

Decision No. 46395

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of The Independent Telephone Co. for authority to increase Exchange Service rates at Kenwood and Knights Landing and to issue additional shares of its Common Stock.)

) Application No. 32177

E. A. Hosmer, Thelma Devine and Betty Parker,
for applicant; Eldon N. Dye for California
Farm Bureau Federation, interested party;
Charles E. Greenfield, attorney, on behalf of
certain Kenwood subscribers; W. W. Dunlop,
for the Commission staff.

O P I N I O N

In this application, filed March 5, 1951, The Independent Telephone Company, a California corporation, seeks authority to increase rates and charges for telephone service in its exchanges at Knights Landing and Kenwood. In its application, applicant also requested authority to issue additional shares of its capital stock but at the public hearings in this matter, held before Examiner Emerson at Woodland on August 16, 1951 and at Kenwood on August 17, 1951, it was requested by applicant that this portion of the application be held in abeyance pending the completion of certain valuation studies.

Applicant's present and proposed rates, segregated by principal classes and grades of service, are compared in the following tabulation:

Class or Grade of Service	: Present Rates :		: Proposed Rates :		: % Increase :	
	:Knights:		:Knights:		:Knights:	
	:Landing:	:Kenwood:	:Landing:	:Kenwood:	:Landing:	:Kenwood:
<u>Residence Service, Per Month</u>						
Individual line	\$2.25	\$2.25	\$4.50	\$4.50	100%	100%
Two-party line	-	2.00	4.00*	4.00	*	100
Four-party line	1.75	1.75	3.50	3.50	100	100
Ten-party suburban line	2.75	1.75	3.75	3.75	36	114
Farmer line	.30	**	2.00	**	566	**
Installation charge	3.50	3.50	6.00	6.00	71	71
<u>Business Service, Per Month</u>						
Individual line	2.75	2.75	5.50	5.50	100	100
Two-party line	-	2.25	5.00*	5.00	*	122
Four-party line	2.25	-	4.50	4.50	100	*
Ten-party suburban line	3.25	2.25	4.50	4.50	38	100
Farmer line	.60	**	2.50	**	317	**
Installation charge	3.50	3.50	6.00	6.00	71	71
<u>Line Extensions</u>						
Per 100 feet	2.00	2.00	6.00	6.00	200	200

* New service offering.
** Service not offered.

Applicant corporation was formed in 1949 and in March, 1950 purchased the Knights Landing and Kenwood telephone properties from its president, Mr. E. A. Hosmer. Properties comprising the Kenwood exchange were acquired as an individual by Hosmer on November 1, 1948, while those properties comprising the Knights Landing exchange were acquired on May 1, 1949.^{1/} At the time of acquisition by Hosmer, the Kenwood system included 25.5 circuit miles of wire and 112 telephone stations. The exchange rates now in effect in Kenwood are substantially the same as those established prior to 1915. The Knights Landing system, when acquired by Hosmer, had approximately 98 circuit miles of wire and 176 stations. Knights Landing exchange rates have been unchanged since 1926.

^{1/} See Decision No. 42111 in Application No. 29704, Decision No. 42679 in Application No. 30152 and Decision No. 43881 in Application No. 30937 for details of acquisition and transfer.

Knights Landing exchange is presently served by means of a two-position, 300-line, common battery switchboard, equipped with 160 lines, 85 of which are working exchange lines. As of June 1, 1951, some 294 stations received exchange service. Seven 10-party and twelve 4-party lines are still served on a magneto basis. Applicant owns no toll lines. However, there are presently seven toll circuits, owned by The Pacific Telephone and Telegraph Company, connecting Knights Landing and Woodland and one additional circuit is programmed for early completion. All toll operating and ticketing is handled at Woodland. The operating force at Knights Landing consists of one manager-chief operator, three operators, and one maintenance and construction man.

At Kenwood there is a one-position, 70 line, magneto switchboard which has been modified for common battery operation. As of June 1, 1951, there were 193 stations receiving exchange service. Three lines, serving 26 stations, are still served on a magneto basis. Applicant owns no toll lines at Kenwood. Toll service is available, however, through six toll trunks, owned by The Pacific Telephone and Telegraph Company, connecting Kenwood and Santa Rosa. All toll operating and ticketing for Kenwood is performed at Santa Rosa. Applicant's operating force at Kenwood consists of five operators and one part-time maintenance and construction man.

