

Decision No. 36869

ORIGINAL

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the investigation upon the Commission's own motion into the reasonableness of the rates, tolls, rentals, charges, classifications, rules, regulations, contracts, and practices, or any of them, of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY and SOUTHERN CALIFORNIA TELEPHONE COMPANY applicable to intrastate message toll telephone and private line telephone and teletypewriter services rendered directly or indirectly by said companies.

Case No. 4710

Alfred Sutro, Felix T. Smith, and Arthur T. George,
for The Pacific Telephone and Telegraph Company and
Southern California Telephone Company.

F. V. Rhodes, for California Independent Telephone
Association.

A. N. Johns, for California Water & Telephone Company.

John J. O'Toole, Dion R. Holm, and Paul Beck, for
City and County of San Francisco.

J. J. Deuel, for California Farm Bureau Federation.

Walter W. Cooper, for City of San Diego.

Ray L. Chesebro, Gilmore Tillman, and Stanley M. Lanham,
for City of Los Angeles.

Gilmore Tillman, for League of California Cities.

F. J. Keys, for Public Utilities California Corporation.

SACHSE AND HAVENNER, COMMISSIONERS:

O P I N I O N

This is a proceeding instituted on the Commission's motion for the purpose of determining and effecting modifications of the rates and charges, etc. of respondent companies and with particular reference to intrastate message toll service, private line service, and teletypewriter exchange service.

At the hearing in this proceeding held in San Francisco on February 1, 1944, evidence was presented and the matter was submitted for decision.

The Pacific Telephone and Telegraph Company, hereinafter sometimes termed Pacific Company, is a Bell System subsidiary operating exchange telephone service, message toll telephone service and various other communication services in California and other states. Southern California Telephone Company, hereinafter referred to as Southern Company, operating in southern California, is a subsidiary of Pacific Company.

After the Federal Communications Commission reduced the interstate telephone message toll rates of the Long Lines department of the American Telephone and Telegraph Company last year, the Commission instructed its staff to make a study of the California operations of the Pacific Company and its subsidiary, the Southern Company.

Studies were undertaken in cooperation with the Companies' representatives and a report was completed in July, 1943, entitled "Results of Operation of The Pacific Telephone and Telegraph Company in Northern California and Southern California Telephone Company Year 1942." Concurrently a report entitled "Toll Rate Structure, The Pacific Telephone and Telegraph Company" was prepared by the staff of the Commission. Copies of these reports were furnished the Companies for comments. Thereafter a series of conferences between the Commission and its staff and officials and representatives of the Companies were held on August 2, 3, 23 and 31; September 7, 14 and 20; November 22 and 24 and December 1, 1943. These conferences disclosed the fact that there were a number of differences between the Companies' view and the reports of the Commission's staff. In an effort to arrive at a constructive and speedy result with reference to the toll rate structure a proposal of certain toll rate reductions was submitted to the Companies. After discussions between officials of the Companies and the Commission, a reduction of \$3,803,000 per year was agreed upon effective March 1, 1944, with the understanding that the Companies and the Commission would continue the study of the toll rate structure and related problems.

Testimony was presented at the hearing by members of the Commission's staff. No other testimony was offered. The Companies read into the record a

statement to which reference will be made below.

Exhibit No. 1, the "Report on the Results of Operation of The Pacific Telephone and Telegraph Company in Northern California and Southern California Telephone Company Year 1942" was placed in evidence by Arthur B. Fry, Telephone and Telegraph Engineer of the Commission's staff. This report on the results of operations of these Pacific System companies in California shows the following:

Undepreciated Rate Base	\$442,297,000
Deduction for Depreciation	<u>123,109,000</u>
Depreciated Rate Base	\$319,188,000
Operating Revenue	\$131,602,799
Operating Expenses	68,886,398
Taxes (including federal surtax (and excess profits tax)	27,158,342
Depreciation (Straight-Line)	<u>16,570,582</u>
Total Expense	\$112,615,322
Net Revenue	\$ 18,987,477
Rate of Return on Average Rate Base (Depreciated)	5.95%

For the purposes of the report, the revenues and expenses recorded by the Companies were used. As the Pacific Company operates in other areas in addition to northern California, prorations of certain expenses were necessary. Certain modifications in taxes were made resulting in a net decrease of \$34,503. Straight-line depreciation expense, including \$457,457 applicable to \$3,080,673 of "emergency facilities," was used. The historical cost rate base developed from the recorded telephone plant was modified to exclude telephone plant under construction and certain property held for future use. Adjustments were made in the telephone plant acquisition account. Land was included at book cost except that those parcels in the San Francisco-East Bay exchange area and in the Los Angeles extended area were adjusted to their appraised market value as of December 31, 1942. Adjustments were made to transfer a portion of the book cost of administration buildings (including land, furniture and office equipment) located in northern California on a use basis. Materials and supplies were added to the adjusted telephone plant. No working cash was used in the rate base. In arriving at the theoretical apportionment of the depreciation reserve of the Pacific Company

to the state of California area as of December 31, 1942, the net credits for the years 1939 to 1942, inclusive, were added to the estimated amount determined for the year 1938. An amount, representing a prorate of the San Francisco administration building was then deducted from the average depreciation balance for 1942.

