

Decision No. 36324

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Investigation
 on the Commission's own motion of
 THE PACIFIC TELEPHONE AND TELEGRAPH
 COMPANY and SOUTHERN CALIFORNIA TELE-
 PHONE COMPANY, and connecting telephone
 utilities in the State of California,
 with reference to a determination of the
 basis and method of separating telephone
 property, revenues, and expenses.

ORIGINAL

Case No. 4674

Alfred Sutro, Felix Smith and Arthur T. George,
 for The Pacific Telephone and Telegraph Company and
 Southern California Telephone Company.
 C. F. Mason and Marshall K. Taylor, for Associated
 Telephone Company, Ltd., and San Joaquin Associated
 Telephone Company.
 C. F. Mason, Frank V. Rhodes and Marshall K. Taylor,
 for California Independent Telephone Association.
 A. N. Johns, for California Water & Telephone Company
 and West Coast Telephone Company of California.
 Chester C. Fisk, and Gerald W. Stutsman, for the City
 of Berkeley.
 Gerald Kepple, for Consolidated Telephone Company.
 Charles R. Schwanenberg and J. Kerwin Rooney, for
 the City of Oakland.
 F. J. Keys, for Public Utilities California Corporation.
 John J. O'Toole, Dion R. Holm and Paul Beck, for the
 Public Utilities Commission and City and County of
 San Francisco.
 J. J. Deuel for California Farm Bureau Federation.
 Stanley M. Lanham, for Board of Public Utilities and
 Transportation, and Gilmore Tillman, for the City of
 Los Angeles.
 H. A. Dannenbrink, for Siskiyou Telephone Company.
 B. E. Hart, for Delta Telephone and Telegraph Company.
 W. G. Snyder, for Western Telephone Company.
 H. F. Knapp, for Sanger Telephone Company.

BAKER AND SACHSE, COMMISSIONERS:

O P I N I O N

This proceeding was instituted on the Commission's own motion to
 determine a principle and a method of separation of telephone plant, revenue
 and expense as between interstate and foreign service on the one hand, and
 intrastate exchange and toll service on the other hand.

While the order is primarily directed to The Pacific Telephone and Telegraph Company and its subsidiary, Southern California Telephone Company, all connecting telephone companies in the State of California were named as respondents and served with the order of investigation. The Commission notified the regulatory boards of the other states in which The Pacific Telephone and Telegraph Company, or its subsidiary, Bell Telephone Company of Nevada, operates. Honorable C. B. Sexton, Chairman, Public Service Commission, Nevada, and Honorable B. Auger, President, Public Utilities Commission of Idaho, sat as guests at the public hearing herein at San Francisco, on March 26, 1943. Representatives of the larger independent telephone companies, as well as the California Independent Telephone Association, appeared. The larger cities of the State and the California Farm Bureau Federation were likewise represented.

In order that a separation study may be made with a view to practical results in application to exchange and toll rate regulation, a sound basis, or principle of separation, must be established. For twenty years or more, differing views among the industry and regulatory commissions have resulted in countless days of testimony and argument, resulting in conflicting decisions and in litigation. On two occasions the matter of the principle has been before the United States Supreme Court.⁽¹⁾ That the separation should be based on actual usage of the plant and facilities, measured by time in use and other appropriate means, has already been established by these decisions. The controversy essentially involves the question of whether the separation of property to toll service should be between the respective toll switchboards or whether it should extend to include an allocation of all property used in a toll call between the calling and called telephones. Sharp differences of opinion have existed. The Bell System has almost uniformly advocated the board-to-board principle.⁽²⁾

(1) Smith vs. Illinois Bell Telephone Company 282 U.S. 133 (1930)
Lindheimer vs. Illinois Bell Telephone Company 292 U.S. 151 (1934)

(2) An exception exists in New York intrastate toll rates.

