was "entirely possible to use a specific end-of-period figure for the interest deduction corresponding to the end-of-period level of debt." He tied this interest adjustment closely to petitioner's end-of-period capital structure which he found, reflects greater debt costs than actual test year debt. Based on his burden/benefit analysis, he found that the ratepayer should enjoy the benefit of the associated tax deduction, and accordingly applied the full twelve months value of the adjustment, in the sum of $5.5 million.

We adopt the reasoning of the administrative law judge in his initial decision where he stated:

With respect to the petitioner's argument that the adjustment is a disallowance of the taxes actually paid in the test year by the petitioner, it must be remembered that rates are set for the future. The end-of-period level of debt provides a better indication of the level of debt which the petitioner will have to bear during the life of the new rates than does the test year average level of debt. Correspondingly, the end-of-period interest deduction provides a better indication of the level of the interest deduction during the period the new rates will be in effect. . . .

The proposed adjustment is not associated with end-of-period rate base and, accordingly, should not be limited by the benefit associated with the use of an end-of-period rate base. Rather, the adjustment should be made in order to reflect the interest deduction benefit corresponding to the greater burden placed on the ratepayer because of the higher end-of-period cost of debt used by the petitioner in the capital structure for rate of return purposes.

Year End Level of Revenues: The Board found as follows in its February 18th Order:

We further find reasonable Rate Counsel's year-end adjustment for added customers which we believe will more accurately match test year revenues and expenses and track conditions during the period these rates are to be in effect.

The positions of the parties is clearly set forth by Administrative Law Judge McGill and does not need elaboration herein. We agree with the administrative law judge that Rate Counsel's adjustment "goes too far." But we are not prepared to accept Staff's overall year
end adjustment (which in effect matches average revenues and expense against average rate base) in lieu of separation consideration of the various "normalizing" adjustment—year end revenues, end of period debt and appropriate separations.

We conclude that the customer growth component developed in rate counsel's methodology—as distinct from the usage component will more accurately track recognizable revenue growth during the life of these new rates. This position on this issue represents a middle ground between the growth projections of petitioner on the one hand, and Rate Counsel, the administrative law judge, and Board Staff on the other, and in our judgment, represents a prudent course.

*Productivity:* We have denied Rate Counsel's proposal for a productivity offset to wage increases. Our policy has been and remains, to encourage productivity by not denying the benefits of efficiency to petitioner where the rate of inflation is outstripping the benefits of productivity.

The record supports the continuation of this policy. Petitioner's witness, Mr. Penza, supported a study on the disaggregation of cost increases experienced by New Jersey Bell over the 1973-1979 period into real and inflationary increases, to measure the impact of inflation. He identified the 1974-1976 period, when inflation levels were closest to those now prevailing, as most relevant to the analysis of the current productivity-inflation relationship. The study demonstrates that non-labor inflationary cost increases will exceed any reasonably anticipated levels of productivity improvement.

This is not to suggest that the Board is ignoring the subject of productivity improvement, nor that petitioner should slacken its effort to achieve productivity gains. Productivity gains result in real benefit to the customer by offsetting inflationary costs in the non-labor sector. But in the face of high rates of inflation in expense which outstrip any quantifiable productivity benefits, an offset to known and committed labor costs for productivity is not reasonable under the circumstances of this case. As we stated in the last base rate case, under similar inflationary conditions:

It is the conclusion of this Board therefore that in these circumstances application of a productivity offset would be inappropriate even at the lesser levels recommended by the Hearing Examiners and the Staff. It is an economic fact that this adjustment is one which is most influenced by current economic conditions. Docket No. 7711-1136, *Decision and Order*, dated January 31, 1979, at pg. 5.
August 1981 Wages: The Board adopted the Staff's proposal to allow five-twelfth of the costs associated with petitioner's contracted wage increases for August 1981 as an adjustment to test year earnings in this case. This approach, in our view, permits petitioner to recover substantially all of the costs it will experience for this item during the first year of the rates approval in this case. There is little or no uncertainty associated with this known change. We cannot accept Rate Counsel's argument that the actual size of the associated wage bill is uncertain, depending as it does in part for its computation upon inflation or cost-of-living factors embodied in the collective bargaining agreements. It appears, in fact, that any uncertainty as may exist cuts against, not in favor of the company. Rate Counsel's own witness, Dr. Meyers, has acknowledged the likely continuation of double-digit inflation rates throughout the relevant period of this adjustment.

Rate Design: We add the following comments in explanation of the rate design we approved on February 18, 1981:

Directory Assistance Charging (D/A): We do not authorize Directory Assistance Charging at this time. petitioner may deal with this issue again in the next general rate case.

Vertical Services: petitioner's indicated revenues for vertical services exceeded the embedded level of their direct costs. Nevertheless, minimal consideration has yet been given to these services making a contribution toward the common overhead costs of the business, which petitioner, Rate Counsel and the Board's Staff indicate is appropriate, although, there is some difference in the positions.

