

**ORIGINAL**

Decision No. 50258

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
 THE PACIFIC TELEPHONE AND TELEGRAPH )  
 COMPANY, a corporation, for authority )  
 to increase certain intrastate rates )  
 and charges applicable to telephone )  
 service furnished within the State of )  
 California. )

Application No. 33935

(Appearances and list of witnesses  
 are set forth in Appendix B.)

O P I N I O N

The Pacific Telephone and Telegraph Company, a California corporation and an affiliate of the Bell System, filed the above-entitled application on December 10, 1952 and amended same by filings on March 6, 1953 and December 2, 1953 seeking authority to raise rates designed to increase California intrastate revenues by approximately \$53,500,000 or 14.5 per cent on the basis of the test year 1952. This request is the largest filed during the postwar period. Applicant served 3,635,435 company stations in California as of December 31, 1952.

Public Hearings

After due notice, 51 days of public hearing were held on this application, as amended, before Commissioner Peter E. Mitchell and Examiner M. W. Edwards during the period April 29, 1953 to April 22, 1954. Applicant, the Commission staff, interested parties and protestants, presented 102 witnesses who introduced 147 exhibits and whose testimony covered 6,851 pages of transcript.

Most of the days of hearing were held at Los Angeles and San Francisco; however, three days of hearing were held at other

places in the state. The hearing on July 13, 1953 was held at Santa Cruz for the purpose of receiving evidence on extended service in the Santa Cruz area. An interim order herein, Decision No. 49048, was issued on September 1, 1953 authorizing applicant to proceed to introduce extended service among the Aptos, Ben Lomond, Boulder Creek, Felton and Santa Cruz exchanges at the approximate time of conversion of the Santa Cruz exchange to dial service. The hearing on June 2, 1953 was held at San Bernardino on a consolidated record with Case No. 5466 for the purpose of considering extended service in the San Bernardino area. Studies by the utilities have been completed and recently filed with the Commission but our analysis is not sufficiently complete at this time to rule on this subject. This matter will be left for completion under Case No. 5466. A similar day of hearing was held in Sacramento on July 1, 1953 on a consolidated record with Case No. 5473. A motion is pending to dismiss this investigation but since studies of the Sacramento area are not sufficiently complete to decide this matter, it will be further considered under Case No. 5473.

Five of the 51 days of hearing were devoted to the question of rates for Telephone Answering Service, being consolidated for hearing purposes with Cases Nos. 5400 and 5417. A separate concurrent order is being issued on answering service under the case numbers. Similarly, a concurrent order is being issued under Case No. 5462 in connection with multiple message unit conversations in the Los Angeles extended area. Applicant had requested an increase in the multiple message unit rate but inasmuch as three other telephone companies<sup>1/</sup> were involved a separate investigation was

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<sup>1/</sup> General Telephone Company of California, California Water & Telephone Company, and Sunland-Tujunga Telephone Company.

instituted and hearings held under Case No. 5462. The record under Case No. 5462 was made a part of this record by reference on April 7, 1954.

Applicant's Position

In justification of its need for further rate increases applicant claims that the current level of inflation has resulted in increased prices for labor and materials which in turn have resulted in a sharp decline in its rate of earnings. It states that the average cost of adding telephones had risen to approximately \$447 per station in 1951 compared to an average plant cost of \$265 per station in the period 1935-1939. Applicant contends that higher rates are needed to maintain earnings on this increased plant cost at a level that will attract new capital in order to enable it to continue the present program of expansion of plant and service with prudence and reasonable safety.

Applicant maintains that the combination of a low rate of return and the necessity for raising large amounts of new capital has put its credit in serious jeopardy. Despite the postwar rate increases, amounting to \$68,407,000 on an annual basis, applicant claims its rate of earnings in the five-year period (1947-1951) has been lower than in any other five-year period in its history. Applicant believes that the sharp postwar growth rate in California will continue in the future and states that its earnings must be sufficient to attract the necessary money under future and unpredictable market conditions. Applicant contends that its securities must compete with other securities generally for the investor's dollars and unless its credit standing is at least equal to that of other marketers of securities, it cannot expect to obtain capital in anything like the amounts needed to be invested in California in the years to come.

Additional reasons for the requested rate increase, given in the amendments to the original application, were a new round of wage increases and revised settlements with connecting companies offset in part by revised depreciation rates in accordance with Section 43.43 of the Federal Communications Commission's Rules and Regulations.

Evidence - Communications - Protests

Evidence was offered by witnesses for the applicant, by members of the Commission staff and staff consultants, by representatives of certain interested parties and protestants and by members of the public. In addition the Commission received some 1,000 communications from the public, many protesting and some approving the requested increase. All communications from the public were made a part of the public record for consideration by all parties. Careful consideration has been given by the Commission to all matters brought to its attention by these communications and the many witnesses.

A main subject of protest by the public was the level of advertising expenditures. Applicant listed the objectives of its advertising program as follows:

1. To educate the public on how to use the telephone.
2. To recruit new employees to take care of the large rate of turnover, particularly among the female employees.
3. To sell telephone service, promote use of long distance service.
4. To sell classified advertising.
5. To inform the public of the company's operations, plans and objectives.

A public witness and authors of some of the communications were of the view that much of the advertising is unnecessary since telephone service can be obtained from only this one company in its service areas.

Applicant's program, in our opinion, results in obtaining sufficient numbers of employees to avoid expensive overtime pay, increasing revenues from directory advertising and long distance service, improved service and reduced cost of handling public inquiries. In 1952 the applicant spent less than three quarters of 1 per cent of its revenue on advertising. In our opinion an expenditure of no greater magnitude than this is not excessive considering the results achieved. It is obvious that should the amount be disallowed in its entirety, such action would not obviate the need for a rate increase, as some protestants appeared to believe.

Position of Certain Appearances

During the course of the hearings several parties changed their positions from protestant to interested parties or to neutral parties. By communication and by comment of counsel it was alleged that applicant sent its officials out to certain individuals and groups for the purpose of discouraging appearances before the Commission, even to the point of endeavoring to dissuade them from bringing their protests and problems to the Commission. Applicant stated its conduct in this regard was necessary in order for these parties to understand all of the facts regarding its business before taking a position. While applicant claimed a constitutional right to so do, to interfere with a party or a witness in a proceeding before this Commission is no different than such action would be before a court.

The basic public policy underlying the function of this Commission is to provide a place where all public utility customers may come with their problems and protests, either formal or informal, for consideration and investigation. Action which is intended to dissuade subscribers from appearing at public hearings or filing written statements is inconsistent with the policy of this Commission, and in our opinion, is not in the public interest.

Inflation

A number of witnesses called by applicant testified on the subject of inflation or the effect of using today's dollars with a purchasing value of roughly one half of the prewar purchasing value. One of applicant's witnesses testified as to the desirability of considering the book investment in terms of dollars equivalent to the 1939 dollars to obtain a more accurate conception of the rate of return and as to the general impact of inflation on applicant's telephone business as compared with other businesses, although he did not recommend that the books be so restated. All that he suggests, apparently, is that the Commission continue with its traditional method of determining an historical cost rate base less depreciation and a fair return to be applied to such rate base, and compare the results in some fashion with rates of return upon that same rate base converted into equivalent 1953 dollars.

A consulting engineer with long regulatory experience, called by the staff, testified to the stability and advantages of the historical cost method of determining rate base which has been consistently followed by the Commission in regulation of utilities. Such method has been consistently followed during periods of deflation as well as inflation.

No one can deny that there has been a serious inflationary trend since 1941 and particularly since the close of the war. However, it is significant to note that, so far as the applicant is concerned, of the \$1,235,000,000 plant investment at the close of

1952 only \$220,000,000 was installed prior to 1941. In other words, only 18 per cent of the plant as it existed at the end of 1952 was financed with the preinflationary dollars which prevailed prior to 1941. Even as to plant installed prior to 1946, it appears that this represents only 31 per cent of the plant investment at the end of 1952 (Exhibit No. 8).

The law contemplates that people who buy securities are charged with the knowledge that certain risks will be attached to their ownership and that one of the risks is the possibility of the decline in purchasing power of the dollar. Certainly the investing public has not felt the same way about its holdings in utility stock as do the applicant and its witnesses. A witness for the City of San Francisco carefully analyzed the securities market and applicant's securities over a long period of years but failed to find any evidence of marked inflation in the cost of capital. At the time applicant filed its application the outlook was for a sharply increasing cost of debt capital. However, before the matter was submitted for decision the outlook was for a lower or stabilized cost.

The record shows that the applicant has been able to finance itself under reasonable terms during the inflationary period, that the shareholders have been compensated to some extent through the rights which have been offered them with regularity and that the company itself has been authorized to charge rates which have been based on operating costs at prevailing prices rather than on the pre-inflationary price levels. It has been authorized to recover in depreciation charges the inflated dollars it has invested in its business. It, therefore, appears that the Commission has given adequate consideration to inflation in fixing rates for this company.

The securities market has recognized it in assessing the value of applicant's stock. The claim here made by the applicant is not unlike the claim for reproduction cost.

While there is currently emphasis in testimony on the subject of inflation, we find no reason to depart from our long established and stable method of computing rate base on the basis of the actual dollars in plant, unadjusted up or down for changes in the purchasing power of the dollar, and allowing expenses at the full current rate adjusted for foreseeable near-future conditions. Applicant's inflation testimony is designed to support its request for extensive increases in rates, which would result in considerably higher earnings and increased common stock dividends compared to the Commission's traditional allowances. Such action would protect only one class of security holder, the common stockholder, against the risk of loss of purchasing power and not benefit the bondholder or preferred stockholder. It would penalize the ratepayer without a concomitant consideration. We will proceed to analyze applicant's operations in the traditional manner.

#### Rate of Return

In all, eight witnesses testified on the subject of rate of return. One of applicant's witnesses asserted that a return of 7½ per cent is required while witnesses for the protestants contended that a lower return would be reasonable and expressed opinions of a fair rate which ranged from 5.79 to 6.25 per cent. A review of the testimony on this point indicates a general tendency on the part of the witnesses, or at least some of them, to consider the total capital, that is, the debt, stock and surplus, as synonymous with rate base or net investment in plant, in their discussion of rate of return.

The development of the rates of return urged in this matter proceeded from estimates of required earnings on common stock or calculations of cost of equity capital. The witness for applicant took the position that rates for service should be fixed by the Commission which would develop earnings sufficient to produce a return of \$12 a share on applicant's common stock. Witnesses for



other parties, using a series of calculations, estimated the costs of equity capital from 7.84 to 8.50 per cent. These estimated earnings requirements or estimated costs of equity capital, when weighted with the calculated costs of senior securities which, of course, are susceptible to factual determination, led to the production of the several recommended rates of return.

The differences of opinion expressed by the witnesses offering expert testimony in this proceeding are striking. On the one hand, spokesman for the company asserted that the present debt ratio of about 41 per cent is too high and should be reduced, that the surplus balance of about \$25,000,000 at the close of 1952 is too low, that the credit position of the company has been impaired, and that the annual earnings should be \$12 a share on the common stock so as to permit the increase of the annual dividend from \$7 to \$8 and the accumulation in surplus of an amount equivalent to \$4 a share. On the other hand, there is of record the contention by others that applicant's debt ratio is too low and should be increased, that its surplus is sufficient to meet future contingencies, and that the company has been able to raise large sums of money successfully. The record also contains the allegation that interest rates are declining daily with further declines expected for the coming year, while elsewhere in the record the position is taken by a witness that the general trend of interest rates is upward.

From a review of the record it is apparent that applicant has placed undue emphasis upon the interests of the equity owners. In fact, its entire case, despite protestations to the contrary, seems to be predicated upon a theory that the Commission in fixing applicant's rates for service at this time, under present conditions, should prescribe such schedules as will develop earnings, after all income charges and preferred stock dividends, equivalent to \$12 a

share on the common shares. In testing the revenue requirements on this basis applicant has employed issued and outstanding shares in its calculations rather than an objective capital structure. Thus, a significant factor in applicant's conclusions as to rate of return is the number of outstanding shares of stock.

The number of issued and outstanding shares reflects the exercise by applicant of managerial judgment. It has been applicant's practice to offer its common shares to its existing shareholders from time to time at par for cash, regardless of the prevailing market price, and in seeking the Commission's approval of its common stock financing it has made representations that the offering price of the shares, and hence the number of shares, and the dividends to be earned do not enter into the determination of the rate of return which the company might be allowed to earn on its investment in properties.<sup>2/</sup> In passing on applicant's requests to issue common stock the Commission repeatedly has placed applicant upon notice that it will not regard dividends paid on common stock as determining or fixing the rate of return applicant should be allowed to earn. If the outstanding shares and the amounts of the dividends were now to become factors in arriving at a fair return it might be appropriate to require future common stock offerings by applicant to be made at a price more nearly approximating the market at the time.

<sup>2/</sup> Compare applicant's brief in Application No. 27709 where it was seeking authorization to issue 328,125 shares of common stock at par when the market was approximately \$129. Quoting in part, "That a larger capital issue is necessary to realize a given amount of money when stock is sold at par instead of at the higher market price, should create no hesitancy in the minds of the commissioners, as above stated, for your body is not concerned with the dividends to be earned. You are interested only in the question of rates as determined by actual investment and not with the mode of distribution of that return among shareholders as dividends."

