

Decision No. 22835.

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA.

The City of Redlands, a Municipal Corporation,

Complainant,

vs.

The Southwestern Home Telephone Company, a Corporation,

Defendant.

ORIGINAL

Case No. 2788.

Walter J. Hartzell, City Attorney of City of Redlands, for Complainant.
Baciagalupi, Elkus & Salinger, by Frank B. Austin and A. N. Johns, for Defendant.
Ernest Irwin, for California Independent Telephone Association.

LOUTHER, COMMISSIONER:

O P I N I O N

This is a proceeding in which the City of Redlands, a municipal corporation, makes complaint against Southwestern Home Telephone Company alleging that its practices are unfair and unjust and that its rates for telephone service in the City of Redlands are excessive and disproportionate to the value of the service rendered.

Public hearings in the matter were held in Redlands on January 21, March 18, April 16 and 17 and June 18, 1930, and on this latter date the case was taken under submission.

This complaint refers particularly to the City of Redlands where defendant, hereinafter at times called the Company, operates one telephone exchange of a group of exchanges which form its system.

At the hearing on January 21, 1930, Barry Dibble, consulting engineer, as a witness for the City of Redlands, presented the report of his investigation of the operations of defendant Company based upon its Annual Reports to the Railroad Commission.

It appearing that certain matters brought to the attention of the Commission at this hearing should be fully investigated, the Commission directed its engineers and accountants to make investigations of the records of the Company and studies of its utility operations and practices. The results of this work were placed in evidence at subsequent hearings.

Valuation and Rate Base:

Considerable testimony and a number of exhibits were presented in this proceeding by the witness for the City of Redlands, by Company witnesses and by engineers and accountants of the Commission.

The Company presented historical reproduction costs of the Redlands exchange and of the system. These costs, based upon Commission engineers' appraisals as of December 31, 1920, were brought forward to December 31, 1929, by adding to them net additions and betterments as shown by the books of the Company. The Company also submitted in evidence the book costs, unmodified,

of the Redlands exchange and of the system.

Since the beginning of this proceeding the Company has made an inventory of its Redlands exchange plant, which it has used in a reproduction cost less depreciation appraisal as of December 31, 1929.

The following valuation estimates as of December 31, 1929, and estimates of working cash capital and materials and supplies were submitted by the Company:

	<u>Redlands Exchange</u>			<u>Total</u>
	<u>Fixed Capital</u>	<u>Materials & Supplies</u>	<u>Working Cash</u>	
Historical reproduction cost (C.R.C. 1920 appraisal Plus A's and B's)	\$367,471.08	\$12,113.17	\$7,766.04	\$387,350.29
Book cost	\$489,578.59	\$12,113.17	\$7,766.04	\$509,457.80
Reproduction cost less depreciation	\$544,195.00	\$12,113.17	\$7,766.04	\$564,074.17

System

Historical reproduction cost (C.R.C. 1920 appraisal Plus A's and B's)	\$720,119.54	\$20,188.62	\$13,072.15	\$753,380.31
Book cost	\$879,473.35	\$20,188.62	\$13,072.15	\$912,734.12

L. E. Torrey, Assistant Engineer of this Commission's staff, placed in evidence his estimate of the reproduction cost less depreciation of the Redlands exchange as of December 31, 1929. The inventory used by the Company in its reproduction cost valuation was checked and used as the basis of Mr. Torrey's appraisal.

At a later hearing Mr. Torrey submitted in evidence his historical cost appraisal of the Redlands exchange property as of December 31, 1929, based upon the same inventory.

J. T. Jordan of the Department of Finance and Accounts of the Commission, placed in evidence as Exhibit No. 9, his

report on the net additions and betterments to the Redlands exchange and to the system January 1, 1921, to December 31, 1929. Starting with the Commission's engineers' historical cost appraisal of property as of December 31, 1920, he has added additions and betterments in order to arrive at his historical reproduction cost of the property of the Redlands exchange and of the system. The net additions and betterments, as determined by the Commission's accountant, are \$17,568.92 less than those shown by the Company's books for the Redlands exchange and \$24,267.81 less for the system.