Applicant's headquarters is located in Kenwood and occupies space in a one story, four-room building, rented from Mrs. E. A. Hosmer, also occupied by E. A. Hosmer & Company, a corporation, of which applicant's president is also the president. While E. A. Hosmer & Company is not the applicant herein, it is noted that the owners, officers, and directors of the two organizations are identical. In addition, applicant's president

testified that "The entire operations of the company are conducted as a unit and in so far as the separate corporate entities will permit, this unit concept includes the operations of other companies which may be served by E. A. Hosmer & Company." Also, "The staff of E. A. Hosmer & Company and the Telephone Company staff's function as one organization for all practical purposes..."

The arrangements between the two organizations are not reduced to writing, but it is claimed that E. A. Hosmer & Company performs various management, engineering, accounting and certain other maintenance, operating and construction functions for The Independent Telephone Company. The books of the telephone company show charges for such services. Because of the interrelationship and apparent interdependence of the two corporations we believe an explanation thereof is of importance to an understanding of the operations of applicant.

According to applicant's president, most companies the size of applicant's would be operated by one man, frequently the owner of the property. At the time of acquisition both the Kenwood and Knights Landing systems were primarily rural telephone systems and in poor physical condition. Instead of a mere expansion of existing technically sound telephone systems, therefor, both exchanges presented problems of substantial rehabilitation which approached the creation of entirely new systems. Such work, according to applicant, required the services of an engineering staff, capable technical personnel, the assistance of construction forces and adequate purchasing, clerical and accounting services. E. A. Hosmer & Company has provided such services for the telephone company. The Hosmer Company is a research and developmental organization which at times, prior to May, 1951, had as many as seven engineering or otherwise technically qualified

employees engaged in various phases of its laboratory, other communications or commercial work. These employees, from time to time, have been available for work on the telephone company's system on the basis of a prorata salary charge for actual time expended on telephone company problems. At the time of the hearing in this proceeding, however, the Hosmer organization had no such employees. As applicant's president, Mr. Hosmer testified that the modernization program was 98% complete at Kenwood and 85% complete at Knights Landing and expressed concern over his inability to proceed with the program. He averred that the telephone company has operated at a loss since its inception and that absence of rate relief would have an adverse effect upon the quality of telephone service and hinder the financing of the reconstruction program. The record in this matter indicates that, to date, E. A. Hosmer & Company has handled the financing of additions and betterments made by The Independent Telephone Company.

Operating revenues for the year 1950 were reported by applicant as totaling \$26,569.61. Approximately 60% of this amount was obtained from the Knights Landing exchange and 40% from the Kenwood exchange. On a company-wide basis approximately 45.7% of 1950 total revenue was from local service, 50.4% from toll service and 3.9% from miscellaneous services.

Total 1950 operating expenses, including taxes and depreciation, as recorded by applicant were \$30,934.64. Of this amount approximately 59% pertained to the Knights Landing exchange and 41% to Kenwood. The sum of approximately \$8,849 or 31% of total expenses, excluding taxes and depreciation, were charged for the services of E. A. Hosmer & Company. Also recorded for the year 1950, and included in the above total expenses, is an amount

of \$1,202.02 charged for attorney fees in connection with applicant's incorporation. This latter amount is a nonrecurring item.

From the above, it is apparent that the recorded expenses of applicant for the year 1950 exceeded the recorded revenues and that, therefore, applicant's books showed a loss for such year.

Estimated results of operations for the year 1951 were presented in detail by the Commission staff. No estimate of 1951 operations was presented by applicant, although profit and loss statements for the period January 1 to June 30, 1951 were testified to by the Controller of E. A. Hosmer & Company. No more than a seven months' period of operations in 1950 was used by applicant to give any indication of the effect of the proposed rates on applicant's operations in that year. Applicant did, however, present an estimate of 1952 operations under proposed rates.