Nor does a review of the factual data presented in this proceeding lead to the acceptance of applicant's claim of required earnings. Applicant's estimated requirement of \$12 a share is equivalent to a return of 11.4 per cent on equity capital, including surplus. The record shows that such a return is greatly in excess of the actual earnings of applicant, and also of American Telephone and Telegraph Company, since 1929, and that it was only during the years 1925 to 1929 that earnings closely approached those now sought. <sup>3/</sup> Comparative figures appearing in the record show that for 16 large electric utilities the earnings on equity in 1953 ranged from 5.58 to 14.15 per cent, although it is true that some of these companies, especially those with lower earnings, were requesting or had received rate increases. The record also shows reported returns on total capital of selected electric utilities for the period from 1946 to 1952 ranging from 4.9 to 7.8 per cent, with only one company having a higher figure than the 7.5 per cent now requested by applicant and with the median being 6 per cent. It should be noted that with the 16 electric utilities the equity position ranged down as low as 31 per cent as compared with the 54 per cent equity position of applicant and the 58 per cent position of its holding company. It appears to be true, generally speaking, that the higher the equity position in the capital structure, the lower the return on it.

<sup>3/</sup> Exhibit No. 124 shows earnings on book equity of applicant since 1925 and of American Telephone and Telegraph Company since 1920 up to 1952, which are summarized as follows:

	<u>Applicant</u>	<u>A.T. and T.Co.</u>
For entire period	7.48%	7.78%
1936 to 1952	6.91	7.39
1946 to 1952	6.61	7.65

Analysis of the protestants' showing indicates that they have based their recommendations on the maintenance of the present \$7 dividend and, in part, on assumed or objective pay-out ratios and capital structures and that they have placed dominant emphasis on the attraction of new and additional capital to the enterprise, relying primarily on earnings-price and dividend-price ratios in arriving at their conclusions.

Earnings-price ratios and dividend-price ratios merely reflect the prospective investors' appraisal of the market value of stock and as such are influenced by prevailing market and economic conditions and the individual requirements of the purchaser. While useful for comparative purposes and of value in presenting background information, they are not conclusive in themselves in the determination of the allowable fair return on investment in operative properties. It is one thing to say that those ratios indicate the terms under which a new investor might devote his money to the business; it is another thing to say that these terms represent or limit the return the applicant is entitled to receive on the capital committed to the service. It seems to us that reliance on ratios of this nature results in a restricted view of the subject of rate of return. Obviously, the price at which a security is bought on the market reflects anticipated earnings rather than past results of operations and it by no means follows that the rates at which present market sales prices are related to the past earnings represent the returns the purchasers at those prices are willing to accept in the future.

With the wide range in the claims now before us and with the opposing opinions of the witnesses to be considered, it is apparent that our final determination of rate of return must represent the exercise of judgment on our part, having in mind the lawful interests of the ratepayer and the utility.

The record indicates that the return of 5.6 per cent found by the Commission to be reasonable in 1948 would not be appropriate at the present time. That return was based on the conditions then obtaining and on the record presented to the Commission at that time. It now appears that applicant's earnings have not maintained the level heretofore found reasonable and while past deficiencies in earnings cannot be recovered in future rates, the possibility of further declines in rate of return arising from material, labor and other costs is always present. The record shows that interest rates, even after the recent declines, generally are higher than they were in 1948 and it is apparent that applicant's earnings experience has not been adequate to maintain its securities at levels consistent with those of other utilities. During the intervening time since our 1948 decision, applicant has extended and enlarged its plant and is now called upon for capital expenditure of a substantial nature in the future. It is to the interests of the subscribers to applicant's service for applicant to be placed in a position where it can meet its capital requirements under reasonable terms. It appears, after a full consideration of this matter, that a reasonable return at this time is 6.25 per cent and we so find.

#### Earning Results

The applicant and the Commission staff presented evidence on revenues, expenses, rate base and rate of return for the test year 1952. A witness for the City of Los Angeles also presented computations on the results of operations based upon applicant's Exhibit No. 84 with certain adjustments. Applicant's Exhibit No. 8 showed

the following trend of earnings as reflected in a rate of return on average net plant and working capital:

Results of California Intrastate Operations  
Applicant's Exhibit No. 8

	<u>Per Cent Return</u>
Year 1951, Recorded Basis .....	5.1
Year 1952, Recorded Basis .....	5.3
Year 1952, Recast to Going Level .....	4.9
Year 1953, First Two Months Annualized ..	4.9
Year 1953, First Two Months Annualized at Going Level .....	5.0

The above results were presented on April 30, 1953. On December 16, 1953 applicant submitted Exhibit No. 84 which reflected the changes mentioned in applicant's second amended application and resulted in lowering the rate of return in 1952 to 4.5 per cent when recast to the going or test level. For this same test period the City of Los Angeles in Exhibit No. 98 computed a rate of return of 5.17 per cent after adjustments while the staff computed 5.20 per cent.

The Commission staff's study on this subject was presented in Exhibits Nos. 120, 120-A and 143. It may be summarized and compared to the applicant's study in the manner following:

Adjusted 1952 Results of Intrastate Operations  
at Present Rates and 52% Federal Income Tax Rate

Item	Applicant Exh. No. 84	Staff Exh. No. 143	Difference
<b>Operating Revenues</b>			
Local Service	\$258,105,000	\$258,045,000	\$ (60,000)
Toll Service	86,413,000	86,413,000	-
Miscellaneous	19,163,000	22,392,000	3,229,000
Less: Uncollectibles	1,242,000	1,253,000	11,000
<b>Total Operating Revenues</b>	<b>362,439,000</b>	<b>365,597,000</b>	<b>3,158,000</b>
<b>Operating Expenses &amp; Taxes</b>			
Maintenance	82,820,000	82,316,000	(504,000)
Depreciation and Amortization	31,736,000	29,778,000	(1,958,000)
Traffic	74,683,000	74,683,000	-
Commercial	37,762,000	37,642,000	(120,000)
General Office, Salaries and Expenses	25,438,000	25,438,000	-
Operating Rents	1,764,000	1,764,000	-
General Services and Licenses	3,416,000	2,946,000	(470,000)
Balance Other Operating	14,909,000	13,343,000	(1,566,000)
Federal Income Taxes	23,704,000	27,586,000	3,882,000
Social Security Taxes	4,561,000	4,956,000	395,000
Other Taxes	25,598,000	25,512,000	(86,000)
<b>Total Operating Expenses and Taxes</b>	<b>326,391,000</b>	<b>325,964,000</b>	<b>(427,000)</b>
<b>Net Revenue</b>	<b>36,048,000</b>	<b>39,633,000</b>	<b>3,585,000</b>
<b>Rate Base, Depreciated</b>	<b>796,493,000</b>	<b>762,594,000</b>	<b>(33,899,000)</b>
<b>Rate of Return</b>	<b>4.53%</b>	<b>5.20%</b>	<b>0.67%</b>

(Applicant Exceeds Staff)

Details on the many differences between the staff and the applicant are also summarized in Exhibit No. 143.

Revenues

With regard to revenues the only item of controversy was the adjustment for directory advertising as analyzed in the staff's Exhibit No. 108. By Decision No. 47211, dated June 5, 1952,

in Application No. 33316, the Commission authorized applicant to increase rates for telephone directory advertising for directories issued generally in and after September, 1952. Applicant made no adjustment to the test year for this item. In our opinion such adjustment is necessary if the test year is to be at all representative of near-future conditions for rate-making purposes.

In addition to the increased revenue of \$3,229,000 shown, the staff estimated a decrease in expense of producing directories, due to the anticipated reduced size and number of advertisements at the higher rates, of \$120,000 on the basis of the test year 1952. Applicant questioned the justice of making these adjustments for increased directory net revenues because the expenses of issuing new directories are incurred several months in advance of receipt of revenues and because of the increased cost of issuing directories.

The staff's Exhibit No.108 shows that the directory net revenue, after expenses, increased from \$7,432,491 in 1952 to \$10,807,558 in 1953 as recorded. Such increase is slightly more than the \$3,349,000 total gain estimated earlier by the staff, although the full effect of the directory increases starting in September, 1952 is not shown in the 1953 results because new directories are issued at staggered intervals throughout the year. Furthermore, the effects of directory advertising rate increases authorized from time to time for individual directories when the increased circulation placed a particular directory in a higher rate group is not fully shown in the 1953 results.

While applicant does incur directory expense considerably in advance of receiving revenue, the testimony and cross-examination show that applicant would be compensated for this lag by means of the working cash formula and computation used by the staff. Our conclusion on revenues is that we find the staff's proposed adjustments are reasonable and these will be adopted by the Commission.



Expenses

The major items of expense adjustments by the staff were for general services and licenses, for pension accruals (under the item Balance Other Operating Expenses), depreciation, taxes and for Western Electric costs as reflected in the items of Maintenance, Depreciation and Other Taxes. These expense adjustments, as well as the rate base adjustments, will be discussed in the sections following herein.

License Fee

Under the "license contract" applicant pays the American Telephone and Telegraph Company 1 per cent of its total operating revenue except miscellaneous revenue. Applicant claims this 1 per cent fee as an operating expense despite the fact that on a rate increase the amount would suddenly increase with no corresponding increase in costs or benefits. If applicant's rate request were granted this one item would account for over one-half million dollars of questionable increase in expense. In justification of this method of computing expense applicant states that its experience has been that the cost incurred by the American Telephone and Telegraph Company in rendering the license contract services have been increasing as a result of factors similar to those which have required the operating companies to seek rate adjustments, and that such increases in cost generally have been experienced well in advance of any increases in payments.<sup>4/</sup> Also applicant supports this claimed expense by testimony and by Exhibit No. 23 as to the value of the services rendered by the American Telephone and Telegraph Company.

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<sup>4/</sup> Exhibit No. 22, Page 41.

It is the applicant's position that the Bell System organization, including the license contract, is designed in the interest of the best nationwide telephone service and that all the expenses and taxes of American's General Department, except minor "non-license" deductions, are properly allocable to the licensee companies and its Long Lines Department. It is the staff's position that the license contract expense should be based on allocated cost, and that "investor costs" should be excluded.

In support of a license fee of \$3,416,000 based on revenues, American allocated \$3,472,000 of its 1952 expenses to Pacific's California intrastate operations. The staff excluded \$568,000 of the claimed expense as "investor costs", \$277,000 representing items identifiable as wholly "investor costs", and the remainder of \$291,000 representing the staff's estimate of the "investor costs" portion of activities which it contends involves both service functions and investor functions.<sup>5/</sup>

Some \$244,000 of the staff's exclusion represents California intrastate allocation of the cost of servicing American's securities. Applicant claims that if its stock were distributed as widely as the stock of either American Telephone and Telegraph Company or Pacific Gas and Electric Company its cost of servicing its securities would be increased by more than the \$244,000 allocated to it by American. The staff's position is that Pacific's subscribers should not be required to pay the cost of servicing American's securities, and it supports this position with the example of Pacific Lighting Corporation, a corporation controlling certain California utilities, which does not seek to allocate any of its security servicing costs to its three subsidiaries in southern California.

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<sup>5/</sup> Exhibit No. 113, Table 4-A.

The staff's estimate of \$291,000 as additional "investor costs" represents 9½ per cent of the remainder of American Company's expenses allocated to Pacific's California operations, after deducting the \$277,000 which the staff excluded as wholly "investor costs". The use of 9½ per cent is based upon the staff's presentations in three prior postwar rate proceedings involving applicant, Applications Nos. 28211, 29854 and 32640, and upon the Commission's adoption of the staff's adjusted allocated costs in those proceedings. The judgment of the staff witness, after investigating American's present operations at first hand, was that this basis afforded a reasonable measure of the "investor costs". Applicant challenged the staff's investor cost exclusion on the ground that it was based on an unsound mathematical extrapolation and introduced Exhibit No. 137. The evidence shows that the staff's estimate was based only in part upon extrapolation of the experience of other companies. While American's accounting procedures prevent a precise determination of "investor costs" we are of the opinion that the staff's estimate is reasonable.

In addition the staff made a deduction of \$47,000 from 1952 allocated expenses to spread, for rate-making purposes, the abnormal costs of a large catch-up project of revising Bell System practices, undone for many years.

The staff's adjusted allocated costs include 5.6 per cent return on the investment devoted to license contract services and also include the income and other taxes assignable to furnishing such services.

Applicant claims as part of allocated costs a return on a pool of funds which American allegedly holds available for advances to the licensees. We have previously held that such cost is not a proper charge to applicant's operating expense (Decision No. 41416 in Application No. 28211).

Applicant introduced Exhibit No. 139 to show that all but four state Commissions<sup>5a/</sup> have allowed the 1 per cent license fee in full. This record does not show why each of the majority group of states has allowed the full 1 per cent fee, or why so few states have disallowed it in part, but it is probable that comprehensive studies such as are available in this record were not available in all of the other states. To illustrate this point we refer to the September 30, 1953 decision of the Massachusetts Department of Public Utilities, D.P.U. 10349, page 8, which states with regard to license contract payments:

"The form of this contract has been criticized on obvious and sound grounds by practically every court and commission which has had occasion to scrutinize it ever since it was adopted. The Securities and Exchange Commission has outlawed this form of agreement for use by holding companies under its jurisdiction. There is no doubt but that the cost figures of the American Company furnished to us include a number of expenses attributable to its position as a holding company as distinct from its position as an operating or a service company. As we said in D.P.U. 8181, we disapprove of the methods by which payments are computed under this contract as a matter of principle, but here, as there, we are not in position adequately to study the accounts of the American Company.