The Board particularly takes note of objections concerning the pricing for the 557B Switchboard and the concentrator-identifier system. petitioner should provide a cost study for these services upon its next application for a rate increase for these services. The Board recognizes the Embedded Direct Analysis as a cost indicator and a rate-making guide and concludes that exclusive of the Rotary "500" set and Public Announcement Service (Weather), a revenue award to the vertical services category of $15.83 million is not unreasonable and is awarded.

The Rotary "500" telephone set, formerly a part of basic service is, in a competitive environment, now a vertical service. The Rotary "500" set has been associated with a 75 cents credit applicable when a customer provides his own telephone set. petitioner proposed increasing the rate associated with this set by 20% to 90 cents. At 90 cents, the basic "500" station set will be priced marginally above its embedded cost of 85 cents. Accordingly, the Board concurs with petitioner's proposed rate treatment for the "500" set.
Petitioner proposed an increase for certain calls to the Weather Announcement. Presently, the geographic designation determines whether or not a one message unit charge is made. Since distance sensitivity is no longer relevant in applying the rate, the 5 cent charge should be eliminated and a single standard rate of 10 cents be applicable for all such calls for the report in the caller’s home area code when originated from non-coin, flat rate telephones. Calls to Weather from message rate business or residence service should continue to be billed one message unit per call.

Disaggregation: petitioner proposed the separation of rates and charges for station instruments and sets from the rates and charges for exchange access service. Today, both business and residence subscribers can at their option provide their own telephone instruments and inside wiring within the Federal Communications Commission Registration Program requirements and consistent with N.J.B.P.U. tariffs.

Heretofore, the provision of customer provided instruments has been reflected via a credit of 75 percent per instrument charged for but not provided by the company. With disaggregation the existing credit arrangement is no longer required as the charge for instruments provided by the company is separated from the line charges. No credit or allowance has been made for customer provision of inside wiring to the first outlet or jack provided as part of the exchange access charges, nor at this transitional stage does the Board believe any tariff change is required, although this should be further explored no later than next general rate case.

The Board believes that petitioner’s proposals concerning disaggregation more fully reflect a registration environment and should be implemented.

Itemization: The Board agrees with the administrative law judge’s initial decision that an explicit statement should be made in residential customer’s billings as to how a itemization can be obtained. Such notice should be given quarterly.

Selective Calling, Message Unit Charges and Econo Pak: Selective Calling provides optional special rate treatment for calls to nearby exchange areas beyond a customer’s local calling area. Residence customers may select unlimited calling on a flat rate basis, which rate is based also on distance and the number of customers in the exchange.

Petitioner proposed increases in message unit charges and Econo Pak, as well as certain changes in Selective Calling.

The Board concurs with petitioner’s Selective Calling proposal to
change its application of the flat rate charge per route from a "per line" basis to a "per account" basis, in response to multi-line customer complaints that they must pay a per route charge for each line. We are not inclined at this to implement the other proposals in this area, nor to accept changes in message unit charges and Econo Pak.

Regrouping of Basic Exchange: Regrouping is the moving of an exchange area from one of the four rate groups into another rate group. The groups are based upon the number of customers in the local calling area. When two consecutive annual reviews indicate that a local calling area of an exchange has at least 1 percent more or less customers than the limits of its rate group, that calling area is subject to regrouping to insure uniform rate treatment for exchanges with local areas having a comparable number of customers.

As of July 1, 1979, 32 exchange areas (18 percent of all exchange areas) had exceeded their rate based limit. The Board has considered the seasonality aspects of July 1st data and orders the regrouping of the 32 exchanges involved. In the future the Board directs that the count to determine whether or not further regrouping in shore communities is indicated should be performed once a year, but in January rather than in July.

Semi-Public Service: This service occupies a unique position within New Jersey Bell Telephone Company's array of services. Semi-public service as viewed by the petitioner is located in areas where a coin telephone would not generate sufficient revenues to be considered public. A subscriber may feel a need nevertheless to locate a coin telephone on his premises. Thus a subscriber will contract for a coin telephone on his premises and agree to pay a fixed monthly charge and a revenue-sensitive daily guarantee.

The petitioner proposed to raise the monthly rental from $2.00 to $6.00 and to increase the daily guarantee 25 percent. Other parties have made other recommendations. Based upon our review of this issue, we direct that an increase from $2.00 to $6.00 be accepted, thereby raising rates to a more cost causative level for these services. The increase of 25 percent for the daily guarantee should be rejected because it appears to result in a disproportionate increase for those customers who do not satisfy their daily guarantee. A $20.00 installation charge is appropriate to reduce the high churn of installations and removals for this service and is to be implemented.