The staff estimate of 1951 revenues at present rates, based upon the trending of revenues during the year 1950 and the first five months of 1951 and allowing for anticipated growth in accordance with applicant's planned expansion, shows amounts of \$16,800 for Knights Landing and \$11,300 for Kenwood or a total of \$28,100 on a company-wide basis. In arriving at an estimate of 1951 revenues under proposed rates, the staff repriced exchange services as of June 27, 1951, and thereby derived estimated increases in revenues of \$5,600 for Knights Landing and \$4,500 for Kenwood. Such increases indicate a total estimated revenue, under proposed rates, of \$38,200 on a company-wide basis for the year 1951.

Estimates of 1951 expenses, as made by the staff, were made for each account and segregated between exchanges. In general,

expenses were estimated by giving consideration to actual experience in 1950 and the first three months of 1951 and on the assumption that the present methods of operation, whereby services of E. A. Hosmer & Company are charged to expense accounts, would continue and, further, that normal growth also would continue. The staff's estimated total of all operating expenses, before taxes and depreciation, for this company's 1951 operations is \$29,900.

Estimates of taxes and depreciation expense both are influenced by the value of fixed capital or telephone plant in service. The total of telephone plant to be properly entered on applicant's books is not at present known as it is the subject of another proceeding before this Commission which has not as yet been concluded. Ad valorem tax rates for this utility are also not known with certainty at the present time. The record in this proceeding is not conclusive on these subjects. The staff, in making its estimates, has applied current tax rates for all the various kinds of taxes assessed against the utility and with respect to ad valorem taxes has utilized an appraisal of the total property, made by applicant, as a base. Of greater influence than ad valorem taxes are those taxes on income, which under present telephone rates are nil but which under proposed telephone rates are estimated at a total of \$1,400 if said proposed rates were to have been in effect for the full year 1951. The total estimated 1951 taxes, as presented by the staff, are \$1,900 under the company's present rates and \$3,300 under the telephone rates proposed in this application.

Annual depreciation expense for the estimated normal year 1951 was determined by the staff on the remaining life straight-line basis. Such basis in this instance produces a

composite depreciation rate of 3.79% and develops a total depreciation expense of approximately \$1,700 for the entire system when applied to the staff's estimate of average depreciable plant of \$44,000 for the year 1951.

The following tabulation summarizes the items above discussed, segregated between exchanges:

Item	: Year 1950: : Recorded	: Year 1951, Staff Estimate: : Present Rates	: Proposed Rates:
<u>OPERATING REVENUES</u>			
Knights Landing	\$16,033.07	\$16,800	\$22,400
Kenwood	10,536.54	11,300	15,800
Total	26,569.61	28,100	38,200
<u>OPERATING EXPENSES</u>			
<u>Knights Landing</u>			
Before Taxes and Deprec.	16,567.74	17,600	17,600
Taxes	566.95	1,200	2,000
Depreciation	1,101.00	900	900
Subtotal	18,235.69	19,700	20,500
<u>Kenwood</u>			
Before Taxes and Deprec.	11,680.22	12,300	12,300
Taxes	513.84	700	1,300
Depreciation	504.89	800	800
Subtotal	12,698.95	13,800	14,400
TOTAL OPERATING EXPENSES	30,934.64	33,500	34,900
NET REVENUES	<u>(4,365.03)</u>	<u>(5,400)</u>	3,300
	<u>(Red Figure)</u>		

From the above, it will be noted that applicant will operate at an out-of-pocket loss in 1951. It may also be noted that the proposed rates, if in effect for the full year, would have produced some profit. It seems apparent from the record in this proceeding that applicant was well aware of the possibilities of such losses, for its president and former individual owner, testified that the telephone system was in "extremely poor physical condition" and that portions were technically obsolete when purchased by him. Both exchanges presented the problem of creating an entirely new system. Nevertheless, it is fundamental that no enterprise should long

continue to absorb losses. The rehabilitation program thus far completed has placed the system in an improved operating condition and one in which, according to competent testimony in this proceeding, above-average quality of service may now be normally expected by its patrons. What may be termed the basic redevelopment period seems to be at an end and applicant now seeks a fair return for its efforts and investment.