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<sup>5a/</sup> Iowa and Texas do not have state regulation of telephone companies.

Accordingly, we cannot find that the payments made under the License Contract by the New England Company should be disallowed as proper expenses, at least for the present and under the circumstances of this case."

We conclude that a flat percentage of revenue is an inappropriate way of determining service and license expenses for rate-making purposes and that adjusted allocated costs, determined in the manner proposed by the staff, should be substituted. The staff's adjusted service costs allocated to California intrastate operations amount to \$2,946,000, or \$470,000 less than the 1 per cent license fee which applicant claims as expense. In view of the fact that we are allowing applicant a rate of return of 6.25 per cent and allowing as expense for rate-making purposes the pension accruals charged to Account No. 323, Miscellaneous Income Charges, both by applicant and American, applicant's claimed general services and licenses expense will be reduced by \$453,000 instead of by \$470,000 as proposed by the staff.

A final observation on this subject, we believe to be appropriate. The applicant contends that the Bell System corporate combine is in the public interest and constitutes a positive benefit to the ratepayers of its operating subsidiaries of which applicant is one. The ratepayers have a lawful right to expect a rate decision to make avail of any of these asserted benefits, if any, flowing from such a corporate combination. It is inconsistent and improper for applicant to say, on the one hand, that this corporate aggregation is justified by the alleged benefits which it confers upon the ratepayer and, on the other hand, contend that the same must be paid for by the ratepayers at a price which would largely nullify such claimed benefits.

#### Pensions

Pensions for applicant's employees are paid for in full by the applicant except for the portion obtained by an employee from his contribution toward U. S. Government Social Security.

Applicant's pension accrual is divided into two parts; one, a charge to operating expense, Account No. 672, Relief and Pensions, computed by applying a current pension accrual rate to payroll, and two, an amount in lieu of interest, charged to Account No. 323, Miscellaneous Income Charges, to freeze a \$21,827,000 unfunded actuarial reserve requirement.<sup>5b/</sup> This latter amount has been charged to Account No. 323 rather than Account No. 672 by order of the Federal Communications Commission which has recently issued an order changing this rule. For the company as a whole, in 1952 the normal accrual charged to Account No. 672 (a portion of which is transferred to plant and other accounts) was \$18,127,246, and the "freezing" accrual was \$600,240.

It is the applicant's position that both the net accrual charged to Account No. 672 and the entire accrual charged to Account No. 323 should be included in operating expenses for rate-making purposes. It is the staff's position that the accrual charged to Account No. 672 is greater than necessary due to certain of the actuarial factors employed in developing the accrual rate and that only a portion, approximately two thirds, of the accrual charged to Account No. 323 should be considered as a current operating expense.

Applicant's claimed pension expense for 1952 reflected use of an accrual rate of 6.56 per cent of payrolls recommended to it by the American Company. The staff introduced a study by an independent consulting actuary who arrived at an accrual rate of 5.77 per cent of payrolls. The difference between the two figures is accounted for

<sup>5b/</sup> Under applicant's modified remaining cost accrual procedure, \$21,827,000 of the total Pacific Company's pension reserve requirement is intentionally not included in the pension fund, and this unfunded requirement is prevented from increasing by an accrual in lieu of and equivalent to interest at the actuarial interest rate.

mainly by differences in assumed rates of retirement on service pension and assumed actuarial interest rates, the other differences being substantially offsetting.

In developing rates of retirement on service pension the staff witness utilized Bell System retirement experience for the entire period 1922-1952, excluding years 1933 and 1934 for which data were not available. Applicant's retirement rates were developed from Bell System experience for the period 1922-1941, excluding years 1933 and 1934. The staff indicated that the applicant's retirement rates should have included weighting of recent experience and were too conservative. It is of importance to note that starting in 1954 applicant itself is revising its retirement rates to give weight to more recent experience.

The staff witness assumed an actuarial interest rate of 3.0 per cent, whereas applicant used  $2\frac{3}{4}$  per cent. The staff's use of the higher rate was based on an upward trend of interest rates, as shown in Exhibit No. 112, since 1947 when applicant realized a yield rate on its pension trust fund of 2.51 per cent. For 1953 the yield was 2.98 per cent. The record indicates that the average earnings of the funds of American life insurance companies is about 3 per cent and some companies have higher earnings. Furthermore applicant can and has been shifting its pension fund portfolio to higher yield securities in recent years.

We are of the opinion that the staff's proposed accrual rate of 5.77 per cent is reasonable and should be adopted for this proceeding.

Heretofore this Commission has disallowed the payment in lieu of interest on the unfunded reserve requirement for rate-making purposes on the basis that it represented prior service costs. However, in this case, the staff recommended that a portion of this payment in lieu of interest be allowed after considering applicant's

position, former California Commission decisions, the practices of other state commissions and the relationship of depreciation and pension accruals. The staff considered such treatment as being consistent with its recommendation in this proceeding for the use of remaining life depreciation. In so recommending allowance of part of the payment charged to Account No. 323 the staff recognizes certain present benefits from the pension program relative to past, present and future service.

We are of the opinion that the allowance of 5.77 per cent of payrolls should be augmented by the full amount of the payment in lieu of interest on the unfunded reserve rather than approximately two thirds of such amount as advocated by the staff. The Commission recognizes the social need and benefit of maintaining a sound condition in the pension fund and now that we have before us an unbiased and up-to-date actuarial study of applicant's pension plan we feel justified in reversing our former stand and will now allow the full component in lieu of interest for rate-making purposes. Such allowance will be computed at the interest rate adopted for the actuarial computations by the staff consultant. On such basis the staff's proposed pension allowance for intrastate operations will be increased by \$185,000 for the test year 1952.

We desire to make it clear that our action in this regard is based upon the facts reflected by this record and not upon any changed view or interpretation of the rules of law applicable to the subject in question. The evidence of record shows, and we so find, that these payments in lieu of interest, reasonably, bear a relationship to present and future pension benefits sufficient, lawfully, to justify their charge against present and future ratepayers for the purposes of rate fixing.



Depreciation

The difference of \$1,958,000 in depreciation expense between the staff and the applicant is due primarily to the fact that the applicant used the total life method whereas the staff used the remaining life method. The applicant contends that the Federal Communications Commission has preempted the field in prescribing depreciation rates (Exhibit No. 130) and that it is confronted with an accounting order. It may be noted that approximately 90 per cent of the depreciation expenses are assignable to intrastate operations.

Applicant further contends that the total life method follows the Uniform System of Accounts. The staff contends, however, that either the total life or remaining life method may be used under the provisions set forth in the Uniform System of Accounts for Telephone Companies as prescribed by the Federal Commission or the system as prescribed by this Commission. The staff points to the fact that the Federal Commission has allowed depreciation rates of a Class A telephone company in California to go into effect on a remaining life basis. The record shows that a total of six Class A telephone utilities in California, following the corresponding provisions in this Commission's Uniform System of Accounts, use the remaining life method.

Applicant has taken the position that it would be impracticable to maintain two sets of books; that is, one set reflecting total life depreciation, and the other set reflecting remaining life depreciation. The staff is of the opinion that a record reflecting depreciation accounting required by this Commission could be kept similar to the record which the applicant now keeps of the depreciation deduction claimed for income tax purposes. Applicant's witness indicated that it would be possible to keep such a record.<sup>6/</sup>

That such procedure is lawful is beyond question. (Arkansas Pr. & Lt. Co. v. Federal Power Commission, 185 Fed. 2d. 751, 752, certiorari denied by the Supreme Court of the United States 341 U.S. 909, L.ed. 1346). There is a strong presumption that federal authority has not superseded state authority. (Arkansas R.R.Com. v. C.R.I. & P.R.R.Co. 274 U.S. 597; 603; 71 L.ed. 1224, 1228).

Applicant contends that the remaining life method overlooks one of the main objectives of depreciation, namely, determination of the depreciation expense appropriate for each year's operation. It stated the view that, in applying the remaining life method, first a determination of the depreciation expense for each year's operation must be made which then must be modified for past over or under accruals in the reserve. In the remaining life method envisaged by the staff no over or under accruals are assumed or considered; rather, today's book values of the plant and the reserve are used, with estimates of future service life expectancy and future net salvage, ratably to recover the unrecovered portion of the plant over its anticipated remaining life. The remaining life method recognizes that estimates of the lives of property may prove erroneous when subjected to the test of experience and rectifies such error.

Applicant contends that under the remaining life method it would be more expensive to determine depreciation rates because a system to apply this method would have to be developed; because applicant could not discontinue present studies or studies of past experience; and because yearly reviews would be required. The staff is of the opinion that the introduction of the remaining life method would permit elimination of certain procedures now used by the applicant and that this would more than offset the cost of those added items that might be required to ascertain and determine remaining life.

The primary objective of depreciation, in our opinion, is to recover, during its useful service life, the original cost of

plant, not more, not less, and the remaining life method is the best method to accomplish this objective where the characteristics of service life and net salvage vary over the life of the plant because of wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities and changes in the cost of removal and salvage market. Obviously, these many factors cannot all be correctly foreseen at the time of installation of plant as required under the total life method. In our opinion the remaining life method is fairest both to the ratepayer and to the applicant. It protects the ratepayer from overcharges and reasonably assures the applicant that it will fully recover its original cost of plant. Any depreciation method or procedure which may either overcharge the ratepayer or under compensate the utility is not calculated to produce lawful results. Under or over accruals could well result from the application of the total life method if not repeatedly adjusted over the varying lives of the many items of plant.

It must be realized that at best the annual depreciation allowance is an estimate and the mortality and life statistics kept and different methods used are but an aid in making this estimate. The staff's allowance, which is approximately 6 per cent below applicant's total depreciation estimate is, we find, in harmony with the objective of determining depreciation expense appropriate for each year's operation.

The staff has recommended the change in method of determining depreciation accruals and the applicant objects. What we are doing here is determining a fair and reasonable depreciation allowance for rate-making purposes for intrastate operations. Section 795 of the Public Utilities Code gives the Commission authority to specify the depreciation method for intrastate operations, but to remain in harmony with the Federal Communications Commission we

should at this time do as contemplated in Section 793 of the Code and only require applicant to maintain additional records for determining remaining life rates. It is of importance to note that the Federal Communications Commission in prescribing total life rates states by letter to this Commission that: "Our prescription of these rates, therefore, is without prejudice to a subsequent review and we shall be glad to cooperate in a joint consideration and study of any proposal regarding this matter."

The staff's estimate of depreciation allowance appears reasonable and will be used for rate-making purposes. The extra operating expense, if any, of keeping supplemental records or memoranda to show remaining life results determined by methods comparable to those outlined in Exhibit No. 117, in our opinion, is not of sufficient magnitude to forego the advantages of this method. In view of the large number of California utilities that have adopted the remaining life method, the fact that all of the other Bell System companies use total life methods does not imply that more accurate depreciation estimates are possible under the total life method. We do not intend to indicate here that we are passing upon the propriety of the use of the total life method for interstate operations. The accrual rate proposed by the staff under the remaining life method reflects, and affords present ratepayers the advantage of, the present level of the depreciation reserve. By the order in this decision we are requiring applicant to establish and maintain memorandum records showing depreciation expenses calculated by the remaining life method as contemplated by Chapter 4 of Exhibit No. 117.

Taxes

The major difference between the staff's and the applicant's allowances for taxes was in the federal income tax. Because of a higher adjusted net revenue for income tax calculations the staff's adjusted income taxes were some 14 per cent above the applicant's when using a 52 per cent tax rate. However, under the present law the tax rate was reduced to 47 per cent on April 1, 1954. It is of record that the President has recommended that the former 52 per cent rate be maintained, and Congress now has under consideration a bill which would in effect restore the 52 per cent rate but would also revise the depreciation deduction allowances. The final action which Congress and the President may take is unknown. Applicant's customers should not be required to provide more than the amount of taxes properly chargeable to operating expense under the existing law.

Generally speaking a regulatory body in the prescription of rates should base its decision upon the tax rate which exists at the date of such decision, unless the existing law provides for a change at a future date. The federal law now provides for a 47 per cent corporate income tax rate. However, it is evident that this rate may be changed within the next few weeks but we do not know when. In such circumstances, we are of the opinion that the decision herein should not be postponed because of such contemplated eventuality. When and if the Congress revises the existing tax law, the applicant may file a supplemental application setting up that fact and alleging the effect which such revised law has upon its operating results. If new elements are included in such revised law their impact upon the applicant's operating results should be fully treated in any such supplemental application. Upon the filing of the same containing the appropriate information, the Commission will expedite the disposition thereof to the end that any modification of the rates herein prescribed, which may be required as a result of such revised tax law, shall be effected expeditiously.

In recognition of such situation, the adjusted operating expenses found reasonable herein will include federal taxes on income at the rate of 47 per cent.

With regard to social security taxes the staff adjusted the recorded test period federal old age benefit taxes to reflect the higher 1954 tax rate, and adjusted the recorded state unemployment insurance tax to reflect the long-term average tax rate, since large fluctuations in the tax rate are inherent in the unemployment insurance law. Applicant did not adjust these recorded taxes except for wage increase.

