Composite index of 300 Toronto stocks closed this week at 1,081.5, down 5.0

Money & Markets

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Dow Jones average of 30 industrials closed this week at 837.32, up 24.52

★ *Love it or hate it, you just can't ignore Bell Canada. The Star's Richard Conrad examines the phone giant as it seeks another rate hike.*

Ma Bell vs. millionaire at Ottawa shootout

— Star photo by Ted Dinmore

LESLIE SZABO, using antique phone at his Oakville country home on millionaires' row, has a more profound interest in modern telephone systems. He's out to slash Bell Canada's $400 million rate hike request.

IT'S HARD not to feel some emotion about Bell Canada. On the one hand, it's the huge corporation that makes an almost annual pilgrimage to Ottawa — eight times in the last 10 years — to ask for rate increases.

On the other, it has more shareholders than any other Canadian company — 221,000 of them at last count — and over the years it has built up a solid reputation as the "widows and orphans" stock, with dividends as sure as daybreak.

Back for more

Not so incidentally, Bell also provides a service whose efficiency is rarely questioned. (Canadians make cracks about the post office; in Britain the telephone service is the butt of jokes.)

Right now, it's Bell's nasty habit of asking for more money that is uppermost in the minds of Canadians.

On Tuesday morning at 9.30, Charles Dalfen, vice-chairman of the Canadian Radio-television and Telecommunications Commission (CRTC), will take his seat in the hearing room of Ottawa's l'Esplanade Laurier complex to open the formal hearing into Bell Canada's application for a $400-million-a-year rate increase.

For Toronto subscribers, this would include an increase of 20 per cent to $9.80 a month for residence phones and a jump of 28 per cent for most business telephone services — if the CRTC awards Bell the full amount requested.

Annual rite

Bell was awarded a $162 million increase last June, and subscribers have become resigned to the rate applications as a sort of annual rite.

Despite the almost monotonous regularity of their requests, Bell officials will not be skulking into the CRTC hearing caps-in-hand. They argue — with the support of a large segment of the financial community — that the latest increase is necessary if the company is to maintain its "financial integrity" and raise the estimated $6 billion needed to finance capital expenditures and assure satisfactory service over the next five years.

However, a number of "intervenors" don't buy Bell's argument and will take the floor at l'Esplanade Laurier to oppose the application.

One of the most interesting — and potentially deadly to Bell's case — is Leslie Szabo, a flamboyant 44-year-old utilities expert who has represented the province of Ontario at previous Bell rate hearings.

"Unfortunately, when I worked for the Ontario government (as a consultant), we somehow always mysteriously ran out of time and money just before we got into the really detailed analysis of Bell's operations," Szabo laments.

"I'm not trying to accuse anybody, but it seems funny to have only a $40,000 or $50,000 budget to fight a rate case of $150 million in size."

This time Szabo is representing himself — as a Bell subscriber — and he's confident that "if I am given a reasonable time to interrogate . . . I'll cut between $200 million and $300 million from the $400 million (Bell) requested."

Bell's clout

Sceptics, awed by Bell's obvious clout in the capital, may tend to dismiss Szabo's ambitions as foolhardy if not downright naive. But he is no modern Don Quixote tilting at the telephone company's corporate windmill. If credentials count for anything, he has to be taken seriously.

Szabo, who holds a doctoral degree in econometrics (a sort of statistical son-of-economics), fled his native Hungary in late 1956 at the time of the uprising against the Soviets.

After a brief stint in Britain, working for the National Coal Board, the former university professor wound up in Canada. He spent three years as a design engineer with Dominion Bridge Co. Ltd. in Edmonton, before moving over in 1960 to become research director of the Alberta Public Utilities Board.

It was at the utilities board that Szabo "fell in love with the subject of econometrics related to public utilities."

In 1964 he launched his own one-man consulting firm in Edmonton, the Gamma Group, specializing in public utilities and telecommunications. Within nine months, Gamma had 200 employees, and the staff later mushroomed to almost 500, undertaking major assignments for telephone companies throughout North America.

"Two years ago, I retired so that I can devote more time to such things as Bell Telephone — only this time I'm working for free," he says.

"Retired," to the hard-driving Szabo, means he works only 10 hours a day instead of 14. Gamma Group has been reduced in size and, although he retains ownership he is no longer active in its day-to-day affairs.

A consultant

He does act as consultant to another of his holdings, Toronto-based Omega Consultants, which operates a number of franchise operations including Convenient Food Mart, Inc. of Chicago — with 856 outlets and annual sales of $650 million.

For a man who arrived in Canada 20 years ago "with 15 cents and the clothes on my back," Szabo has done rather well. He has amassed a personal fortune "conservatively estimated" at more than $25 million — $26.6 million to be precise — which allows him to travel extensively with his wife and two daughters — dividing his time between principal residences in Toronto and Vienna.

Recently, however, he has been holed up at his luxurious country home-office retreat on Lake Ontario near Oakville, preparing for the Bell hearings. A former professional basketball and water polo player — "they say there's no such thing as a professional athlete in Hungary, but we got paid for it anyway" — Szabo retains a fierce competitive spirit.

Profit down

In its rate increase application, Bell points to the fact that its consolidated earnings declined from $6.50 to $6.04 a share last year, while earnings of its regulated telephone operations — on which rates are based — fell to $4.73 a common share from the 1976 level of $5.23.