Applicant's testimony and exhibits respecting estimated 1952 operations were based upon the requested rates and an assumed 600 telephone stations. Revenue estimates, both local service and toll, were determined by applying an average revenue per station to the estimated average number of stations. Applicant's total 1952 estimated revenues are \$47,284. Operating expenses for 1952 are estimated to amount to \$34,700 before taxes and depreciation and as \$41,400 when all expenses are included. Such estimate of expenses allows for increased maintenance, traffic, and general services expenses, over those presently being incurred, for such items as a paid vacation schedule for employees which will have the effect of adding an additional operator's position, freeing the Chief Operator from switchboard duties so as to care for routine office duties, and increased maintenance requirements resulting from system growth. Applicant's estimate indicates a net revenue of \$5,884 for the year 1952.

With respect to telephone plant in service and a rate base by which the reasonableness of applicant's rate request may be tested, applicant presented one base for 1952 and the staff presented four bases for 1951. Applicant arrived at an average net plant figure of \$95,000 and applicant's president stated that such figure was one of judgment. Applicant claimed a rate base of \$101,000 for the year 1952.

As above discussed, applicant's total fixed capital is not known nor has the reasonableness of the company's appraisal of its Knights Landing properties been determined. The staff, therefore, estimated 1951 rate bases by four methods; that is, (a) whereby the plant figure used included the purchase price plus net additions, excluding Account No. 276, with the depreciation reserve based on the books, (b) with plant based on company books and depreciation reserve based on the company's appraisal, (c) with both plant and depreciation reserve based on the company's appraisal and (d) with plant and depreciation reserve based on the company's appraisal but excluding amounts for two telephone systems donated or otherwise obtained without cost to applicant. These latter systems are known as Reclamation District system and Western Union system and are in the Knights Landing exchange of applicant. The four methods used by the staff produce 1951 estimated rate bases, depreciated, ranging from \$48,900 to \$83,500.

The following tabulation summarizes the above-discussed estimates and indicates rates of return thereunder:

Item	Staff 1951 Estimate		Applicant 1952:
	Present Rates	Proposed Rates	Estimate
NET REVENUES	\$ <u>(5,400)</u>	\$ 3,300	\$ 5,884
<u>RATE BASE, DEPRECIATED</u>			101,000
Method a	48,900	48,900	
Method b	71,400	71,400	
Method c	83,500	83,500	
Method d	50,200	50,200	
<u>RATES OF RETURN</u>			5.82%
Method a	Loss	6.7%	
Method b	Loss	4.6	
Method c	Loss	4.0	
Method d	Loss	6.6	

(Red Figure)

From the above it is apparent that applicant is in need of relief in the form of increased revenues. With respect to the various bases before us, evidence presented in this proceeding indicates that the base to be finally determined will undoubtedly be above the lowest presented but will not reach that estimated by applicant. For the purpose of this proceeding, therefore, we shall adopt a depreciated rate base of \$68,000 as being the average depreciated base applicable to a normal 12-month period in the year 1952. Such base is derived by using plant and depreciation reserve figures based on the company appraisal, adding thereto estimated net additions and betterments of \$17,300 as estimated by applicant, excluding the donated plant and adding materials and supplies and working cash as estimated by the staff. Using such rate base for the purpose of this proceeding shall not, however, be construed to be a final determination of such base nor shall its use herein preclude applicant from having a proper base established by this Commission in an appropriate future proceeding.

Applying applicant's estimate of net revenues of \$5,884 to the above-adopted base indicates a rate of return of approximately 8.6%. Such a return, in this instance, would be excessive. The order herein will provide for rates which on the basis of 600 stations as estimated by applicant, will produce gross revenues of approximately \$45,800. After deduction of \$41,400 as operating expenses, including taxes and depreciation, a net revenue of \$4,400 will result thereby indicating a rate of return of 6.5% on the assumed rate base. We find that said return and assumed base are fair and reasonable for the purposes of this proceeding.

Applicant's rate request, in addition to increases in basic rates, includes proposed increases in charges for initial installations, line extension charges, and charges for certain supplemental equipment. Also proposed is a new charge for signal or control circuit service. Applicant will be authorized to increase its charges to the level established by this Commission in recent proceedings, for comparable telephone companies and services, for installation charges, move and change charges, and charges for supplemental equipment. We are in accord with applicant's desire to place line extension charges on a basis which will more nearly approach the costs involved than do the present charges. Line extension charges will be increased to \$5 per 100 feet and will be placed on the so-called "refundable" basis, used by companies of comparable size, and in the form presented by Exhibit No. 11 in this proceeding.