Applicant's adjustment to social security taxes to reflect the wage increase is somewhat greater than the staff's adjustment inasmuch as the applicant applied the average tax rate to the wage increase while the staff made allowance for the fact that a substantial portion of the wage increases was beyond the limit of taxable earnings.

Over all, the staff's adjusted social security tax figure is \$395,000 higher than applicant's adjusted figure for California intrastate operations and it will be adopted for the purposes of this decision.

#### Expenses Incident to Western Electric Adjustment

The expense adjustments under this heading are discussed in connection with the discussion of rate base adjustments for Western Electric charges hereinafter.

#### Rate Base

The rate base is composed of investment in plant in service plus certain property held for future use, working cash capital, and materials and supplies, less depreciation reserve. The rate

bases for the test year 1952 as adjusted by the applicant and the staff are set forth and compared below:

Average Rate Base as-Adjusted  
for 1952 Test Year

Item	: Applicant : Exh. No. 84	: Staff : Exh. No. 143	: Applicant : Exceeds Staff:
Plant in Service	\$1,006,493,000	\$ 989,116,000	\$17,377,000
Property Held for Future Use	1,090,000	602,000	488,000
Plant Acquisition Adjustment	102,000	0	102,000
Working Cash Capital	19,069,000	8,969,000	10,100,000
Materials and Supplies	13,500,000	-5,559,000	7,941,000
Subtotal	<u>1,040,254,000</u>	<u>1,004,246,000</u>	<u>36,008,000</u>
Deduction for Deprecia- tion Reserve	243,761,000	241,652,000	2,109,000
Rate Base, Depreciated	<u>796,493,000</u>	<u>762,594,000</u>	<u>33,899,000</u>

The largest item of difference is in the classification, Plant in Service. The major portion of the difference in this item is due to Western Electric adjustments which will be discussed later herein. The remainder of this difference, amounting to \$2,091,000, is due to accounting shifts of certain items from plant in service to plant under construction in November and December, 1952 in response to a request by the Federal Communications Commission. Applicant's rate base reflects the accounting shifts when made in applicant's books while the staff's rate base has been adjusted to carry such revisions back to the applicable dates. The staff's adjustment for this portion of the item appears reasonable and will be adopted.

Before discussing the various other items it should be mentioned that telephone plant under construction has not been included in rate base because applicant accrues interest on projects during construction. This is in accord with past Commission practice and there was no controversy on this point.

Property Held for Future Use

Applicant's rate base includes all of Account No. 100.3, Property Held for Future Use. The staff excluded, in general,

property which would not be used within two years of the rate base year (test year), on the basis that the two-year limit is a general measure of "imminent use under a definite plan". The staff did not make a separate field investigation and study on each one of the many items of property in the account because in relation to the total plant investment this property, comparatively, is small, representing in all about one tenth of 1 per cent of the rate base.

Applicant contends that it is necessary in many instances to purchase and hold land adjacent to existing central office buildings for future expansion inasmuch as the land might be unobtainable or obtainable only at excessive cost at the time needed for such expansion. While the staff recognized the needs of applicant for future expansion, its position is that the contemplated future use may never materialize and that even if the property is used the cost of carrying such land for long periods might well exceed the possible increase in market price.



There was extended discussion in the record regarding land held at Pine and St. Anne Streets in San Francisco which was purchased in 1924 and has been held in Account No. 100.3 since 1937 for future expansion of one of the San Francisco central offices. Only a small portion of this property, probably less than 10 per cent of the area, is used for a bank of conduits, some 2 feet wide, to afford an outlet for cables to Pine Street. The conduit bank in no way obstructs the present use of this property as an automobile parking lot. Applicant now obtains a revenue of \$7,200 per year from leasing this property for parking purposes and if this property is not permitted in the rate base the item of \$7,200 should be deducted from miscellaneous revenue. This the staff did not do.

In analyzing the other adjustments proposed by the staff it is noted that some properties which were deleted in 1952 were considered appropriate for a 1953 rate base. It is apparent that under the staff's two-year limit the adjustment would change from year to year as plans of use are changed and as new property is acquired or old property sold.

It appears that when use is imminent the property should be included in rate base. We are including in the 1952 rate base those items which the staff included in the 1953 rate base and which will not have been in this account more than five years. The effect of this inclusion is to substitute for the staff's two-year rule a three-year rule looking into the future from the base year with a five-year limit for any item residing in the account. Following the adopted rule the property held for future use, which is excluded from rate base, is reduced from \$488,000 to \$251,000. An appropriate increase of \$7,000 will be made to the staff's ad valorem tax allowance.

In acquiring property for future use an unreasonable burden must not be imposed upon the ratepayer, nor should the utility be penalized if it exercised reasonable judgment. However there are certain "risks of the business" which a utility must bear and which may not be transferred to the ratepayer.

#### Acquisition Adjustment

The staff did not include the telephone plant acquisition adjustment account in the rate base because that account reflects the difference between original cost and the market value of certain lands acquired many years ago from predecessor companies. This subject was discussed in our Decision No. 41416, dated April 6, 1948, and we see no reason to depart from the position stated therein. The staff's proposal in this case is reasonable and will be adopted.

#### Working Capital

Working capital in the rate base includes allowances for materials and supplies and working cash. For 1952 California intra-state operations applicant's allowance of \$32,569,000 includes \$13,500,000 for materials and supplies and \$19,069,000 for working cash, while the staff allowance of \$14,528,000 comprises \$5,559,000 for materials and supplies and \$8,969,000 for working cash.

With regard to working cash capital, applicant, as in prior proceedings, determined the allowance for this item on the more or less arbitrary basis of one twelfth of annual operating expenses exclusive of taxes and depreciation. The staff's working cash allowance is predicated upon the amount of capital supplied by investors for this purpose as determined by the average balances in Account No. 113, Cash, and Account No. 115, Working Funds, the lag in the payment of operating expenses and taxes, and the lag in the collection of revenue.

An item of \$1,627,000 in the computation of the staff's allowance for working cash represents the average amount of credit extended to applicant by Western Electric Company on purchases used for operation and maintenance. In addition, there is an average amount of \$8,948,000 representing credit extended to applicant by Western Electric Company on purchases used for construction that has not been included in the staff's working cash computation but has been included in Western Electric Company's net investment (rate base) as accounts receivable.

The staff, after adjusting the \$8,948,000 figure down to \$8,696,000 because of the purchase adjustment on Western Electric Company, deducted the latter amount from applicant's materials and supplies on the assumption that the rate base should not include plant and materials and supplies for which applicant has not yet paid. The applicant's position on this point was that there should be included in rate base the full book amount of materials and supplies which it has purchased. In our opinion applicant's position is reasonable and these materials and supplies represent plant devoted to the public service which should be included in rate base.

By having a credit of \$8,696,000 available from Western however, the applicant's need for working cash is correspondingly reduced. If this amount is not shown as an adjustment to materials and supplies it follows that it should be deducted from the applicant's working cash as computed by the staff. In applicant's summary of position for oral argument, page 46, it states that telephone plant under construction has not been included in rate base and that the portion of the \$8,696,000 attributable to purchases in construction work in progress has, in effect, been disallowed twice by the staff. Such contention disregards the fact that applicant is capitalizing interest during construction on part of these purchases prior to paying for them and is receiving a rate of return on the parts that reside in the accounts of plant in service and materials and supplies.

Our conclusion on working cash is that \$7,941,000 (the intrastate portion of the \$8,696,000), should be deducted from the staff's allowance of \$8,969,000.

In view of our use of the present 47 per cent federal income tax herein in determining applicant's earnings, it is necessary to increase the working cash allowance to compensate for the lesser amount of tax accruals available for working cash. Adjustment is also necessitated by revision of certain of the staff's expense figures. The net effect is to increase the working cash allowance predicated upon the 52 per cent tax rate by \$1,872,000.

An allowance of \$16,400,000 for working capital will be included in the California intrastate rate base for the test year, comprising \$13,500,000 for materials and supplies and \$2,900,000 for working cash.

#### Deduction for Depreciation Reserve

The difference between the staff and the applicant of \$2,109,000 in the reserve for depreciation is due primarily to two items. The first is an amount of \$439,000 resulting from certain accounting changes requested by the Federal Communications Commission heretofore referred to which has the effect of decreasing "plant" and "depreciation reserve" and increasing "plant under construction". The second adjustment is \$2,076,000 to reflect the lower Western Electric prices assumed by the staff. From the sum of these two figures must be deducted an adjustment of \$406,000 (to arrive at the \$2,109,000) made by applicant to reflect the lower depreciation rates effective January 1, 1953.

The effect of these lower depreciation rates on the reserve was not reflected backward in 1952 by the staff; it took the average reserve as shown on the books for 1952 as its starting point. In its summary of position for oral argument applicant states that this

treatment of the reserve is inconsistent with the staff's treatment as to Western Electric, where in applying remaining life accruals the staff also made a corresponding reduction in the reserve. The reasons for this difference in treatment are twofold: first, in the staff's study of Western, depreciation accruals for years prior to 1952 were adjusted which obviously would affect the average reserve for 1952, and second, applicant's reserve has been built through accruals recognized for rate-making purposes, and to adjust downward such actual reserve would in effect require a double depreciation contribution by the ratepayers on a portion of the service value of the utility's plant.

#### Western Electric Adjustments

Applicant purchases most of the equipment, materials and supplies it requires from Western Electric Company under a standard supply contract. The prices under this contract are fixed by Western. Applicant contends that the prices are, and have been, reasonable and that Western's earnings have not been excessive. In support of this contention applicant submitted statements of Western's profits and earnings on net investment over the period 1916-1952, and other evidence.

In view of the close affiliation of Western and applicant,<sup>6a/</sup> the Commission staff made an investigation of Western's accounting procedures and earnings results, inspected Western's principal manufacturing plants, and studied the reports filed by Western with this Commission, to determine the reasonableness of the prices paid to Western by applicant. The staff also considered prior decisions of this Commission as related to applicant's purchases from Western Electric.

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<sup>6a/</sup> American Telephone and Telegraph Company controls both applicant and Western Electric Company through majority stock ownership.

Starting with the earnings results of Western's Bell business as set forth by applicant in Exhibit No. 19, the staff made a number of adjustments designed to place Western's net investment and net income on a proper basis for rate-fixing purposes. Having arrived at a revised net income and net investment for each year by means of these adjustments, the staff then determined the amount by which each year's revised net income would have to be increased or decreased to yield Western the same level of rate of return as this Commission had found reasonable for applicant. These indicated increases or decreases in Western's net income from Bell business were then converted to corresponding increases or decreases in Western's gross revenue by applying net-to-gross tax factors to allow for the effect on income tax. The staff then applied, for each year, a set of factors designed to allocate the indicated adjustment to Western's total revenue from Bell business, either decrease or increase, to that portion of the plant purchased from Western by applicant in the particular year, which remained in applicant's California plant in the test year.

The staff adjusted applicant's expenses as well as the rate base, first, because approximately 17 per cent of its California purchases from Western are charged to expense and second, because the adjustments to plant necessitate adjustments to depreciation expense and ad valorem taxes. The two most important of the staff's adjustments to Western's net investment and net income, namely, cash and marketable securities and reserve for equalization of development, will be discussed in the following paragraphs.

The staff excluded a portion of Western's book amounts of cash and marketable securities. Applicant's witness states that Western needs to maintain large amounts of cash and marketable securities for effective operation; for the proper discharge of its obligations to its customers, suppliers and employees; for use in

case of strikes or other interruptions of transportation of supplies; and for expanding plant, merchandise and other assets.<sup>6b/</sup> The staff's position is that Western's working cash requirement, in so far as lags in the payment of expenses and collection of revenues are concerned, is recognized in the weighted average receivables and payables which have gone into Western's rate base; that strikes or other contingencies could be more economically met by borrowing; that inventory and plant build-ups could be more cheaply financed through temporary borrowing; and that as soon as cash is used to purchase materials or construct plants those amounts have been included in Western's rate base.

Applicant's witnesses allege that Western no longer has access to the pool of resources of the American Company so that Western is, in effect, an independent manufacturing company. As the staff pointed out, such a disavowal is meaningless in light of Western's known subsidiary relationship to the American Company.

Applicant's witnesses justify the amounts of Western's cash and marketable securities by comparison of its ratios of cash and marketable securities to working capital with the corresponding ratios of other manufacturing companies. The staff's position is that these ratios vary so much that they are of little practical value in judging Western's cash requirement.

The reserve for equalization of development referred to above amounted to \$41,447,000 as of December 31, 1952. This amount represents the net excess of accruals over actual expenditures for research and development work during the 13-year period since the

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<sup>6b/</sup> Exhibit No. 20, page 10.

reserve was established. The staff holds that this is a contingency reserve to provide for the continuation of a program of research and development during future periods of economic stress and that accruals to such a reserve should be charged to surplus rather than to operating expense.

Applicant contends through several witnesses<sup>6c/</sup> that the charging of accruals for equalization of development to operating expense is in accordance with generally accepted accounting practice. One witness quoted from Bulletin No. 43 of the American Institute of Accountants a list of types of reserves the accruals to which should not enter into the determination of operating expense, and stated that Western's reserve for equalization of development did not fall within that list.