Exhibit No. 10 introduced by W. B. Wessells of the Commission's Engineering Staff, shows estimated rate bases obtained by adding amounts for materials and supplies and working cash capital to the elements of value estimated by other Commission witnesses. Materials and supplies were estimated in accordance with the experience of the Company in the past and the necessities of the future. The allowance for working cash capital is based upon one month's operating expenses less depreciation expense, which method is consistent with the practice followed in other telephone rate proceedings. The following valuation estimates for the year 1929, together with estimates of materials and supplies and working cash capital were submitted by the Commission's Engineers:

	<u>Redlands Exchange</u>			
	<u>Fixed Capital</u>	<u>Materials & Supplies</u>	<u>Working Cash</u>	<u>Total</u>
Historical reproduction cost (C.R.C. 1920 appraisal Plus A's and B's) Exhibit No. 9	\$348,924.42	\$12,360.00	\$6,081.51	\$367,365.93
Historical cost Ex. No. 8	\$381,882.22	\$12,360.00	\$6,081.51	\$400,323.73
Reproduction cost less depreciation	\$403,146.22	\$12,360.00	\$6,081.51	\$421,587.73

	<u>System</u>			
	<u>Fixed Capital</u>	<u>Materials & Supplies</u>	<u>Working Cash</u>	<u>Total</u>
Historical reproduction cost (C.R.C. 1920 appraisal Plus A's and B's Exhibit No. 9),	\$638,987.26	\$20,000.00	\$10,097.55	\$699,084.81
Historical Cost Ex. No. 8,	\$681,156.98	\$20,000.00	\$10,097.55	\$711,254.53
Reproduction Cost Less Depreciation,	\$720,098.98	\$20,000.00	\$10,097.55	\$750,196.53

Revenues:

The evidence of witnesses in this proceeding shows no material differences as to accrued revenues for the Redlands Exchange and for the system for the year 1929. Some differences of opinion of witnesses as to the accounting for certain items were noted but little difference in the final results is evident.

Expenses:

The general expenses of the Company merited a critical investigation in this proceeding. Records indicate that this expense, on a station basis, has been higher generally than that of other companies similarly situated and with similar operating conditions. A considerable apparently unnecessary increase was noticeable in the 1928 general expense over 1927 and again in 1929 over 1928. It was in 1928 that the Western Utilities Corporation acquired the stock of the defendant Company. The holding Company then began to charge the defendant Company \$1,200.00 per month as a management charge for 1928. In 1929 the management charge was increased to \$1,500.00 per month in addition to a similar large fee for engineering and superintendence. In the hearing in this proceeding, on March 18, 1930, the defendant Company, by counsel, agreed to make

a showing at the next hearing as to the reasonableness of the management fees paid to the holding Company. Defendant failed to keep this commitment and by its Vice-president in open hearing related a change in method of charging for general expense and construction overheads by arbitrarily fixing monthly salaries and expenses for the officers of the Company amounting to \$3,025.00 per month without regard to the amount of construction performed by the defendant or the services to be performed by its salaried officers and without any reduction in the number or the salaries of necessary operating officers or employees. These officials, with one exception, are officers of the Western Utilities Corporation and some are officials of seven other companies whose relations are considerably interwoven. None of these officials resides in the service territory of the Company and apparently none of them is active in the Company's operations with the exception of Vice-president Johns, who spends but a portion of his time on this Company's business.

Arthur B. Fry, Telephone and Telegraph Engineer for the Commission, gave testimony concerning his investigation of the general expense of the Company. In his opinion, the maximum allowable general expense of the Southwestern Home Telephone Company for the year 1929 was \$18,950.00. This judgment was based upon a study of general expense of numerous telephone companies of the A, B and C classes as defined by the Interstate Commerce Commission but with particular reference to California companies of comparable size and having similar operating conditions, his experience in analyzing such accounts in other rate proceedings and a study of the actual experience of this Company over a

period of years and with a view to its reasonable requirements for the future. The Company's books show general expenses for the year 1929 amounting to \$29,730.22, or \$10,780.22 more than the estimated maximum allowable expenses.

We will use \$18,950.00 as the amount of the allowable general expense for Southwestern Home Telephone Company for the year 1929, a very liberal allowance under the circumstances.

Mr. Wessells, witness for the Commission, offered in evidence the following table showing the estimated net revenue which would have resulted from the operations of the Southwestern Company in 1929, based upon the revenue modified as before stated, current maintenance modified, traffic expense as shown by Company's books and commercial expense proration modified, depreciation expense, uncollectibles, taxes and rent deductions as he had estimated them and general expense as estimated by Mr. Fry:

	<u>Redlands Exchange</u>	<u>System</u>
<u>Revenues:</u>		
Exchange,	\$112,547.80	\$171,050.22
Toll,	25,446.90	61,569.80
Miscellaneous,	<u>1,612.69</u>	<u>1,918.24</u>
Sub-total,	<u>\$139,634.39</u>	<u>\$234,538.26</u>
<u>Expenses:</u>		
Current Maintenance,	\$ 20,920.10	\$ 35,568.02
Traffic,	28,808.14	48,222.40
Commercial,	11,738.79	18,430.24
General,	<u>11,711.10</u>	<u>18,950.00</u>
Sub-total,	\$ 72,978.13	\$121,170.66
Depreciation,	<u>\$ 13,128.97</u>	<u>\$ 23,767.14</u>
Sub-total,	<u>\$ 86,107.10</u>	<u>\$144,937.80</u>
<u>Deductions:</u>		
Uncollectibles,	\$ 515.35	\$ 1,307.00
Taxes,	9,219.51	15,144.51
Rent Deductions,	<u>437.62</u>	<u>4,916.62</u>
Sub-total,	<u>\$ 10,172.48</u>	<u>\$ 21,368.13</u>
Total Expenses and Deductions,	<u>\$ 96,279.58</u>	<u>\$166,305.93</u>
NET REVENUE,	<u>\$ 43,354.81</u>	<u>\$ 68,232.33</u>