On April 1, 1941, the Federal Communications Commission instituted an investigation (Docket 6053) into the reasonableness of the interstate telephone rates of the Bell System. This Commission was scheduled to participate in the investigation. That proceeding, however, was terminated by a negotiated reduction in toll rates, announced June 4, 1941, whereupon this Commission joined with other state regulatory agencies in requesting the Federal Communications Commission to co-operate in joint studies of fundamental telephone problems which the states had expected to present at the said hearing. The Federal Communications Commission arranged a conference with state representatives in Washington on June 11, 1941, which conference was attended by the presiding commissioner in the instant proceeding. At such conference it was agreed that the most pressing and important problem of telephone regulation was the determination of a sound principle of separating telephone property, revenue and expense as between jurisdictions, together with an appropriate method whereby to apply the principle.

The separation problem had also been placed before the Federal Commission by a petition filed by the Bell Companies in which they requested the Commission to institute an investigation on its own motion to determine rules and methods for a separation between interstate and intrastate operations, and, after notice and hearing, to prescribe such rules and methods.

A joint staff committee, comprised of members of the staffs of the Federal and State Commissions, was appointed at that time to make the technical studies and prepare a report on separation methods. After the completion of the studies, the Federal Communications Commission, on June 9, 1942, instituted a formal investigation (Docket No. 6328) on its own motion. The separation report of the Staff Committee was attached to the order instituting the investigation, as well as a method proposed by a member of the staff of the Federal Communications Commission. Hearings were held in Chicago, Illinois, in August and October, 1942, before two members of the Federal Communications Commission and a Panel of Five Co-operating State Commissioners, and the matter is now under submission before the Federal Communications Commission.

History of California Rates

The first proceeding before the California Commission involving toll rates was Application No. 2 filed March 22, 1912, and decided on November 14, 1913 (3CRC 903). This proceeding was heard prior to the time jurisdiction over exchange rates had been vested in the California Railroad Commission. At that time 15% of originating tolls were allocated to exchange. The Commission said:

"It has been customary in the past to apportion 15% of toll revenues to exchange accounts. We have made a most thorough investigation of the present method of apportionment and find that an allowance of 15% to be credited to exchange accounts to handle these expenses of operation which are a part of the toll function and the value of such exchange equipment used in connection with toll service is unreasonably low and should be increased to 30%. The telephone company has agreed to this apportionment and the agreement is of record in these proceedings. With a just apportionment of toll revenues so as to provide a proper allowance to be credited to exchange accounts, we know of no reason why the toll and exchange business should not be kept separately and each class of service bear its just proportion of supporting the institution."

In reviewing the history of proceedings before the California Commission and the fixing of the so-called Burleson schedule by the United States Government in 1919, Arthur B. Fry, Telephone and Telegraph Engineer for the Commission, testified that in his opinion there had been no specific development of the terms "board-to-board" and "station-to-station" at the time of hearings in Application No. 2, but that there had been the intention to assign a fair share of tolls to the exchange. He reviewed the 1924, 1929 and 1936 orders fixing rates in the Los Angeles exchange and pointed out that the first definite use of the term "station-to-station" was in the order in Case No. 3800, in re City of Los Angeles vs. Southern California Telephone Company, decided in 1936 (39 CRC 739).

Mr. Fry testified that in his opinion the station-to-station principle of separation of telephone plant, revenue and expense, should be adopted.

Principles Involved

Evidence as to the principles involved was submitted by Edward F. McNaughton, Director of the Public Utilities Department of the Commission, who,

in his testimony submitted the following reasons for the adoption of the station-to-station principle of separation:

1. The station-to-station method is the only complete separation covering all operations from the calling telephone to the called telephone, while the board-to-board method applies to arbitrarily selected intermediate points.
2. There is a great diversity in toll use as between users. The great majority of toll calls originate at a relatively small percentage of stations. In California, a recent check shows that 70 per cent of the toll business originates at only 22 per cent of the stations. Under the board-to-board theory, part of the toll costs are borne by all the exchange subscribers.
3. Toll calls have increased and are continuing to increase at a higher rate than exchange calls. Toll facilities are being installed at a rapid rate and considerable research is being devoted to toll facilities, looking toward improvements which reduce the cost of the service.
4. By far the larger amount of recent rate reductions has been made in toll rates rather than in exchange rates. The trend of long distance rates, particularly for transcontinental service, has been decidedly downward, while exchange costs remain more or less fixed.
5. The board-to-board basis in and of itself does not provide full compensation to independent connecting companies. Thus, if settlements are made on a board-to-board basis, the exchange subscriber or independent connecting company is required to bear part of the toll service cost.
6. Fundamentally, the station-to-station separation should be adopted, since it clearly meets the test recognized by the United States Supreme Court in what is commonly termed the "Smith case,"⁽³⁾ namely, that by some practical method the different uses of the property may be recognized and the return properly attributable to the intrastate service may be ascertained accordingly.