In substantiation of its position the staff introduced Exhibits Nos. 146 and 147. Exhibit No. 146 is an article written by the Director of Research, American Institute of Accountants, wherein accruals to a reserve of this type through operating expense were considered as clearly not conforming to generally accepted accounting principles. In Exhibit No. 147 this same author, in response to a request of the comptroller of the American Company, stated that a peculiar relationship might exist between Western and the Bell operating companies which justified an exception in the public utility field, admitting however, that he was not sufficiently familiar with Western to express a positive opinion.

The staff has allowed all actual expenditures for research and development as operating expense. Consistent with excluding the

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<sup>6c/</sup> Exhibit No. 19, Exhibit No. 2 and testimony of a rebuttal witness, Transcript 6203-6209.



equalization reserve accruals from expense it has increased Western's net investment on which a return was computed by eliminating the reserve deduction.

Based upon prior decisions of this Commission fixing the rates of applicant, <sup>7/</sup> the staff made adjustments to applicant's rate base predicated upon a 7 per cent rate of return for Western for all years prior to 1936, 6.8 per cent for 1936-1943, inclusive, 5.95 per cent for 1944-1947, and 5.6 per cent for 1948 and subsequent years.

Applicant's witnesses contend that Western is entitled to higher rates of return than those allowed the applicant by this Commission because manufacturing companies are subject to greater economic risks than public utilities. The staff does not take issue with applicant as to the volatility of earnings of manufacturing companies generally as compared with public utilities, but has sought to meet and eliminate this as a factor when applied to Western by stabilizing and adjusting Western's rate of return, year by year, to the rates of return allowed applicant by this Commission. When earnings fell below the allowed level the staff in effect increased Western's prices to Pacific and vice versa.

In this connection Interim Decision No. 42530 in Application No. 29854, dated February 23, 1949, states:

"In Decision No. 21766 on November 7, 1929 (33 CRC 737), this Commission applied to the applicant with respect to its purchases from Western the principle that a manufacturing and construction company should not be permitted to profit at the expense of a public utility when the construction company controls the public utility or is owned and controlled by the same interests which own or control the public utility. We believe the principle to be as necessary of application here today as it was then." (48 Cal. PUC 492)

<sup>7/</sup> Decision No. 21766 (33 CRC 737), Decision No. 42530 (48 Cal. PUC 492), Decision No. 43145 (48 Cal. PUC 834).

The final decision in Application No. 29854, Decision No. 43145, reaffirmed this principle in the following language:

"We adhere to the principle announced by us in Interim Decision No. 42530, rendered in this proceeding, that Western Electric is entitled to no greater return on its sales to applicant than applicant is entitled to as against its ratepayers." (48 Cal. PUC 834)

In our opinion this principle is equally applicable in this current proceeding.

Applicant contends that, since in the earlier periods the rate of return fixed by this Commission for Pacific was related to an undepreciated rate base, the staff should have applied a correspondingly higher rate of return to Western's depreciated rate base, assuming of course that the staff method is followed at all. We do not agree with applicant in view of the facts pointed out by the staff witness, that 7 per cent return was specifically mentioned in the Commission's 1929 decision as appropriate for Western,<sup>8/</sup> and the 6.8 per cent rate of return used by the staff for the period 1936-1943 compares with a finding of 6 per cent rate of return on an undepreciated rate base for applicant's Southern California area in 1936.<sup>9/</sup>

Applicant points out also that in Application No. 29854 there was proposed a 6 per cent return to Western for the first six months of 1949 and that in Application No. 32640 there was a similar proposal of a 6 per cent return for the first six months of 1951, whereas in this proceeding the staff has proposed only 5.6 per cent return allowance to Western for both of these periods. The staff's use of 5.6 per cent is consistent with the fair rate of return found by the Commission in those proceedings. In each of the instances

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<sup>8/</sup> Decision No. 21766, November 7, 1929 (33 CRC 737, 763).

<sup>9/</sup> Decision No. 28764, April 27, 1936 (39 CRC 739, 781).

cited a 6 per cent rate of return was applied to results for a past test period in order to yield applicant 5.6 per cent return for the future.

After determining the amounts by which Western's net income should be reduced or increased, year by year, to yield the rates of return fixed by this Commission for applicant, the staff in Table 6-D of Exhibit No. 115 applied net-to-gross tax factors to convert the staff's adjustment to Western's net income into the corresponding gross revenue adjustment. In determining the net-to-gross factors the staff adopted a conservative approach by excluding the effects of excess profits tax.

Applicant objected to the staff's use of the net-to-gross factors on the grounds that Western has paid income taxes as incurred and cannot now recoup them. It appears to us that the staff's use of such net-to-gross tax factors is equitable since applicant's subscribers should not be required to underwrite income taxes which Western paid as a result of charging prices so high as to result in excess profits.

Applicant questioned the survivor ratios developed and used by the staff in arriving at the amounts of applicant's test year California plant investment subject to adjustment on several grounds, namely, in that central office equipment placements subsequently retired were not included in the placements (this omission apparently arose from some misunderstanding between the applicant and staff respecting a request for information), in that the ratios fail to give recognition to the fact that reused central office equipment had been reported in both placements and survivors by the applicant, in that "terminals and cases" should have been included in the main product class "apparatus and equipment", instead of in "cables and wires", in that certain placements and survivors included a non-Western labor component, and in that the survivor ratios used were determined as of January 1, 1952 rather than as of June 30, 1952 and June 30, 1953. The evidence shows that the staff's conclusion, from calculations based on as much data as could be obtained from

applicant without delay, that further adjustments to recognize the above-questioned items would have minor effect on the over-all Western Electric adjustments.

In oral argument applicant pointed out that whereas the staff witness in Application No. 29854 had suggested an adjustment of \$535,000 for purchases over the period 1918 to 1947 from Western Electric Company, the staff witness in this proceeding suggests an adjustment for the same period of \$4,460,000. Decision No. 42530 in Application No. 29854 calls attention to the fact that in that proceeding no adjustment was made for years prior to 1948 since the staff's studies for prior years were not completed and that a further deduction would be justified if years prior to 1948 were studied.

In order to show that Western's prices are reasonable in comparison with those of other manufacturers, applicant introduced Exhibit No. 18. We attach little significance to such price comparison because it ignores the great disparity in the size of manufacturing facilities and production volume between Western and the other telephone equipment manufacturers and also ignores the corporate affiliation between Western and applicant.

Applicant introduced Exhibit No. 140 to show that throughout the United States, except in Missouri, Michigan and California, Western Electric charges have been included in full for rate-making purposes. No conclusion can be reached with regard to Iowa and Texas because of the limited regulation in those states. Here again as we indicated under the license contract, we do not know the individual reasons why so many states have allowed the full prices but it is reasonable to surmise that comprehensive studies such as are before us here were not available to at least most of the commissions and courts in those states.

In its summary of position in connection with oral argument and after the evidence was all in, applicant made a recomputation of Western's operations using the staff theory and what it classed as proper data and ratios and arrived at a rate base adjustment of roughly 33 per cent of the staff's and an expense adjustment of roughly 40 per cent of the staff's. In relation to the total rate base this lower adjustment represents about six tenths of 1 per cent and in relation to total expenses represents about two tenths of 1 per cent. The total adjustment proposed by the staff amounts to 1.7 per cent of rate base and 0.4 per cent of expenses. An examination of page 4 of Appendix B to applicant's summary of position shows Western's earnings running as high as 15 to 18 per cent in several years. Upon consideration of this matter we conclude and find that the higher adjustments computed by the staff are reasonable as contrasted with the applicant's belated computations which seek to minimize the impact of the staff's presentation.

Our general conclusion with regard to the subject of Western Electric Company is to reiterate the position adopted by this Commission in previous decisions that an affiliated manufacturing company should not be permitted unreasonably to profit at the expense of a public utility where the manufacturing company is owned and controlled by the same interests which own or control the public utility. To assure that the utility's ratepayers will not be unduly burdened, the manufacturer's profits, for rate-making purposes, should be adjusted so as to be no greater than that allowed the utility. In our opinion all of the adjustments made by the staff are reasonable, and they are adopted for rate-making purposes, with the single exception that the staff's adjustment to operating expenses is revised to recognize the 6.25 per cent rate of return adopted herein.

The Western Electric adjustments for applicant's intrastate operations which we hereby find to be reasonable and adopt for purposes of this decision are:

Expense Adjustments	
Maintenance	\$ (396,000)
Depreciation	(532,000)
Ad Valorem Taxes	(319,000)
Total	(1,247,000)

Rate Base Adjustments	
Rate Base, Undepreciated	(15,286,000)
Depreciation Reserve	(2,076,000)
Rate Base, Depreciated	(13,210,000)

(Red Figure)

Adopted Rate Base

The following tabulation shows the rate base for California intrastate operations which we adopt as reasonable for the test year 1952 compared with the applicant's and the staff's results.

Item	Commission Adopted Rate Base	Applicant Exh. No. 84	Staff Exh. No. 143
Plant in Service	\$ 989,116,000	\$1,006,493,000	\$ 989,116,000
Property Held for Future Use	839,000	1,090,000	602,000
Plant Acquisition Ad- justment	0	102,000	0
Working Cash Capital	2,900,000	19,069,000	8,969,000
Materials and Supplies	13,500,000	13,500,000	5,559,000
Subtotal	1,006,355,000	1,040,254,000	1,004,246,000
Deduction for Depre- ciation Reserve	241,652,000	243,761,000	241,652,000
Rate Base Depreciated	764,703,000	796,493,000	762,594,000

Separation of Interstate and Intrastate Operations

Since most of the telephone equipment is used for both intrastate and interstate communications and the California

Commission has jurisdiction only over intrastate operations, it is necessary to apply some method for segregating the revenues, expenses and property connected with this jointly used plant. Applicant and the staff agree that the separations as between intrastate and interstate operations should be accomplished in accordance with the procedures set forth in the October 1947 Separations Manual and 1952 Addendum Thereto, a copy of which is included in this record as Exhibit No. 95.

Applicant's revenue from total California operations for the year 1952 as recorded was \$409,610,781. Of this amount, \$44,696,800 was received from interstate operations, leaving \$364,913,981 as the revenue from intrastate operations. Both the applicant and the staff used this amount (\$364,913,981) as the basic revenue figure to which adjustments were applied to arrive at the comparative revenue figures heretofore shown.

With regard to expenses and taxes the total 1952 recorded figure, including pension accruals of \$471,394 (Account No. 323) charged to income, is \$362,153,869 before separation to interstate and intrastate operations. Applicant assigned \$322,378,000 or 89 per cent to intrastate while the staff, after elimination of the pension accrual charged to income less the offsetting income tax adjustment, and exclusion of the portion of administration building expense assignable to other states, assigned \$322,186,000 to intrastate. Except for these items it is evident that the staff and applicant were in substantial agreement as to the separation of recorded expenses before test year adjustments.

In so far as the separation of property is concerned applicant's recorded average plant in service was \$1,128,706,000 for the year 1952 of which \$1,006,493,000 or 89.2 per cent was assigned to intrastate. This basic intrastate amount likewise was used by the staff.

The same separation methods were used to separate the test year adjustments. In separating the license contract fee, applicant used the separation percentages of the revenues upon which the license payment is based. The staff separated the cost of services covered by the license contract through application of appropriate allocation factors, consistent with its treatment of the license contract costs.

Summary of Adopted Operating Results

The following tabulation shows the intrastate operating results which we adopt as reasonable for the test year 1952, compared with the applicant's and the staff's results.

Item	Commission Adopted Oper. Results	Applicant Exh. No. 84	Staff Exh. No. 143
Operating Revenues	\$365,590,000	\$362,439,000	\$365,597,000
Operating Expenses			
Maintenance	82,387,000	82,820,000	82,316,000
Depreciation	29,778,000	31,736,000	29,778,000
Traffic	74,683,000	74,683,000	74,683,000
Commercial	37,642,000	37,762,000	37,642,000
General Office Salaries and Expenses	25,438,000	25,438,000	25,438,000
Operating Rents	1,764,000	1,764,000	1,764,000
General Services and Licenses	2,963,000	3,416,000	2,946,000
Balance Other (In- cludes Pensions)	13,528,000	14,909,000	13,343,000
Federal Income Taxes	24,750,000	23,704,000	27,586,000
Social Security Taxes	4,956,000	4,561,000	4,956,000
Other Taxes	25,509,000	25,598,000	25,512,000
Total Oper. Expense and Taxes	323,398,000	326,391,000	325,964,000
Net Revenue	42,192,000	36,048,000	39,633,000
Rate Base, Depreciated	764,703,000	796,493,000	762,594,000
Rate of Return	5.52%	4.53%	5.20%

The Commission's adopted results reflect the adjustments heretofore discussed and the current legal federal income tax rate of 47 per cent whereas the above results by the applicant and the staff reflect a 52 per cent tax rate.



Trend of Rate of Return

During the postwar period of increased prices of labor and materials, utilities generally have been faced with the problem of adding to plant at unit prices which are above the system average unit prices. The result of this process usually is to lower the rate of return unless there are offsetting factors. Applicant's Exhibit No. 84 shows the adjusted rate of return to be 4.5 per cent for the test year 1952 and 4.7 per cent for the first nine months of 1953 on an annual basis.