Applicant has proposed a rate of \$6 per quarter mile for signalling or control circuit service, such service now being performed without charge. At the present time such service is provided for sounding fire alarms at Kenwood and Knights Landing. Applicant's president testified that it was intended to file a rate schedule for the service and apply it to industrial organizations but to deviate therefrom and not to make charges to fire districts. Nothing in the record in this proceeding indicates that there is any demand for such service except by the fire districts and, under the law, they may be served at reduced rates or at no charge should the utility so elect. As applicant has elected to serve free of charge, we feel that no useful purpose would be served by establishing said rate at this time and it will not be authorized.

The record shows that at least one prospective subscriber has been denied service on the ground that her premises was outside applicant's exchange boundary. However, the exchange areas of both the Kenwood and Knights Landing exchanges were recently revised and enlarged. The revised Kenwood exchange area now includes the premises of the prospective subscriber referred to above. It is expected that applicant will provide service to those within its enlarged boundaries as soon as possible, consistent with its filed rules.

The present base rate areas have been unchanged since the original boundaries were established. Applicant will be required to enlarge the base rate area in the Knights Landing exchange to that set forth in Exhibit No. 7. Applicant should undertake a study looking toward the enlargement of the Kenwood base rate area.

Several witnesses, called or represented by counsel, testified relative to service matters. Applicant also produced company employees as witnesses who testified as to service. The respective testimony cannot be reconciled, the company insisting that its service is superior while subscribers insist that it is poor in several respects. All subscribers, however, agreed that except as to toll service, over-all service has generally improved since applicant began operating the telephone system.

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One complaining witness testified as to having had a competitor placed on his two-party line and the loss in resort business resulting thereafter. He claimed that the other party "listened in" or answered rings not intended for him and that applicant's president, when apprised of the situation, indicated the only recourse was to take an upgrade in service to an individual line. This latter course complainant refused to take, claiming that another available line was only a short distance away and further that the ringing is customarily confusing and the actual rings indistinct. We are of the opinion that this embarrassing and aggravating situation might have been avoided by the company without attempting to force upgrading of service and the company, before the next resort season begins, should take steps to improve the service and, where required, consideration should be given in compliance with Rule and Regulation No. 3 Section (c) as to undue party-line interference.

Applicant will be required to file a revised set of rules and regulations and forms normally used in its relations with its subscribers.

O R D E R

The Independent Telephone Company having applied to this Commission for an order authorizing increases in rates, public hearings having been held and the matter having been submitted for decision,

IT IS HEREBY FOUND AS A FACT that the increases in rates and charges authorized herein are justified and that present rates, in so far as they differ from those herein prescribed, are unjust and unreasonable; therefore,

EXHIBIT A
Page 1 of 4

RATES

The presently effective rates, charges, conditions, and rules and regulations are changed only as specifically set forth in this exhibit.

Map of Base Rate Area - Knights Landing

The map of the Knights Landing base rate area is authorized to be revised to show the base rate area boundary as set forth in Exhibit No. 7.

Flat Rate Exchange Service, System-wide

Rate per Month - Each Station

Residence service:

Each individual line primary station	\$4.25
Each two-party line primary station	3.60
Each four-party line primary station	3.10
Each extension station	1.00

Business service:

Each individual line primary station	\$5.50
Each two-party line primary station	5.00
Each four-party line primary station	4.50
Each extension station	1.25

The Special Conditions presently effective in Kenwood are authorized to be made effective system-wide.

Suburban Service, System-wide

Rate per Month - Each Station

Residence service:

Each suburban primary station	\$3.60
Each extension station	1.00

Business service:

Each suburban primary station	\$4.50
Each extension station	1.25

The Special Conditions presently effective in Kenwood are authorized to be made effective system-wide.

EXHIBIT A
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RATES (Continued)

Farmer Line Service, Knights Landing

The schedule set forth in Exhibit No. 9 is authorized with the following rates:

	<u>Rate per Month</u>		
	<u>Residence Service</u>	<u>Business Service</u>	<u>Minimum Charge Per Line</u>
Each station	\$0.75	\$1.25	\$3.75

Supplemental Equipment
Move and Change Charges
Service Connection Charges

The schedules set forth in Exhibit No. 8 are authorized to be filed for the system.

