

ORIGINAL

Decision No. 7438

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

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In the Matter of the Application of )  
UNION HOME TELEPHONE AND TELEGRAPH )  
CORPORATION for an increase of exchange )  
rates in the Cities of Long Beach and )  
San Bernardino, in the State of Calif- )  
ornia, and territory adjacent to said )  
Cities now served from the exchanges )  
therein. )  
..... )

Application No. 4817.

W. W. Butler, for Applicant.  
Geo. L. Hoodenpyl, City Attorney and Emil  
Scharff, Jr., for the City of Long Beach.  
J. L. Adams, for the Chamber of Commerce of  
Long Beach.  
William Guthrie, City Attorney, for the City  
of San Bernardino.

EDGERTON, Commissioner.

O P I N I O N

The Commission is asked to increase the exchange telephone rates of this Company in the territory served by it and particularly in Long Beach and San Bernardino. For a number of years prior to October 1, 1918, in addition to the property owned and operated in Long Beach and San Bernardino, applicant controlled and operated other telephone properties in Anaheim, Santa Ana, Wilmington, Ventura, Placentia, Garden Grove, San Pedro, Highland, Colton, Fullerton and Rialto. In all or most of these places applicant was at that time operating in competition with the Pacific Telephone

and Telegraph Company. On October 1, 1918, it sold to the Pacific Telephone and Telegraph Company its property in all of these points except Long Beach and San Bernardino and acquired that company's property at the two latter points.

It is claimed in the application that for ten years past petitioner has operated at a loss varying from \$5,000 to \$19,000 per annum and that as a result of the competition which existed between it and The Pacific Telephone and Telegraph Company, it has been unable for more than five years to meet in full fixed charges and sinking fund requirements and that it has not set aside a fund for depreciation reserve.

On March 1, 1919, on petition of the Company, an increase in the rates formerly in effect in Long Beach and San Bernardino was authorized by the Postmaster General and became effective in these exchanges. Petitioner now claims that notwithstanding the rate increases put into effect by the Postmaster General, the earnings are insufficient to meet operating and other charges and that it is necessary to further increase the rates.

#### 1 -- Operating Revenues, Expenses and Rate Base.

It was necessary to analyze and check applicant's statement of actual and estimated revenues and expenses under existing and proposed rates, to consider the matters of valuation and rate base and to study the operation and service conditions of this property. It is apparent to me that the estimates submitted to the Commission by applicant are not reliable and do not accurately reflect normal operating conditions.

The consolidation of the formerly competing properties in Long Beach and San Bernardino was under way when the application was filed and during the course of this proceeding and is even now not entirely completed in these two cities. Expenditures for maintenance and other operating purposes have been, and now are, abnormal and cannot be expected to become normal until the consolidation is fairly well completed. Notwithstanding the abnormal operating conditions during this period of consolidation and notwithstanding the unfavorable effect of the consolidation period on the service, the business of the company is increasing at an unusually rapid rate and promises to continue to increase in the future.

In the estimates of earnings and expenses under the rates proposed in this opinion (as shown hereafter), account is had of the increase in labor and material costs. Allowance is made in this estimate for an adequate depreciation annuity which should be set aside in cash in a special depreciation fund and amortized and used strictly in accordance with rules approved by the Commission.

There is a further allowance for special work which the company will have to perform in compliance with the state laws and city ordinances requiring certain standards of construction and maintenance, and the sum of \$36,000 estimated for these items is spread over a period of six years.

Allowance is also made for uncollectible revenue and for the necessary rental payments and taxes. With these considerations it will be noted that there remains to the company,

according to the statement of the Commission's engineers in their estimates under the proposed rates, a new revenue of \$85,423.

The net earnings of \$85,423 are the equivalent of a fair return of 8 per cent on \$1,067,800. I wish to call attention to the fact that this estimated net return is practically the same net return (and is, in fact, slightly in excess of it) that the company expects to receive from the rates it proposes in accordance with exhibit "K". This is in spite of the fact that the Commission's engineering Department's estimates for revenue and expenses differ radically from those of the company.

There is not available an inventory or appraisal of this property. Neither was such an appraisal considered essential in this proceeding for the reason, principally, that a large amount of duplicate property is in existence as a result of the consolidation. This duplicate property should be amortized as rapidly as possible by the company, since otherwise it will be a permanent and increasing handicap to applicant's operating and capital accounts.