The staff's Exhibit No. 120-A shows the following trend in rate of return:

Year 1952 .....	5.20%
First 6 months of 1952, Annual Basis .....	5.06
Second 6 months of 1952, Annual Basis .....	5.33
First 6 months of 1953, Annual Basis .....	5.26

Applicant's study indicates an increase in rate of return of 0.2 per cent per year, while the staff's study shows a lesser amount of increase. Our analysis of this situation indicates that the greater rate of increase in the applicant's study is due to the fact that the 1952 test year was not adjusted for increases in directory advertising rates as heretofore discussed. After such an adjustment the trend of rate of return is less than 0.1 per cent upward per year. Such trend indicates that the rates may now be at a level that supports the increased unit costs of plant additions without a depressing effect on rate of return. Consequently, in this order we find the trend so nearly level that we see no reason for an upward or downward adjustment in rate of return because of a downward or upward trend in such return.

Revenue Increase

When a rate of return of 6.25 per cent is applied to a depreciated rate base of \$764,703,000 for the test year 1952 after adjustments, a net revenue figure of \$47,794,000 results. Compared with the adopted net revenue of \$42,192,000 for the test year an increase in net revenue of \$5,602,000 is warranted. Under prevailing tax rates (47 per cent federal income tax) a net-to-gross multiplier of 1.982 is indicated, which is equivalent to an increase in gross operating revenues and in rates of \$11,100,000. Such increase will be authorized and is estimated to result from the rate changes to be authorized by the order herein.

Rate Factors

Among the factors which the Commission has enumerated in recent decisions <sup>10/</sup> on other utilities as influencing the rate of return which also might affect the level of rates or of a particular rate are: investment in plant, cost of money, dividend-price and earnings-price ratios, territory, growth factor, comparative rate levels, diversification of revenues, public relations, management, financial policies, reasonable construction requirements, prevailing interest rates and other economic conditions, the trend of rate of return, past financing success, future outlook for the utility, outstanding securities and those proposed to be issued. Additional factors to be considered are adequacy of the service, rate history, customers acceptance and usage developed under existing rates, value of the service and cost to serve. No one of the above factors is solely determinative of what may constitute reasonableness of earnings, rates, or rate of return.

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10/ Decisions Nos. 47990 and 48833.

Intrastate Separations

Applicant takes the position that no separation of plant, revenues and expenses as between exchange and toll within the intrastate category is necessary or appropriate for rate-making purposes by the Commission. The staff contends that separation within the intrastate category is necessary to determine the relative cost of furnishing toll and exchange service and that such separation is useful as one element in determining relative rate relationships. Applicant asserts that if such a separation is required by the Commission it should be done in accordance with the Separations Manual, except in so far as it relates to the separation of Category A exchange plant.<sup>11/</sup> Applicant further asserts that in such case Category A exchange plant should be separated between intrastate toll and exchange on the relative number of message-mile-minutes of use rather than on the relative number of message-minutes of use as prescribed in the manual for the separation of interstate and intrastate operations.

The separation of Category A exchange plant between intrastate toll and exchange on the basis of message-minutes of use for each service is consistent with the separation of the identical plant between interstate and intrastate service. We find that the separation of Category A exchange plant between intrastate toll and exchange on the basis of message-minutes of use for each service is reasonable so long as the same basis is used for the separation of Category A exchange plant between interstate and intrastate operations. Future reports of separated intrastate operating results required of applicant by this Commission should be prepared in accordance with this finding.

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<sup>11/</sup> Category A includes outside plant used for subscriber lines, interlocal trunks, toll connecting and number checking trunks and station equipment.

Where applicant settles with connecting telephone utilities for the handling of interchanged toll traffic <sup>and</sup> on a cost basis the separation of Category A exchange plant for the purpose of determining such costs shall be in accordance with the above finding. The toll rates herein authorized will provide applicant with sufficient revenue, in addition to that required to produce the return herein found reasonable, to meet the increased settlement amounts resulting from the separation of Category A exchange plant in accordance with the above finding. <sup>11a/</sup>

Cost To Serve

The relative cost to serve the various classes of business and areas in relation to revenues received may be judged by the rate of return shown by the staff's study in Exhibit No. 120-A. Such returns are computed after deducting the separated expenses and taxes from the revenues and applying such figures to the allocated rate bases. The staff's summary for 1952 adjusted operations on a 52 per cent income tax basis follows:

Rate of Return on Separated Intrastate Operations

Exchange Service

	<u>Per Cent</u>
San Francisco-East Bay Extended Area	6.17
Los Angeles Extended Area	6.60
San Diego Extended Area	5.67
Other Northern California Exchanges	3.27
Other Southern California Exchanges	3.64
Total Exchange	5.76

Toll Service

Message Toll	2.61
Special Services	5.98
Total Intrastate Toll	2.81
Total Intrastate Operations	5.20

11a/ A witness for the General Telephone Company of California testified in Case No. 5462 that separation of General's Category A exchange plant between intrastate toll and exchange would result in an increase of approximately \$300,000 annually in the cost assigned to the handling of toll traffic interchanged with applicant.

On request applicant prepared and presented results of separated intrastate operations employing both its method of separation and the staff's method which follows the 1947 Separations Manual and the 1952 Addendum Thereto, Exhibits Nos. 84 and 96. Such figures differ from those above outlined because of adjustment to applicant's 1952 test year level and may be summarized as follows:

Item	Total	Intrastate Toll	Exchange
Revenues	\$362,439,000	\$ 85,957,000	\$276,482,000
Expenses and Taxes			
Company Method	326,391,000	79,976,000	246,415,000
Staff Method	326,391,000	82,104,000	244,287,000
Balance Net Revenue			
Company Method	36,048,000	5,981,000	30,067,000
Staff Method	36,048,000	3,853,000	32,195,000
Average Net Plant and Working Capital, Depreciated			
Company Method	796,493,000	133,503,000	662,990,000
Staff Method	796,493,000	153,178,000	643,315,000
Rate of Return			
Company Method	4.53%	4.48%	4.54%
Staff Method	4.53	2.52	5.00

#### Rate Spread

The applicant in Exhibits Nos. 13 and 85 proposes rates which it estimates will increase gross revenue by approximately \$53,500,000 based on the level of business for the test year 1952. In developing the rate spread as between exchange and intrastate toll and the basic exchange rates as between various areas in the State, applicant relied mainly on the value of service factors and disregarded the cost factor. It developed the spread mainly by judgment using the so-called state-wide approach to telephone rate making. In developing the spread of basic exchange rates among exchanges, applicant takes the position that the rates should increase with size of exchange as measured by station availability, claiming the value of

the service increases with increasing station availability. With respect to basic exchange rates, applicant proposes to classify all exchanges in the State into 11 rate groups in relation to station availability as of June 30, 1952, and generally to apply higher levels of rates to exchanges with higher station availability.

The Commission staff presented testimony on principles of rate spread, taking the position that the cost factor should be considered along with all other appropriate and pertinent factors. The staff in this proceeding, as in all other post World War II rate proceedings of this applicant, presented results of operations for the total intrastate category segregated as between toll and exchange, and the exchange category further segregated to (1) San Francisco-East Bay extended area, (2) Los Angeles extended area, (3) San Diego extended area, (4) other exchanges in northern California as a group and (5) other exchanges in southern California as a group. Based on the staff's showing that the rate of return on intrastate toll operations at applicant's proposed rates would be approximately 4.5 per cent, in Exhibit No. 131 the staff presented six trial toll schedules for consideration by the Commission. These schedules are estimated to increase gross revenues based on the volume of business for the test year by amounts varying from approximately \$7,000,000 to \$13,600,000 compared to \$5,510,000 at applicant's proposed schedule excluding the effect of the proposed withdrawal of local service in the Los Angeles extended area.

Little, if any evidence regarding spread of rates was presented by parties other than the applicant and the Commission staff. However, statements and arguments presented by others indicate that the City of San Francisco generally is in accord with the applicant's state-wide approach to rate making while the City of Los Angeles is

of the view that consideration should be given to the costs of furnishing exchange service by areas of the state and intrastate toll service. The cities of Berkeley and Oakland filed resolutions requesting rates in the San Francisco-East Bay extended area be set at the same level as those in the Los Angeles extended area. The City of Glendale in its written argument urged the Commission to reject applicant's proposal for state-wide rates and use the area approach.

Counsel for the Cities of Anaheim, Burbank, Chula Vista, Colton, Coronado, El Monte, El Cajon, El Segundo, Monterey Park, National City, Pasadena, South Pasadena and San Diego and for the County of San Diego stated in oral argument that they agreed to the position taken by the City of Los Angeles in this proceeding.

The record shows that there is a substantial variation in applicant's rate of return on its exchange operations in the various areas of the state. Costs of labor, materials and taxes vary as between areas and a state-wide approach to rates would not recognize this situation. In the past the Commission has given consideration to the economic and social desirability of having telephone service in rural and remote areas and has not required rates as high as indicated by the full costs of rendering service in such areas. The representative for the California Farm Bureau Federation urged consideration of the fact that revenue from the farms, mines and forests has made the business of the centers of population in the state. Also, he stated that there is a different quality of service available in certain rural and remote areas.

The City of Long Beach suggested rates somewhere between the extreme of state-wide rate making, on the one hand, and separate rates for each telephone or for each exchange, on the other hand. Its representative stated that the Commission is entitled to consider

that there is some social and economic value in making telephone services available in remote areas or small communities and that the people in the larger cities may well be expected to help accomplish this purpose.

The past position of the Commission has been that the rate-making unit was the exchange unit and the intrastate toll network and not the state as a whole. Change to a state-wide approach, as urged by applicant, it appears to us, would limit the consideration that could be given to complaints by municipalities or other parties or to investigations on the Commission's own motion as to parts of applicant's operations in the state. In these several broad areas of the state which the Commission considers, it is of importance to note that each represents more telephones than are available in each of certain other states of the United States or groups of states. We are not persuaded by this record to change from our past practice.

Basic Exchange Rates

Applicant requested that \$33,371,000 be obtained from basic exchange rates. Its proposed range of increases by rate groups follows:

Group	Number of Stations	Range of	
		Residence 2-Party Line	Business Individual Line
L	Limited Hours	\$0.25	\$1.00
1	0 - 500	.25 - .75	.75 - 1.75
2	501 - 2,000	.35 - .60	1.25 - 1.75
3	2,001 - 5,000	.20 - .45	.75 - 2.00
4	5,001 - 10,000	.30 - .55	.50 - 2.75
5	10,001 - 20,000	.40 - .65	1.00 - 3.00
6	20,001 - 40,000	.50 - .75	1.00 - 2.50
7	40,001 - 65,000	.60	1.50 - 2.50
8	65,001 - 115,000	.55 - 1.20	1.25 - 2.75
9	115,001 - 290,000	.65 - 1.30	1.25 - 3.25
10	Over 290,000	.75 - 1.40	2.25 - 3.00

The record indicates need for an increase in both the exchange rates and the toll rates. Since the revenue increase being



authorized is about 20 per cent of applicant's request; the problems created by applicant's requested increase of \$33,371,000 in the monthly basic exchange rates, to a large extent, are dissipated thereby, and the present basic exchange rates and relationships will be kept intact. It appears reasonable however, to regroup exchanges outside extended areas because of growth in the territory and the earning level of these exchanges as a group. Sixty exchanges outside the San Francisco-East Bay, Los Angeles and San Diego extended areas will be reclassified in accordance with conditions existing as of January 1, 1954. These reclassifications will result in increases in annual revenues of \$380,000, of which \$325,000 would be applicable to northern California exchanges and \$55,000 to southern California exchanges, based on the 1952 test year.

#### Local Messages and Message Units

Applicant requested an increase of \$7,607,000 in local message and message unit rates. It proposed to increase such unit rates in the Los Angeles extended area from  $3\frac{1}{2}$  cents to  $4\frac{1}{2}$  cents and to reduce such rates in the San Francisco-East Bay extended area from 4.4 cents to 4 cents. The  $3\frac{1}{2}$ -cent message unit rate in the Los Angeles area has remained virtually unchanged since it was established in 1940 and the local message rate of  $3\frac{1}{2}$  cents in the Los Angeles area has been unchanged since 1930. In connection with the multiple message unit proceeding in the Los Angeles extended area (Case No. 5462), the four respondent companies, The Pacific Telephone and Telegraph Company, General Telephone Company of California, California Water & Telephone Company and Sunland-Tujunga Telephone Company, request a uniform rate of  $4\frac{1}{2}$  cents and propose a new basis for divisions of multiple message unit revenues. The General Telephone Company of California was agreeable to the elimination of its toll terminal charge if the message unit rate were increased to a level between  $4\frac{1}{2}$  cents and  $4\frac{1}{2}$  cents.