Its rate of return on common stock — the return a shareholder receives on his investment in the company after interest payments and preferred share dividends have been met — was 9.02 per cent last year, below the 12 per cent level which the CRTC has said is acceptable and well below the 13.5 to 14.5 per cent range which Bell brass "believe is necessary to prudently finance the business."

For the man on the street who is unable to decipher the Bay Street jargon, Bell's message is simpler. If it doesn't get the increase it's requesting, your telephone service will suffer.

James Thaokray, Bell president, cautioned during an interview that the reference to a possible deterioration of service is "not a veiled threat. We've been accused of blackmail before. It shows you the difficulty of dealing with the media.

"There are no magic wands that we can wave to generate the funds needed to buy equipment and pay our people. The money has to come from somewhere."

Thackray notes that the Consumer Price Index has risen 60 per cent since 1971. "If the commission grants us this increase we will still be below the 50 per cent level (in over-all increases) for the same period."

Szabo is not impressed. He says careful scrutiny of three "big ticket items" in Bell's operations — annual depreciation expenses, deferred taxation and its rate base (the total capitalization of the company used to provide telecommunications services) — would reveal that Bell is capable of cutting down on expenses to the point where most of the requested rate increase would not be needed.

"If they can do this, both the equity (share) owners of Bell and its subscribers would benefit," Szabo reasons. "Reducing expenses would enable Bell to hold the line on service charges, and telecommunications use would increase. The increased volume would make up for what they might lose in phantom expenses."

Szabo estimates that Ma Bell has "perhaps inadvertently, inflated its depreciation expenses to the tune of about $150 million a year." In addition, he claims, the company benefits from about $95 million a year in unneeded deferred taxation, and "if its rate base were put in order, we could save subscribers a further $25 million to $50 million a year."

The CRTC has looked at these issues in the past, Szabo concedes. In fact it only recently examined — and approved — Bell's deferred taxation treatment, "but there was absolutely no opposition of any calibre during these hearings. I was away in Europe at the time."

An acknowledged expert on depreciation expenses, Szabo points out that the amount of such expenses is dependent on the life expectancy of a utility's equipment and on the method used to allocate the cost of the equipment over this life expectancy.

In 1970, he says, Bell changed its cost allocation system to a type known as the "equal life group" (ELG) method, which is currently yielding higher depreciation expenses.

"There is nothing wrong with the ELG method. I invented it myself in 1967. The trouble in the case of Bell is that they switched to it without taking my advice — published at the time I originated the system — which is this: 'It is absolutely essential, if the ELG method is introduced, that a utility have detailed, accurate actuarial data for all its fixed asset accounts.'

"Bell does not have that type of data. Hence, they should have stayed with the old system."

As a result, he says, Bell's annual depreciation expenses now are inflated by as much as 25 or 30 per cent.

Szabo also has done extensive studies on the matter of deferred taxes and has written a book — as yet unpublished — on the subject.

Simple test

In the process he developed a relatively simple universal test for use in determining whether or not a particular company really needs deferred taxation. Simply stated, the test involves dividing the growth rate of a company's fixed assets by its tax depreciation or capital cost allowance rate.

"If the resultant ratio is equal to or greater than the company's 'book' depreciation rate (used for accounting purposes), then a company does not need deferred tax expenses."

Applying his formula to Bell — using the "most conservative" estimates of the company's growth, Szabo came up with a ratio of 5.5 per cent — significantly greater than Bell's composite book depreciation rate in 1970 of 4.7 per cent.

Szabo admits his formula has not won acceptance by either the Canadian Institute of Chartered Accountants or the U.S. Certified Public Accountants, but he maintains that it is a reliable yardstick which in this instance indicates that "Bell likely never would need deferred taxation in our lifetime or our children's lifetime."

It's unlikely

The only possible need for such relief would result from an "extremely improbable" combination of circumstances whereby Bell stopped growing completely and inflation — at the same time — was completely stopped, he says.

As for Bell's rate base, the third "big ticket" item on Szabo's list, he says the company's accounting procedures are "not sophisticated enough for today's rate-making purposes."

Bell's accounting system is "not set up to accurately cost out on a true-original-cost basis what is known as the retirement of fixed assets. That is, to remove from its books equipment which is no longer used or useful," he says.

"Also, the method used for 'aging' of equipment — known as the computed mortality method — is not sufficiently accurate to diminish the book value of Bell's fixed assets for equipment taken out of service."

Better accounting systems do exist, he emphasizes, and are already in use by other Canadian telecommunications operators such as British Columbia Telephone Co.

Asked to comment on the criticisms of his company, Bell president Thackray said Szabo is "wrong on all counts."

Does the Bell president expect the CRTC to approve the entire $400 million a year increase in revenue requested?

"I sincerely hope so, for your sake as well as others. Our major objective is to run a damn good phone company, supplying top service to our customers at fair rates."

Lest his intervention in the current rate hearings be misconstrued, Szabo is quick to point out that he is generally supportive of Bell and its role in the economy.

Free enterprise

"I firmly believe that the only way free enterprise can be maintained in the public utilities sector is if the regulatory process is seen to be effective," he says.

"Otherwise, sooner or later, the nationalization process will follow — a move which I would find distressing. I'm a free enterpriser with a capital F. After all, I came to Canada with nothing and here I am in Oakville (at his country home on millionaires' row).

"I know Bell executives will probably curse me for it, but I intervened not only for the benefit of the consumer, but also to make Bell stronger in the long run."