The question of the adoption of either the station-to-station or board-to-board principle is under submission and awaiting decision by the Federal Communications Commission in Docket No. 6328. After the submission of that docket, however, the Federal Communications Commission entered a formal order of investigation of interstate toll rates, Docket No. 6468. In connection with an agreed settlement of the latter proceeding the American Telephone and Telegraph Company voluntarily refiled its interstate rates on

(3) Smith vs. Illinois Bell Telephone Company 282 U.S. 133 (1930)

the station-to-station basis, effective as of February 1, 1943.⁽⁴⁾ Effective the same date, The Pacific Telephone and Telegraph Company likewise refiled its interstate tariffs to include the station-to-station definition.

In the instant proceeding, A. T. George, Counsel for The Pacific Telephone and Telegraph Company and the Southern California Telephone Company, stated that the rates of these respondents were upon a board-to-board basis, and argued that the board-to-board basis should be continued. Counsel presented no evidence, however, to support his view, but stated that the respondent Bell System companies would offer no formal objection if the Commission should adopt the station-to-station basis.

The California Independent Telephone Association, through C. F. Mason, its president, acting on behalf of its Board of Directors, filed a statement outlining the position of the Association in favor of the station-to-station basis. Mr. Mason also filed a separate statement on behalf of Associated Telephone Company, Ltd., and San Joaquin Associated Telephone Company, likewise in favor of the station-to-station basis.

A. N. Johns, representing the California Water and Telephone Company and West Coast Telephone Company of California, testified in support of the station-to-station method, submitting a statement designated Exhibit No. 3.

As is well known in the actual fixing of rates, other elements than cost of operation are considered. To the extent that costs of operation enter into the rate making problem there should be one uniform and sound method for ascertaining what such costs are and that method should be, if possible, adopted and used on a nation-wide basis. The application of such uniform principle and method will result in the preparation of a statement of the plant, revenue and expense applicable to both interstate and intrastate operations of the Bell System network and thereby provide the necessary information for the Federal and state Commissions on a sound and consistent basis.

(4) A panel of five State Commissioners was named to represent the N.A.R.U.C. in the rate proceeding.

It is apparent that it would now be highly unjust to the public to adopt the board-to-board theory for intrastate rate fixing, since interstate rates are now actually filed with the Federal Communications Commission on a station-to-station basis. If such a course were taken, the public would pay twice for the pro rata of exchange plant and expense assignable to interstate toll service on the station-to-station basis. Moreover, the record shows that while some uncertainty exists, California rates in the past generally have reflected the station-to-station principle, and the inadequacies of the board-to-board basis have been pointed out by this Commission.⁽⁵⁾ The Los Angeles exchange rates in 1936 were definitely fixed on a station-to-station basis.⁽⁶⁾ Clearly from the very first decision, when the Commission had jurisdiction only over toll rates, it has been careful to insure that the exchange was adequately compensated.

We conclude that changes in the tariffs should be made whereby to resolve all uncertainties, if any, that may now exist. The testimony of Mr. Fry shows that the present definitions of toll service require no change. He recommends, however, the insertion of the following statement, as set forth in Exhibit No. 1, in the toll schedule to clarify the issue and definitely place these rates for the future on an unequivocal station-to-station basis:

"A toll telephone message is a completed call or telephonic communication between exchange stations where the called station is not within the local service area of the calling station, between toll stations, or between a toll station and an exchange station.

"The toll service charges specified in this tariff are in payment for all service furnished between the calling and the called telephones."