Applicant's annual increase figure of \$7,607,000 is made up of an increase of over \$9,600,000 in the Los Angeles extended area and a reduction of over \$2,000,000 in the San Francisco-East Bay extended area, and does not reflect the effects of the new basis of settlement in the Los Angeles area. The estimated effects on the revenues of the four companies and on charges to the telephone subscribers of the change to a 4½-cent rate in the Los Angeles area and the withdrawal of the toll terminal charge are summarized below:

Item	Year 1952		
	Increase in Charges to Subscribers	Settlement Effect	Increase in Company Revenues
<b>Local Messages and Message Units</b>			
Pacific Company	\$6,475,000	\$(1,615,000)	\$4,860,000
General Company	1,217,000	1,725,000	2,942,000
California Wtr. & Tele. Co.	215,000	(110,000)	105,000
Sunland-Tujunga Company	30,000	-	30,000
Subtotal	7,937,000	-	7,937,000
<b>Toll Terminal Charge</b>			
General Company	(1,499,000)	(509,000)	(2,008,000)
Other California Companies	(1,096,000)	509,000	(587,000)
Total	5,342,000	-	5,342,000

(Red Figure)

A 4½-cent local message rate and message unit rate in the Los Angeles extended area will permit each of the four companies operating in that area to obtain its costs plus reasonable return on investment from this business under the new settlement arrangement and will also permit the elimination of General Company's toll terminal charge. The concurrent order being issued under Case No. 5462 will provide for this uniform 4½-cent rate in the Los Angeles extended area and as above indicated will increase applicant's revenues after settlements by \$4,860,000 on the 1952 test year. In view of the fact that the basic exchange rates are not being increased it does not appear proper to the Commission to lower the message unit rate in the San Francisco-East Bay extended area as proposed by the applicant.

### Foreign Exchange Rates

Applicant proposes to increase foreign exchange rates by \$674,000 on an annual basis. Increases in foreign exchange mileage rates in the Los Angeles extended area to the level generally applicable elsewhere in California accounts for \$542,000 of the total increase. The balance of \$132,000 is made up of a number of items including:

- a. Converting all business foreign exchange services to message rates.
- b. Increases in foreign exchange PBX trunk rates.
- c. Combining exchange messages and message units in determining total foreign exchange usage, and
- d. Furnishing only extended foreign exchange service in the Los Angeles area.

The Commission has long recognized the need for close relationship between rates for toll or multiple message unit service and foreign exchange service (Dec. 14420, dated December 31, 1924, 25 CRC 763). An increase of \$620,000 is being authorized in foreign exchange rates.

### Extension and PBX Stations

Applicant proposed to increase rates for extension and PBX stations by \$2,146,000. Increases of 25 cents per month were requested for extension stations in connection with residence service, business message rate service, semipublic services without coin box (50 cents with coin box), and PBX message rate stations. No increases in these rates are authorized at this time.

### Service Connections and Moves and Changes

Applicant proposed to increase service connection and move and change charges by \$1,946,000. Service connection and move and change charges are nonrecurring charges assessed against new connections for telephone service and for those subscribers

who require moves of service and equipment. Applicant requested service connection charges for business primary service be increased from \$7 to \$10, for residence primary service from \$5 to \$7, for extension and PBX stations from \$3 to \$4, and for move and change charges generally from \$3 to \$4 for telephone sets and by varying amounts for switchboard positions. These requested increases are not being authorized at this time.

#### PBX Equipment

Applicant proposed increases in rates for manual and dial PBX equipment aggregating \$1,879,000. This amount is made up principally of the following items:.....

Manual switchboards .....	\$ 418,000
Dial line finders .....	1,115,000
Dial common equipment .....	241,000
755 Dial PBX .....	105,000
Total	<u>\$1,879,000</u>

This increase is not authorized in this order.

#### Key Telephone

Applicant proposed increases in a number of rates relating to key telephone service which are estimated to increase annual revenues by \$586,000. This item has not been authorized herein.

#### Directory Listings

Applicant proposed to increase all 50-cent directory listings to 75 cents and all 25-cent listings to 35 cents. These changes are estimated to increase annual revenues by \$324,000 and are authorized herein.

#### Other Exchange Rates

A number of miscellaneous increases was proposed by the applicant under this category producing added revenues of \$292,000. The largest single item of increase in this group is joint user rates. However, a substantial portion of the increase in joint

user rates is related to increases in the basic exchange rates. No increases are authorized in this category except as such increases are occasioned by the increases in basic rates herein authorized.

#### Toll Rates

Mention has already been made of applicant's proposed increase in toll of \$5,510,000 and the staff's computations assuming a greater portion of the increase to be allocated to toll. Applicant's proposed toll increases would be obtained by increasing the initial period day station rates by 5 cents for all distances over 45 miles, by increasing the person rates from approximately 50 per cent to approximately 60 per cent higher than corresponding station day rates and by holding the night and Sunday rates at a level approximately 15 per cent lower than the corresponding day rates. The staff's computations were predicated on essentially the same basis except that increases were computed starting with distances over 8 miles in some cases and over 6 miles in others. Such spread of toll increase would bring the rates for short-haul traffic more nearly in harmony with the nationwide interstate rates recently fixed by the Federal Communications Commission.

The present California toll schedule has not been changed since March 21, 1949. On the other hand, the interstate toll schedule has been revised upward twice since that date. Likewise, most state toll schedules throughout the nation have been revised upward since March, 1949. The toll rates herein authorized are estimated to increase applicant's revenues by \$4,916,000 related to the test year 1952 after allowance for increased intercompany settlement as discussed above.

Extended Areas

Applicant requests authority to introduce extended service into the general areas of Sacramento, Merced, Rialto, Arroyo Grande and Willows. In addition, applicant has previously been authorized to proceed to introduce extended service in Orange County, North San Diego County, San Ysidro, and Santa Cruz areas. Currently, extended service is available in Monterey, Arcata and San Lorenzo Valley in addition to the Los Angeles, San Francisco-East Bay, and San Diego areas. With regard to the Sacramento and the Rialto (San Bernardino) areas, as previously mentioned the extended service in these areas is being considered in connection with pending Commission investigations. With respect to Merced, Arroyo Grande and Willows, there was no request by subscribers for such service arrangement and the applicant presented no evidence to justify such extended service. If there is need for such service applicant should apply for authorization in a separate proceeding.

Business Message Rate Service

Applicant proposes to offer business individual line message rate service in 28 additional exchanges within the state in lieu of business two-party flat rate service. Facilities to complete such service arrangements may take two years to install and make ready for such changes. The order herein will authorize applicant to proceed with this program in the following 12 exchanges within the San Francisco-East Bay extended area:

Campbell	Palo Alto	San Mateo
Los Altos	Redwood City	Saratoga
Millbrae	San Carlos-Belmont	Sunnyvale
Mountain View	San Jose	Woodside

These changes will be made gradually over a comparatively long period and the effect on the applicant's net revenues will be too uncertain to reflect any change into the test year.

Since the basic business exchange rates generally are not being raised, the need for the requested changes in the other 16 exchanges is not apparent to the Commission at this time.

Flat Rate Business Service

Applicant requested the substitution of message rates for business individual line flat rate extended service in the Sun Valley district area of Burbank exchange and in the Canoga Park, Crescenta, El Monte, and Roseda exchanges. As these are the only remaining flat rate business services in the Los Angeles extended area, and since message rates more appropriately distribute the charges to customers in proportion to usage, and this appears to be a reasonable time in which to make this change, applicant's request will be authorized.

Telephone Answering Service and Mileage Rates

The Commission's policy regarding telephone answering service rates, secretarial line rates, and mileage rates for off-premises lines is being established by concurrent order under Cases Nos. 5400 and 5417. Secretarial line mileage rates are being changed to a modified flat rate and mileage rate plan. No changes are being made in rates for off-premises lines used for other purposes than telephone answering service. The existing relationships of the several types of service available to patrons of telephone answering bureaus are being maintained except for changes, such as regrouping of exchanges or rate revisions hereinabove mentioned. The secretarial rates being authorized herein will result in increases in charges in certain cases and decreases in others, but over all will be set at a level approximately to maintain applicant's existing level of revenues from this class of service.

Rates for Temporary Suspension of Service  
on Business Equipment

A witness for the California Retailers Association presented three exhibits (Exhibits Nos. 127, 128 and 129) requesting a reduced rate or a rate like the residential vacation rate on equipment used only during the busy seasons of the year, which equipment is idle the remainder of the year. This matter was discussed at some length and the need for further study and evidence was pointed out to the Association. By letter dated May 4, 1954, the Association advised that in the interest of expeditious procedure and to avoid any unnecessary complications it would raise no objection to having its request withdrawn without prejudice from consideration as part of the general rate case.

In this order we will not make any change in the existing vacation rate schedule applicable to residential service nor institute such a schedule for business service. The Association can initiate a new and separate proceeding on this subject at any time that it desires in the future.

Withdrawal of Local Service in the Los Angeles  
Extended Area

Applicant requests authority to discontinue and cancel rates for local service in the Los Angeles extended area on a program basis within two years from date of authorization. Local service schedules have been closed to new subscribers since March 21, 1951.<sup>12/</sup> As of June 30, 1953, there were 20,378 business and residence main stations receiving local service in the entire extended area, of which 11,379 were in the Pasadena exchange. At the end of June 1953 local service represented 17.3 per cent

12/

Decision No. 42530, Application No. 29854.



of the business and residence main stations in the Pasadena exchange, 4.1 per cent of the main stations in the Los Angeles extended area exclusive of the Los Angeles exchange and only 1.7 per cent of the main stations in the total extended area. The withdrawal of these remaining local services, applicant contends, would eliminate special handling and accounting for a small segment of customers and permit more efficient and simplified operations and more efficient use of plant facilities in the long run.

The City of Pasadena is opposed to applicant's plan to withdraw local service. Its witness stated that Pasadena has grown and developed with characteristics quite a bit different from many of the other cities in the Los Angeles extended area. Since March 1949 less than half of the local services have changed to extended service and he claimed that almost 40 per cent of the business services and almost 15 per cent of the residence services are still on local exchange rates.

The applicant disagreed with the figure on business stations in Pasadena and introduced Exhibit No. 71 to show that this figure was 26.1 per cent on June 30, 1953, rather than the almost 40 per cent figure quoted by Pasadena's witness which was apparently based on the ratio of main stations only and did not include all types of business stations.

Applicant's studies, Exhibits Nos. 49 and 50, indicated that by increasing net plant in service by \$529,000 to effect the changes for all remaining local services in the Los Angeles extended area, an annual expense saving of \$176,000 would result on the basis of the 1952 conditions. In addition, applicant's studies indicated an over-all saving in billing to the subscribers of \$622,500 in the year 1952 due to the fact that the savings in toll more

than offset the added cost of multiple message units on extended area calls based on present rates.

While elimination of the local service may be particularly felt in the Pasadena area, by and large the remaining number of local services is comparatively so small in the total Los Angeles extended area that the proposal appears to be a reasonable step at this time. Forms of rates which will permit economies in operation, and encourage usage and extension of service within reasonable limits should be authorized. In reality local service is not being withdrawn, it is being expanded to include adjoining exchanges. The order herein will provide for this change on a program basis over the next two years.

In connection with elimination of local service it is not anticipated that any marked effect on over-all net revenues will result in the immediate future at the rates authorized herein. This change will take place gradually over a two-year period and permit more efficient use of plant in the long run.

#### Special Contract Services

The record shows that applicant is furnishing services under approximately 4,750 contracts with associated annual revenues estimated to be \$950,000. These contracts have not been filed with this Commission. It appears that all of the revenues, expenses, and plant effects relating to these contract services were reflected in applicant's presentation. It is applicant's position that these services, facilities and equipment are of a nonutility character and that the material in the record concerning these contracts is neither necessary nor relevant to a decision in this proceeding. We do not subscribe to this view. These services furnished pursuant to these contracts are performed by the use of operative property and operative personnel of applicant, and necessarily and lawfully constitute public utility service subject to the jurisdiction of this Commission.

Any claimed exemption from the provisions of a regulatory statute must be strictly construed (Piedmont & Northern Ry Co. v. I.C.C. 286 U.S. 299, 311-312, 76 L. ed. 1115, 1123; Interstate Natural Gas Co. v. F.P.C. 331 U.S. 682, 691, 91 L. ed. 1742, 1748; U.S. v. Public Utilities Commission of California, 345 U.S. 295, 310, 97 L.ed. 1020, 1034).

It appears that applicant has failed to comply with the Commission's General Order No. 96 in two respects; first, contracts for furnishing services have not been filed with this Commission and, second, the provision requiring the contract to be subject to the Commission's jurisdiction has been omitted from the contracts themselves. We are constrained to believe a misunderstanding has existed with respect to the applicability of General Order No. 96 and the order herein will require that contracts or contract provisions covering services and/or facilities furnished by the applicant be filed. A review of items numbered 2, 6, and 7 in Exhibit No. 121 involving approximately 4,640 contracts leads us to the conclusion that the contractual provisions should be reduced to appropriate tariff schedule rates and conditions with a form of the contract also as part of the tariff schedules. Contracts with United States Armed Forces containing classified matters may be filed with the location of the service omitted. The other contracts summarized in Exhibit No. 121 should be filed individually. No modification, revision, renewal or extension in any of the above discussed contracts should be made without inclusion of the Commission jurisdiction clause set forth in General Order No. 96.

#### Base Rate Area Changes

Applicant proposed in its application the expansion of base rate areas in 39 exchanges as soon as possible. By letter dated March 24, 1953, the Commission suggested to the applicant that it proceed immediately to make the necessary filings to accomplish the base rate area expansions. The Commission also stated it would be

desirable for the applicant henceforth to make periodic reviews of its base rate areas and file for expansion of such base rate areas wherever and whenever the need therefor becomes apparent.