The total fixed capital of this company is shown in the annual report for the year ending December 31, 1919, at \$3,019,013.39. This figure has no significance as reflecting either the investment or the value of this property. On the basis of the book cost, the cost per station would amount to \$286. This is an impossible figure and shows on the face of

it the unreliability of the book cost as an index to the value of this property. For a plant of the character of this one, the cost or the value per station should not exceed \$100 undepreciated. Since there are 10,476 stations, the valuation of the property on this basis should not exceed \$1,047,600. It is apparent, therefore, that the estimated net return amounts to slightly more than an 8 per cent return on the undepreciated cost estimate of this property on a station basis.

## 2 -- Capitalization and Fixed Charges.

When a telephone plant of this kind is in reasonably normal operating condition and has a growth as healthy as has this property, we should expect to find it in a sound and prosperous financial condition. The chief difficulty with the Union Home Telephone and Telegraph Corporation, however, is its capitalization and the resulting burden of fixed charges.

On December 31, 1919, there were outstanding stocks and bonds as follows:

Common Stock	\$1 800 750
Preferred Stock,	71 800
Total Stock	<u>\$1 872 550</u>
First Mortgage 5 per cent Bonds	\$1 382 000
Underlying 5 per cent Bonds of Long Beach Telephone and Tele- graph Company	25 000
Underlying 5 per cent Bonds of San Bernardino Home Telephone and Telegraph Company	1 400
Total Bonds	<u>\$1 408 400</u>

There were also outstanding on December 31, 1919, as shown in the company's annual report, \$80,390.20 in 6 per cent and 7 per cent notes. The interest charges on bonds and notes

for the year 1919 amounted to \$72,915.69. We find, therefore, a condition in this company where the face value of the outstanding bonds and notes amounts to \$142.00 per station; a figure, it will be noted, considerably in excess of the undepreciated valuation figure on the station basis. It is not to be expected that this company can continue to carry this burden and at the same time continue to give such reasonably good service as the subscribers of the company have the right to expect and as the Commission will insist upon when the proposed rates are put into effect. Apparently only two means exist to remedy this situation: either the company should speedily effect a financial reorganization or assessments should be levied against the outstanding stock in sufficient amount to provide the company with the necessary operating capital, including the capital needed for extensions and improvements and also in order to permit a writing off of duplicate and intangible property which now swells the capital account to a meaningless figure.

The Commission in Decision No. 5314 recognized this situation when the consolidation and the transfer of the properties were authorized. The Commission said:

"While the financial condition of Union Home Telephone and Telegraph Corporation is such that the authorization of the issuance of these securities to go to the public would not be warranted, it is clear that this whole transaction will be of benefit to both of these companies, and inasmuch as The Pacific Telephone and Telegraph Company is fully advised of the value of these securities and their purchase can in no wise affect the rates or service to be given the public, and as these securities will be held by The Pacific Telephone and Telegraph Company and not sold to the public, I believe the proposal should be sanctioned."

In any event applicant must make financial arrangements to provide for new capital urgently required for extension. It cannot be expected that this capital will come from the rates paid by the subscribers. The owners of the property must furnish the plant and the public will maintain it and pay a fair return. New financing with the present showing is impossible and reorganization or stock assessment, or both, seem the only sound solution.

### 3 -- Depreciation Fund.

According to the company's last annual report there has accumulated a depreciation reserve of \$53,750. This reserve is not in cash, however, and is included in the total fixed capital. The annual report also shows that no charges were made during the year against the depreciation reserve and that in consequence, all renewals and replacements became part of ordinary maintenance and operating expenses. The company admits that its depreciation reserve is a book transaction merely. Applicant states that it will welcome an order from the Commission requiring the setting aside in cash of a depreciation fund and the establishment by the Commission of proper rules governing that fund. I have already pointed out that in the estimate set up above there is included the sum of \$45,000 for this purpose and applicant should be required to set aside in cash for this purpose monthly the sum of \$3,750 and should submit to the Commission its suggestions for rules to govern this fund.

### 4 -- Service.

The service given by petitioner, particularly in Long Beach during and immediately following the consolidation, has

been ~~extremely~~ inferior and has brought about a ~~justifiable~~ justifiable complaint from the public. This has resulted, mainly from line and other troubles incident to the cut-over following consolidation and to the difficulty which the company had in clearing up these troubles promptly on account of a strike of its employees occurring at that time. Complaints of faulty operation were also frequent. The Commission's engineering department has already made a general service investigation into the unsatisfactory service conditions, and remedies have been suggested and adopted with the result that these difficulties have been largely overcome and the service greatly improved.