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- (5) Re Pac. Tel. and Tel. Co. 1913 (3 CRC 903)
Re So. Calif. Tel. Co. 1924 (25 CRC 721)
Re Pac. Tel. and Tel. Co. 1929 (33 CRC 738)
City of Los Angeles vs. So. Calif. Tel. Co. 1936 (39 CRC 164)
- (6) City of Los Angeles vs. So. Calif. Tel. Co. 1936 (39 CRC 164)

Methods

Separations of telephone plant, revenue and expense may be required for the following purposes:

1. A separation is required for jurisdictional purposes as between interstate and foreign service on the one hand, and intrastate service on the other hand.
2. A separation is required for regulation of intrastate rates by states like California which regard the exchange as the basic rate fixing area.
3. A separation may be required in the determination by the Commission of the results of exchange and toll operation of an independent telephone company operating both exchange and toll lines.
4. A fourth need for separation, and one important to the independent telephone companies, may occur when the Bell telephone companies and the independents are negotiating their connecting agreements.
5. A fifth necessity for separation arises in connection with the analysis of the periodical exchange and toll operation statements furnished this Commission by The Pacific Telephone and Telegraph Company and Southern California Telephone Company.

In testifying to these several purposes, Mr. McNaughton stated there was no necessity at this time for the Commission to prescribe detailed methods for separation of independent operators, in so far as Commission regulation is concerned.

In respect to the method for separation for jurisdictional purposes between state and interstate operations, Exhibit No. 2 was testified to by Walter B. Wessells, Senior Engineer of the Commission staff. This exhibit summarizes the methods recommended to the Federal Communications Commission in Docket No. 6328 by a joint staff committee of fourteen of the Federal Communications Commission and National Association of Railroad and Utilities Commissioners. Mr. Wessells participated as a member of the subcommittee in drafting the report at Washington and New York in 1941. He testified as to the detailed methods recommended, including separation of plant, revenue and expense.

The Commission is of the opinion that this case should be held open for determination at a later date of methods and the application of such methods

to company records and operations. It is also expected that the Federal Communications Commission will, at an early date, adopt separation methods for interstate operations which may become a guide for the states to use in determining intrastate earnings.

Other phases of this investigation which will likewise be held open are:

1. The development by the staff of this Commission in cooperation with The Pacific Telephone and Telegraph Company of a method of exchange and intrastate toll separation consistent with federal practice;
2. The application of the method to the annual exchange and toll earning statement for The Pacific Telephone and Telegraph Company and Southern California Telephone Company in lieu of the statement presently filed with this Commission;
3. The consideration, jointly with other states served by The Pacific Telephone and Telegraph Company, of an equitable method of allocation of the depreciation reserve and such other elements of cost common to more than one state.

The Pacific Company and American Telephone and Telegraph Company should restate their memorandum of agreement of March 10, 1936, to eliminate the following words on pages 10 and 11 thereof;

"except the exchange service facilities required to establish connection between an exchange station and the toll terminal plant, for the use of which excepted facilities the Licensee is compensated by its rates for exchange service in such exchange,"

The Pacific Company and its subsidiary should also restate on a station-to-station basis any other subsisting contracts or arrangements resting upon the board-to-board basis.

We find the station-to-station principle of cost allocation to be just and reasonable and that it should be adopted. The order will provide for the filing of tariffs consistent with this finding. This proceeding will be held open, however, as indicated, for further consideration of methods and the application thereof.

The above entitled proceeding having been heard and submitted with respect to the issue of principle alone, therefore,

O R D E R

IT IS HEREBY ORDERED that The Pacific Telephone and Telegraph Company and Southern California Telephone Company refile, not more than 30 days from date hereof, their schedules for Message Toll Telephone Service to include the following statement:

"A toll telephone message is a completed call or telephonic communication between exchange stations where the called station is not within the local service area of the calling station, between toll stations, or between a toll station and an exchange station.

"The toll service charges specified in this tariff are in payment for all service furnished between the calling and the called telephones."

This proceeding shall be held open for such further order as to methods which may be appropriate.

For all other purposes, the effective date of this order shall be 20 days from the date hereof.

The foregoing Opinion and Order is hereby ordered filed as the Opinion and Order of the Railroad Commission of the State of California.

Dated at San Francisco, California, this 4th day of

May, 1943.

Francis A. Hoover
[Signature]
Arthur F. Cramer
Richard Sachs
Francis Clark
(Commissioners)