Using a rate base of \$410,000, which sum is found to be the reasonable value of the property used and useful in the public service allocable to the Redlands Exchange and which amount includes the fair value of the property so used, together with an estimate of working cash capital and materials and supplies, the net revenue above results in a return of 10.57% for the Redlands exchange and 9.34% for the system.

The calendar year 1929 was used by the engineers of the Commission for testing the present rates and results of operation. A forecast of the company's operations for the year 1930 indicates a normal increase in exchange revenue, a relatively greater increase in miscellaneous revenue and no material change in toll revenue from the 1929 experience. Some increase in expense is expected in 1930 due to the increase in connected telephone stations. Commercial expense will be somewhat increased over the year 1929 due to the issue of two directories instead of one. Some increase in operators' salaries is due and should be allowed. Other expenses will be increased, in accordance with telephone station growth, and depreciation expense will be greater on account of additions and betterments. An estimate of the expected results of operation for the Redlands exchange for 1930 is as follows:

Estimated fair value of property, plus materials and supplies and working cash capital, - - - - -	\$442,173.00
Revenues, - - - - -	\$145,865.00
Expenses and deductions, - - - - -	\$102,639.00
Net Revenue - - - - -	\$ 43,226.00
Return on rate base above, - - - - -	9.7%

Nothing definite concerning the Company's plans for the remainder of the year 1930 has been forthcoming in this proceeding. The Company's witness, in an early hearing in this matter, stated that the officials of the Company, since about July, 1928, had been considering the question of whether to install automatic equipment or feature type manual apparatus in Redlands. Testimony given at the concluding hearing on June 18, 1930, shows that this question was then undecided.

I find that \$442,000.00 represents the reasonable rate base for the Redlands exchange for the year 1930 for the purpose of testing and determining reasonable rates for telephone service in the Redlands exchange, which will yield an adequate return on the fair value of the property used in the public service. The defendant Company received considerably more than an adequate return on a reasonable rate base for the year 1929 and will continue to do so in 1930 if the present rates are continued.

It is apparent from the estimates for the year 1930, that if the present rates are continued they will provide an amount over and above a reasonable return on the rate base found. The rates hereinafter set forth will effect a reduction in revenue in the Redlands exchange and still allow a

reasonable return on both the Redlands exchange properties and system properties.

The following order is recommended:

O R D E R

This case being at issue upon complaint and answer on file, having been duly heard and submitted, proper investigation of the matters involved having been made,

It is hereby found as a fact that the present rates of Southwestern Home Telephone Company applicable in its Redlands exchange are unjust and unreasonable in so far as they differ from the rates herein ordered to be made effective and which are declared to be just and reasonable rates.

Basing its order on the above finding of fact and such other findings of fact and conclusions as are contained in the opinion preceding this order, which opinion is hereby made a part hereof,

IT IS HEREBY ORDERED that Southwestern Home Telephone Company shall submit for filing with the Railroad Commission on or before ^{Sept 25} September 25, 1930, and make effective for service on and after ^{Oct 1} October 1, 1930, in its Redlands exchange, gross rates which shall be the present gross rates, less twenty-five (25) cents per month, on

each of the following items in the Redlands exchange only:

Each primary station, individual line, business and residence flat rate service, all types of telephone instruments.

Each primary station, two-party line, business and residence flat rate service, all types of telephone instruments.

Each primary station, four-party line, business and residence flat rate service, all types of telephone instruments.

Each primary station, eight-party line, business and residence flat rate service, all types of telephone instruments.

Each primary station, suburban line, business and residence flat rate service, all types of telephone instruments.

First bothway trunk line, private branch exchange service.

Each additional trunk line, private branch exchange service.

First bothway trunk line, intercommunicating system, business and residence service.

Each additional trunk line, intercommunicating system, business and residence service.

Discounts on above modified gross rates are to be allowed as provided in the present schedules.

For all other purposes the effective date of this order shall be twenty (20) days from and after the date hereof.

The foregoing opinion and order are hereby approved and ordered filed as the opinion and order of the Railroad Commission of the State of California.

Dated at San Francisco, California, this 3rd day of September 1930.

Clarence
Emmerts
Leon Coville
W. B. Lott
M. J. Linn
 Commissioners.