As the Companies compute their depreciation expenses on a straight-line basis it is proper to use a depreciated rate base. The rate of return computed from the amounts contained in the report is 5.95% which in view of the treatment of certain tax and other expense items, is considered a wholly adequate rate of return. Certain items of expense, although questioned by the staff members, were used without modification. A more detailed study of those items, especially the excess profits tax, may require adjustments which would increase the computed rate of return shown in the report.

Mr. P. E. Dufour of the Commission's staff gave testimony concerning telephone plant in service and rate base in Exhibit No. 1.

The report entitled "Toll Rate Structure, The Pacific Telephone and Telegraph Company," dated July 21, 1943, was presented in evidence as Exhibit No. 2 by W. B. Wessells, Research Engineer of the Commission's staff. The particular types of service discussed in the report are telephone message tolls, private line telephone service, private line teletypewriter service and program service, with major emphasis upon telephone message tolls.

Since the introduction of the two classes of message toll telephone service (station-to-station and person-to-person) the tendency has been to increase the differential between them for the initial period and to reduce the level of overtime charges for person-to-person service to the station-to-station level. A recent reduction in rates for Long Lines telephone message toll service (American Telephone and Telegraph Company interstate service) applied to the overtime charges and not to the initial period charges. This reduction reflects the considerable decrease in recent years in the line haul costs as compared with the terminal costs incident to the establishment, supervision, and disconnection of the call. These reductions in Long Line rates and reductions in Pacific Company

interstate rates have seriously increased the disparity between these interstate rates and the higher rates for intrastate message toll service in California.

The intrastate person-to-person weekday initial period rates are roughly one-third higher than the similar station-to-station rates. A night and Sunday rate applies to station-to-station traffic over routes of over forty-eight miles and to person-to-person traffic over routes of over fifty-six miles.

Except for the short haul station-to-station traffic, the schedules provide for an initial period of three minutes and an overtime rate for each minute in excess of the initial period. For station-to-station traffic over routes of more than thirty-two miles the overtime rate per minute is roughly one-third the initial period station-to-station rate. For each minute of the first three minutes of overtime of a person-to-person message the rate is roughly one-third of the person-to-person initial period rate. The rate of charge for each minute of overtime of a person-to-person message beyond the initial period of three minutes and the first three minutes of overtime (or beyond six minutes from start of conversation) is the same as the overtime rate for station-to-station traffic over the same route. In the Long Lines schedule the overtime rate per minute is the same for any overtime of a station-to-station or person-to-person message over the same route.

It is thus seen that the Pacific intrastate rates in California are considerably greater than the Long Lines rates for traffic over like distances in respect to both initial period charges and overtime charges. The disparity is considerably greater for the longer distances.

Mr. E. F. McNaughton, Director of the Public Utilities Department of the Commission, introduced in evidence as Exhibit No. 3 a statement setting forth the items of service for which the rates of charge would be reduced in accordance with the agreement heretofore referred to. The annual savings to the public as estimated by the Pacific Company are itemised on the following page:

	<u>Estimated Annual Saving</u>
1. Reduce station-to-station overtime rates (on messages over 56 miles) to a basis of 25% of initial period rates	\$ 916,000
2. Reduce person-to-person overtime rates (on messages over 40 miles) for the first 3 minutes to a basis of 25% of person-to-person initial period rates and the balance of overtime to the equivalent station-to-station rate	1,294,000
3. Reduce private line telephone rates to Pacific interstate levels	619,000
4. Reduce private line teletypewriter rates to Pacific interstate levels	264,000
5. Reduce teletypewriter exchange service rates for overtime (on connections over 60 miles) to a basis of 25% of initial period rates	45,000
6. Advance night discount period from 7 p.m. to 6 p.m. on intrastate tolls	<u>665,000</u>
Total	\$ 3,803,000

Briefly stated the station-to-station overtime rates per minute now applying on a basis of one-third of the initial period rate for the corresponding toll route will be reduced to one-fourth the initial period rate. The reduction to one-fourth applies to day and to night and Sunday service over routes over fifty-six miles.

Person-to-person overtime rates per minute now on a basis of one-third of the person-to-person initial period rates for each of the first three minutes of overtime will be reduced from one-third to one-fourth. The rate for each minute of overtime after the first three minutes of the person-to-person overtime now one-fourth of the person-to-person initial period rate will be reduced to one-fourth of the station-to-station initial period rate for service over the same toll route. The person-to-person night and Sunday overtime rates will be similarly reduced.

Private line telephone and teletypewriter rates will be made to correspond to the rates now applicable to Pacific Company interstate service throughout its service area.

Teletypewriter exchange service rates for overtime now on a basis of one-third of the initial period rates are reduced to a basis of one-fourth of the initial period rates.