Mileage Rates
Public Telephone Service
Alphabetical Listings in Directory
Directory Advertising
Employee Service

The schedules presently effective in Kenwood are authorized to be made effective on a system-wide basis.

Vacation Rate Service, System-wide

Revise vacation rate to read: "Fifty (50) percent discount."

Woodland Foreign Exchange Farmer Line Service in Knights Landing

	<u>Rate per Month - Each Station</u>	
	<u>Residence Service</u>	<u>Business Service</u>
Woodland farmer line service	\$2.00	\$3.50

Minimum Charge:

Under the above rates, service will be furnished to less than three stations provided the total minimum exchange revenue of each circuit is not less than that of three residence stations at the rate applicable in the Woodland exchange area, plus an amount equal to 50% of the Woodland exchange farmer line residence station rate for each station located in the Knights Landing exchange area.

EXHIBIT A
Page 3 of 4

RATES (Continued)

Woodland Foreign Exchange Farmer Line Service in Knights Landing (Continued)

Refile schedule to conform with General Order No. 96 and substitute Special Conditions 4 and 5 in Exhibit No. 9 for Special Condition 5 presently effective.

Add Special Condition to read:

"At the above rates for foreign exchange service, a listing is provided without additional charge in the alphabetical section of the local exchange directory as well as that of the foreign exchange."

- Santa Rosa Residence Foreign Exchange Service in Kenwood
- Sonoma Residence Foreign Exchange Service in Kenwood
- Woodland Residence Suburban Foreign Exchange Service in Knights Landing

The rate for each primary station is authorized to be increased by 25 cents per month.

Foreign exchange mileage rates are authorized as follows:

Rate Per Month for Each
One-Quarter Mile or Fraction Thereof

Foreign exchange mileage rate:

Individual line residence primary station	\$2.00
Two-party line residence primary station	1.75
Four-party line residence primary station	1.50
Suburban line residence primary station	1.00

Add Special Condition to read:

"At the above rates for foreign exchange service, a listing is provided without additional charge in the alphabetical section of the local exchange directory as well as that of the foreign exchange."

EXHIBIT A
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RATES (Continued)

Line Extension Charge, System-wide

The schedule set forth in Exhibit No. 11 is authorized to be filed.

Rule and Regulation No. 9, Service Charge for Restoration of Service
Rule and Regulation No. 14, Directory Listing
Rule and Regulation No. 16, Basis of Mileage Charges
Rule and Regulation No. 29, Move and Change Charges
Rule and Regulation No. 30, Service Connection Charges
Rule and Regulation No. 31, Line Extension

The above rules and regulations presently effective in Knights Landing are authorized to be cancelled.

Consolidation of Tariff Schedules

Consolidate the tariff schedules of the predecessor Kenwood telephone exchange and Knights Landing telephone exchange into a single set of tariff schedules for The Independent Telephone Company. Such consolidation shall be completed not later than 120 days from the effective date of this order.

IT IS HEREBY ORDERED as follows:

1. Applicant is authorized to file in quadruplicate with this Commission, after the effective date of this order and in conformity with General Order No. 96, the rates, charges and conditions set forth in Exhibit A attached to this order and, on not less than three (3) days' notice to the Commission and the public, to make said rates effective for service furnished on and after December 1, 1951.
2. Coincidental with establishment of the new rates hereinabove authorized; applicant shall establish a base rate area in the Knights Landing exchange the boundaries of which shall be not less than as set forth in Exhibit No. 7 in this proceeding, and within sixty (60) days thereafter, shall file with this Commission four copies of a map of said base rate area delineating thereon the precise boundaries thereof.
3. Within one hundred twenty (120) days from the effective date of this order, applicant shall file in quadruplicate with this Commission, rules and regulations governing subscriber relations, revised to reflect present-day operating practices acceptable to this Commission and in conformity with the requirements of General Order No. 96, together with current forms that are normally used in connection with customer service.

The effective date of this order shall be twenty (20) days after the date hereof.

Dated at San Francisco, California, this 6th day of November, 1951.

[Signature]
President

Justin Z. Craver

Harold A. Hule

[Signature]

[Signature]
Commissioners