Non-Recurring Charges: Non-recurring charges are one time charges applicable to the connection, move, or change of telephone services and facilities. The costs associated with these activities are divided,
under governing Federal Communications Commission regulations, between capital and expense accounts. The non-recurring charges are intended to capture the expense portion of those costs.

The Board concurs with petitioner's plan for non-recurring charges involving six multi-element charges. The plan should be readily understood by customers and will be more closely related to the actual work operations performed in connecting, moving and changing telephone services and facilities than the present multi-element plan. However, at this time, it shall be implemented without an increase in revenues, but initial charges for prewiring are not approved.

The Maintenance of Service Charge proposed by petitioner, $20.93, represents an increase of 32.2 percent from $15.83. The increase, 32.2 percent, has been proposed to recover costs for this labor intensive function, but is not specifically supported by a cost study. Although a $20.93 charge may not be excessive, it should not be accepted at this time.

Basic Exchange Services: For many years the concept of the universality of the availability of telephone service was the goal of the industry, the Board and federal regulators involved with telecommunications. To all intents and purposes, this goal has been achieved. All our citizens now have access to safe, adequate and proper telephone service. And part of that universal service concept involved policies of deliberate subsidization, via a carefully structured schedule of charges, so that the affordability issue was seldom an impediment for subscribers to basic telephone.

Now, however changing regulatory cost distribution techniques urge a gradual shift of the economic burden to the "cost causer," which does not, however, imply that the universal service concept will be abandoned. This Board, for one, insists and will continue to insist, that any shifts of the cost burden will be permitted only when supported by irrefutable documentation that such transfers of costs are proper, accurate, justified and reasonable. Thus, disturbance of rates for basic service will be minimized and introduced only where absolutely required.

The Board in this case supports continuation of the residual pricing concept wherein basic exchange services are supported by other services. Nevertheless, such a concept does not mean that basic services should not be increased even if the revenue needs can theoretically be placed elsewhere. The Board considers that some reasonable increase should be considered for basic exchange customers. Even customers whose actual local calling volumes might in fact allow them
to benefit by subscription to a measured service option, probably
would not initially welcome such options.

Petitioner's usage sensitive rates also do not reflect time-of-day
pricing, which should be explored. More work is needed before this
Board will consider implementing usage sensitive rate options and
eliminating or obsoleting certain rates as proposed. The issue of usage
sensitive rates should be fully and completely addressed in the next
case, and a "selling job" to the public is appropriate before any such
plan is implemented.

WATS Service: The Board believes that in light of the September
15, 1980 FCC tariff filing by AT&T, in response to regulatory and
court orders, WAT pricing should be subjected to serious consider-
ation and petitioner should provide support and justification for its
pricing. This activity should take place not later than the petitioner's
next general rate proceeding.

Message Toll Service (MTS): Rate Counsel had proposed certain
reductions in MTS rates. We agree with the initial decision that such
rates should not be reduced at this time.

Local Coin: It is stated by the petitioner that no party has in-
troduced contrary proof in this proceeding that local coin service rates
are below current cost level. However, the Public Advocate has in-
troduced sufficient evidence to show that a rate increase to $.25 is
questionable at best, and there is sufficient evidence to question the
validity of the petitioner's study in this matter. Therefore, no increase
should be awarded.

Hotel/Motel Telecommunications Services: We hereby agree to the
terms in the stipulation of petitioner, Staff and Public Advocate,
which transfers Hotel/Motel Telecommunications Services to this
proceeding and increases its rates by $77,811.30.

Average Versus Year-End Units of Service: In our Order dated
February 18, 1981 (D&O), the Board directed petitioner to supply
additional information with regard to the test year number of units
in service. The Board in that same Order offered the parties in the
case an opportunity to further respond to the information provided.

petitioner's compliance tariffs, which implemented the rate increase
effective on February 18, 1981, were permitted to be priced out on
the estimated mid-year number of units in service, as opposed to the
year-end actual number of units.

The Board has decided to utilize test year-end levels of operations
to determine petitioner's revenue requirement. A year-end rate base
and year-end level of expenses are used in determining the additional
annual revenue requirement of $41,08 million. The growth in operating revenues, expenses, and investment are associated with the growth in the number of subscribers and the number of units in service at the test year-end. Consequently, test year-end actual units in service should be used to price out tariffs in compliance with the award.

The revenue effect of the compliance tariffs based on estimated mid-year numbers of units in service is approximately $41,03 million per year.

Using the test year-end actual units to price out the tariff reveals that the rates now in effect are generating $9.7 million in revenues beyond the approved annual increase (or $1.02 million more than that originally reflected for the compliance tariffs.)

The current rate case is a proceeding whereby the required reduction in rates could be offset against any increase that might be awarded. This would provide an orderly transition to the use of actual end of period units.

The Board, therefore, REAFFIRMS its Decision of February 18, 1981 herein, as supplemented herein, according to the revenue requirement and rate design determinations found herein.