Advancing the night discount period from 7 p.m. to 6 p.m. will make the period the same for intrastate and interstate service.

Mr. McNaughton expressed the belief that after the reductions made in this decision, the Pacific Company's net earnings for the year 1944, on the basis set forth in Exhibit No. 1 will be in excess of six per cent.

The attorney for the Companies, after testimony had been presented, read a statement into the record to record their consent to the entry of an order formally approving the specifically described rate reductions heretofore agreed upon and shown on Exhibit No. 3. The Companies desired "that the record should specifically show the reasons, which prompted the Companies to agree to the revenue reduction insisted on by the Commission, notwithstanding their view that no reduction was warranted. . . ." And further "it is now estimated, as a result of recent analyses, that post-war expenditures of such proportions will be required that it will be necessary for the Companies in meeting them to make plant expenditures requiring millions of dollars. . . ." "These heavy financial requirements clearly emphasize that the test of the adequacy of the Companies' rates is whether they provide sufficient earnings to attract the necessary capital. As we have heretofore pointed out to the Commission in the course of our conferences, the earnings under present rates are below this requirement."

We do not agree with these conclusions. A reduction in the message toll rates and the advancement of the discount period from 7 p.m. to 6 p.m. has been ordered by the Federal Communications Commission for all interstate operations of the Bell System and our order extends these desirable changes, in part, to the California intrastate service of the Companies here before us. We are satisfied that the proposed changes will be of great benefit to the departments of the Government, war industries and particularly to the personnel of the armed forces, and to the general public. No undue financial burden will be placed upon the Companies.

The Commission has given serious and prolonged attention to this rate situation and to the Companies' earnings. The reduction indicated in Exhibit No. 3 will bring the California intrastate message toll telephone and private line tariffs more nearly in line with the interstate schedules and will simplify their administration. The estimated earnings of the Companies for 1944 with these reductions in effect, we believe, will be wholly adequate to meet all of the Companies' operating and financial requirements, including the recent wage increases. In making our order it will be understood that there will be further study and investigation of these matters by the Commission and the Companies.

We recommend the following Order:

O R D E R

The above entitled matter having been initiated by the Railroad Commission on its own motion, a public hearing having been held and the matter having been submitted for decision,

THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA hereby finds as a fact that the reductions in telephone message tolls, private line telephone rates, private line teletypewriter rates, teletypewriter exchange service rates, and increase in the night discount period are justified, therefore

IT IS ORDERED that The Pacific Telephone and Telegraph Company and Southern California Telephone Company shall file with the Railroad Commission not later than February 25, 1944 and make effective on March 1, 1944, modifications of their California intrastate tariff schedules necessary to accomplish the following:

1. Reduce station-to-station overtime rates on messages over toll routes of over fifty-six (56) miles to a basis of twenty-five (25) per cent of the station-to-station initial period rates.
2. Reduce person-to-person overtime rates on messages over toll routes of over forty (40) miles for the first three minutes of overtime to a basis of twenty-five (25) per cent of the person-to-person initial period rates.
3. Reduce person-to-person overtime rates on messages over toll routes of over forty (40) miles for overtime after the first three minutes of overtime, to the station-to-station overtime rates over corresponding routes.
4. Reduce private line telephone rates to the level of The Pacific Telephone and Telegraph Company interstate rates for similar service.

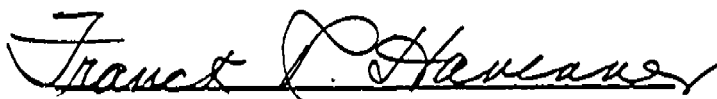
5. Reduce private line teletypewriter rates to the level of The Pacific Telephone and Telegraph Company interstate rates for similar service.
6. Reduce teletypewriter exchange service overtime rates for connections over routes of over sixty (60) miles to a basis of twenty-five (25) per cent of the initial period rates for similar service.
7. Change the night discount period now extending from 7 p.m. to 4:30 a.m. to a period extending from 6 p.m. to 4:30 a.m.

Except as otherwise prescribed herein, 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 15th day of February, 1944.



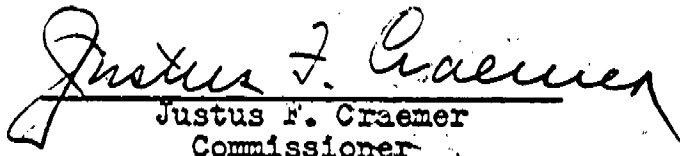



Commissioners

I concur in the result of the order in the foregoing opinion and order.

At this time, however, I am not ready to accept the changes offered by some of the proposals of the Public Utilities Department reversing long and well-established principles, particularly with respect to rate base, working cash capital, and depreciation, which are not in issue, since the company has indicated its willingness to agree to reductions ordered.

Furthermore, it is my understanding that the discussion of these matters in the opinion is but a review of the Department's report rather than Commission rulings upon those questions.


Justus F. Craemer
Commissioner