In Long Beach and San Bernardino, as in other communities in the state, it is apparent that telephone users are demanding satisfactory service and that they are more interested in the best possible service than in the lowest possible rates. The rates proposed in this opinion are increased in some instances to bring them into conformity with similar rates for comparable service in other cities of approximately the same size in this state. These rates are ample to permit good service. The Commission will insist upon such service being rendered by the company and it is expected that service standards will be developed in the near future that will enable a check on service conditions to be made for this and other telephone properties.

6 -- Rates.

The rate increases sought by applicant are not justifiable, in my opinion, either from the standpoint of what are fair and



equitable rates for the service rendered or from the standpoint of applicant's necessities for additional revenue. The need for additional income will be met by the rates suggested in this opinion in accordance with the estimates shown heretofore. The so-called Burluson rates now in effect on this telephone system are sufficiently high for the needs of this company. The changes I am recommending in the existing rates will do away with certain discrimination in favor of certain classes of subscribers when this service is compared with similar service elsewhere.

I recommend the following rate structure:

	Long Beach			
	Business		Residence	
	Wall Set	Desk Set	Wall Set	Desk Set
Individual Line	\$4.00	\$4.25	\$2.50	\$2.75
Two-party Line	3.00	3.25	2.00	2.25
Four-party Line	-	-	1.75	2.00
Extensions	1.00	1.00	1.00	1.00

	San Bernardino			
	Business		Residence	
	Wall Set	Desk Set	Wall Set	Desk Set
Individual Line	\$3.50	\$3.75	\$2.25	\$2.50
Two-party Line	2.75	3.00	1.75	2.00
Four-party Line	-	-	1.50	1.75
Extensions	1.00	1.00	1.00	1.00

Note 1: Rates for private branch exchanges and for miscellaneous equipment not included in the above tables are to be filed with the Commission subject to its approval.

Note 2: All rates are net. The penalty of 25 cents for delinquent payment shall be eliminated. The company is protected in its collections by its rules and regulations filed under Decision No. 2879, Case 683.

Note 3: The company's practice of collecting for installation of desk set \$2.00, in addition to the regular rate, shall be discontinued.

The present practice of the company of making only one charge for service in cases where subscribers are obliged to retain duplicate service, viz., both Pacific and Home, pending completion of the consolidation, should continue until all duplicate service is discontinued. The remaining work of consolidation should be completed as soon as possible and I recommend that within six months of the date of this order applicant shall present to the Commission complete information on the status of the consolidation. At the same time applicant should submit to the Commission its program for the elimination and amortization of such duplicate property as may exist at that time.

I recommend the following form of order:

O R D E R

UNION HOME TELEPHONE AND TELEGRAPH CORPORATION having applied to the Commission for authority to increase its exchange rates in Long Beach and San Bernardino; public hearings having been held, the matter having been submitted and the Commission basing its conclusions on the foregoing opinion:

IT IS HEREBY ORDERED, That UNION HOME TELEPHONE AND TELEGRAPH CORPORATION establish and file with the Commission within thirty (30) days of the date of this order a schedule of rates and services as outlined in the foregoing opinion. On approval by the Commission of the schedules so filed, applicant is authoriz-

ed to put these rates into effect subject to the following conditions:

(1) Adequate and efficient telephone service shall be rendered at all times for all classes of service.

(2) Applicant shall set aside into a depreciation fund the sum of \$45,000 per annum, in monthly installments of \$3,750 for the purpose of taking care of such renewals and replacements as shall be covered by the fund. Applicant shall file with the Commission within thirty (30) days of the date of this order its suggestions for rules governing the functions and use of the depreciation fund and these rules thereafter shall go into effect as approved or modified by the Commission.

(3) Applicant shall complete as speedily as possible the consolidation of all of its property and within six (6) months of the date of this order shall file with the Commission a statement showing the status of the consolidation.

(4) Applicant shall arrange for the amortization and elimination of such duplicate property as is in existence at this time and as should be dispensed with to the benefit of the service and shall within six (6) months of the date of this order submit to the Commission its suggestions for a plan of bringing about such amortization and such elimination within a specified time.

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 19<sup>th</sup> day  
<sup>April</sup>  
of ~~March~~, 1920.

Edwin C. Edgerton  
Frank C. DeWitt  
H. H. Brundage  
James Martin  
Commissioners.