By letter dated March 27, 1953, the applicant advised the Commission of its intention to proceed with the filings to accomplish the 39 base rate area expansions. Thus far tariff filings have been completed for most of these base rate area expansions. The staff of the Commission included the full year effect of these 39 base rate area expansions in its earning exhibits under present rates for telephone service.

#### Service Matters - Selective Ringing

In Decision No. 41416 the subject of full selective ringing was considered and applicant was ordered to furnish certain reports. Full selective ringing provides an improved service on four and ten-party lines in that the subscriber hears only his own signal and does not have to be bothered with code ringing or ringing for some other party. In this proceeding the staff introduced Exhibit No. 110 which contained certain recommendations on this subject.

The staff's first recommendation was that the applicant either give early attention to upgrading four-party line stations in the San Francisco-East Bay, Los Angeles and San Diego extended areas and in Orange County through the provision of two-party message rate service or provide full selective ringing on such four-party lines. Applicant elects ultimately to provide two-party service in the areas mentioned in lieu of full selective ringing on four-party lines and contends that it would not be economically sound to provide four-party full selective ringing equipment. In view of the fact that applicant is introducing automatic message accounting equipment its election would avoid expenditures for short-lived message registers

if such program can be coordinated with other aspects of the whole program. Applicant's position appears reasonable and is acceptable.

The staff's second recommendation was that applicant's revised selective ringing program relating to dial exchanges serving less than 2500 stations be modified to show that the entire program (including those exchanges where temporary departures have been authorized) is to be completed not later than December 31, 1965. Applicant believes that this recommendation substantially can be accomplished by December 31, 1965, but that in order to prevent the uneconomical expenditure of capital money and also the construction of extremely expensive plant that would benefit relatively few subscribers, the exchanges recommended for conversion after 1964 should be programmed where possible to coincide with major equipment replacements. Applicant's answer to this recommendation appears reasonable; however, after reviewing this matter further the applicant should, within sixty days, indicate by letter to the Commission as to those projects, if any, which might be delayed beyond December 31, 1965 to fit in with the major equipment replacement program. The order herein will provide for this report.

The staff's third recommendation was that applicant review its practice of not making available, where desired, selective ringing on farmer lines and file a report with the Commission covering its review. Applicant states it has been giving active consideration to the conditions under which it might be practicable to make available selective ringing on farmer lines and to the costs which would be involved. Applicant may see

its way clear to provide eight-party semiselective ringing on farmer lines, assuming a reasonable program basis, provided that the farmer line subscribers, at their own expense, can construct or rehabilitate their plant to meet company standards of construction and circuits so that their stations will operate satisfactorily with applicant's selective ringing power plants and that they maintain their plant accordingly. Negotiations to furnish semiselective ringing to certain farmer groups have been concluded by applicant. Applicant's answer here does not constitute a sufficient report on this subject. While it points out the obligation of the farmer, such supplemental report should contain data as to the feasibility of making such ringing available to farmer line subscribers, the date when such service can be offered, and estimates of the cost of providing selective ringing on farmer lines assuming a reasonable program basis for its introduction. Such supplemental report will be required within 90 days after the effective date of this order.

Service Matters - Timing of Telephone Conversations

The Commission staff presented evidence by Exhibit No. 109 on timing of telephone conversations, pointing out certain excerpts from Decision No. 43145 relating to this subject indicating that the quality of the work in timing of telephone messages is not only important to the telephone using public, but also has a direct and important effect upon the revenues of the applicant. The staff's exhibit indicates that the percentage of messages overtimed more than five seconds has

increased from 12.5 per cent for the first quarter of 1953; to 13.0 per cent in the second quarter and to 13.5 per cent in the third quarter. The 1953 performance is below the 1950 and 1951 experience.

The staff's first recommendation on timing was that the applicant continue its efforts to improve toll timing performance. Applicant answered that it is striving continuously through training and supervision of the operating force to improve timing performance on calls handled by operators. Through the provision of facilities for automatic timing of messages applicant claims that the number of messages so timed has increased over 330 per cent between 1948 and 1953. This represents an increase from 8.5 to 27 per cent of the total toll and multiple message unit messages handled in the years indicated and applicant's current programs for 1954 and 1955 will produce additional facilities that will substantially increase these percentages. In general applicant's answer appears to meet the recommendation; however, its efforts along this line should be increased because with the rapid system growth the actual number of messages manually timed is still increasing.

The staff's second recommendation was that applicant renew its efforts to develop and place in service automatic timers associated with switchboards handling timed messages. Applicant's position on this matter is that it is planning for the extended use of facilities which permit automatic timing of toll and multiple message unit messages. Substantial progress has been achieved by the provision of automatic ticketing.

automatic message accounting and zone registration equipment, which permits customer dialing and provides mechanized processing of message data. Plans provide for the extension of customer dialing which will progressively reduce that portion of the total traffic subject to operator timing and efforts are being directed towards the development of switchboard timing devices that will produce recordings that can be readily integrated with the present and planned automatic timing system. Applicant does not believe that it would be economically sound to depart from established plans and make large capital outlays on an interim basis for any sort of switchboard timing device not compatible with existing automatic accounting systems. The staff did not have any criticism of applicant's handling of the development of automatic timing equipment but suggested that some of the ideas for automatic timing could be folded in with the applicant's many plans for automatic equipment. The staff's recommendation appears reasonable regarding automatic equipment and should be adopted by applicant.

The staff's third recommendation was that applicant continue the development work necessary for the installation of equipment which will permit the automatic timing of messages from coin-box services. Applicant's reply to this recommendation was that it has been and is actively investigating the possibility of providing some type of coin zone dialing that can be integrated into the present plan. It anticipates that such facilities would be designed to permit automatic timing of station calls up to a maximum of about a 25-cent initial period.



Applicant appears to be working in harmony with this recommendation and its efforts along this line should be implemented in the future.

Applicant has been rendering certain periodic reports regarding timing performances and these should be continued in the future until further order of the Commission.

Service Matters - Marin County

Applicant proposes to modify the existing service arrangement with respect to the Marin County portion of the San Francisco-East Bay extended area to provide a uniform common local service area and rate treatment whereby Belvedere, San Rafael and Sausalito will be furnished the same service arrangement as now being received by Corte Madera and Mill Valley. Such proposal would involve increases to some subscribers and decreases to others as well as an increase in plant investment and some operating expense savings. There is not sufficient evidence in the record to support this change on the part of subscribers or the applicant. If there is need for this change it would appear appropriate for the interested parties to institute a separate proceeding on this subject.

Service Matters - Held Orders

The representative for the California Farm Bureau Federation pointed out to the Commission the lack of telephone service in the rural areas. Following the war, he stated, all telephone companies were in trouble in California because of insufficient material to supply all demands of prospective new customers. However, he contends today we still find thousands of rural people unable to secure telephone service. By Exhibit No: 90 applicant advanced a plan to take care of held orders on its books as of October 31, 1953. This exhibit showed that many of the held orders would not be cleared prior to the second half

of 1955. The Farm Bureau representative stated this proposal was wholly unsatisfactory to the rural people. Now, with materials available, applicant offers the excuse that it doesn't have enough money to procure the necessary materials to provide the service.

In a number of places in the record three of applicant's witnesses refer to uneconomic construction being done by the applicant due to a lack of money. It appears that during the last seven or eight years applicant has been following the policy of constructing plant with less than normal margins for growth. It blames this situation on a lack of funds resulting from low earnings.

In our opinion there are other more realistic reasons. Following the close of World War II we know that applicant did not have the materials to provide the plant margins and take care of all possible held orders. There is indication in the record that the applicant has elected to serve first the business that indicated good return on the investment and left the less economic business to stand unserved. Many of the held orders are undoubtedly due to large subdivisions being conceived and built in a few months whereas it takes many months to engineer and construct telephone plant and interconnect it with all of the existing plant. As revealed in the Reseda situation the rapid and unpredictable subdivision of rural property has made it difficult for the applicant to accurately forecast, on an economic engineering basis, the magnitude, precise location, and time of the growth.

Public utilities in this state are under dual statutory obligation; first, to provide adequate and efficient service to their patrons and the public and, second, to furnish service

at just and reasonable rates. Adequate telephone and communication facilities and services are of paramount importance to the economy of a fast developing community or territory. We are not pleased by the record in this case which shows that applicant, despite the large backlog of held orders, has cut its proposed 1954 gross construction program back from \$199,157,000 to \$161,900,000 mainly because of an estimated falling off in net new demand for main telephone service with an alleged leveling of the business cycle. A telephone utility must assume the obligation of furnishing adequate and efficient service in the territory covered by its operating authority and monopolistic franchises. Management should make this its policy and the Commission should not have to project itself into the functions of management. On new financing which is subject to our authorization, we have never refused any reasonable requests of applicant. Applicant must accept full responsibility for not adequately meeting its public service obligations.

In the public interest applicant should give special and specific attention to the matter of providing new services and regrading of present services in order to effect a performance superior to that indicated by Exhibit No. 90 herein.

A representative of the California State Grange was concerned over obtaining adequate rural telephone service and was opposed to any rate increase. A representative of the California Farm, Research and Legislative Committee in general opposed any increase in rates on the basis of the trends in farmer costs and receipts. In reaching our conclusion in

this matter the positions of these organizations, as well as the position of the California Farm Bureau Federation on rural service and rates, have been considered.

If applicant's present extension rules or rural rates do not warrant it in serving the less remunerative rural business it is incumbent upon the Commission to further consider this matter. The Commission has under way an investigation upon the Commission's own motion into the availability of facilities for telephone service, Case No. 5337, which will be opened to this additional aspect in the near future. To the extent that applicant's failure to serve rural business may have been due to any inadequacy in rate of return, it is our opinion that such condition is being fully corrected by the 6.25 per cent rate of return being authorized herein.

There was also indication in the record that the present priority rule, which gives preference in new service to those concerned with public health, safety and welfare, may be out of date since the suspension of the Korean War and should be revised. This also appears to be a proper subject to consider further under Case No. 5337 and the Commission will schedule hearings thereunder in the near future.

Service Matters - Reche Canyon Extension

Some 26 prospective subscribers living in Reche Canyon request service from the applicant although they are located in the service area of another utility, California Water & Telephone Company. This group lives in a small canyon with high hills on both sides and with the City of Colton located near the mouth of the canyon. Colton is their post office address and is their nearest center of community interest. Exhibit No. 38 herein contains a survey and report on this matter indicating that the California Water & Telephone Company will render service provided each prospective subscriber will pay a construction charge of approximately \$300, subject to certain refunds at the end of three years of continuous service.

By letter dated September 25, 1952, the applicant has stated that it would be more expensive to bring its service to these people than it would be for the California Water & Telephone Company to serve them. These prospective customers contend otherwise. In view of this conflict and the fact that a rate proceeding is not a proper proceeding for a change in service areas between utilities, this matter cannot be resolved herein. This matter could be further considered under Case No. 5337 in the near future on formal request of the prospective subscribers.

Rulings and Motions

In a proceeding as extensive as this one, obviously it is not practicable to rule individually in this order on all the various points brought before us for consideration by the many letters, witnesses and parties. Our objective has been to discuss and rule on those matters which seemed of major importance in

deciding the validity of applicant's request. However, broad consideration has been given to all requests though each may not be specifically treated herein.

Likewise, during the course of the hearing many motions were made. It was possible to rule on some at the hearings, others being left for ruling under this order. All motions consistent with the findings and conclusions in this opinion and order are granted; those not consistent are denied.

At one hearing a witness for the California State Hotel Association requested an increase of 5 cents per message in the charge to guests by hotels if increased rates are granted to applicant. After this matter was discussed by the presiding commissioner with the other members of the Commission, the ruling was made and the association was advised that it could file a formal rate increase application in compliance with the Commission's rules of procedure and support the same with proper evidence.

During the course of the hearings in this proceeding, individual service complaints were made by a number of persons. Solutions to many of these problems were worked out by the applicant and it is not necessary here to individually recount all of these matters. If the persons complaining have further cause for

dissatisfaction with the service, they should pursue the matter further by appropriate representation or application to this Commission.

Summary of Rate Changes

The following table shows the applicant's requested increases by categories compared to the increases being authorized by the order herein:

Category	Applicant's Request	Authorized by Commission
Basic Exchange Rates	\$33,371,000	\$ 380,000
Local Messages and Message Units	7,607,000	4,860,000
Foreign Exchange Rates	674,000	620,000
Extension & PBX Stations	2,146,000	-
Service Connections	1,946,000	-
PBX Equipment	1,879,000	-
Key Telephone	586,000	-
Directory Listings	324,000	324,000
Other Exchange Rates	292,000	-
Subtotal Exchange	48,825,000	6,184,000
Toll	4,741,000	4,916,000
Total Intrastate	53,566,000	11,100,000

Conclusions

The State Constitution, the Public Utilities Act and cognate statutes charge this Commission with the duty of regulating and supervising public utilities in such manner as to protect the public interest. Therefore, for rate-making purposes we have adopted operating results for the test year 1952 which represent an upward adjustment in applicant's claimed revenues; a downward adjustment in certain of applicant's claimed expenses in the items of maintenance, general services and licenses, and pensions; and a downward adjustment in applicant's claimed rate base for excess earnings of the Western Electric Company, property held for future use, plant acquisition adjustment and working cash capital. In this process the license service has been recomputed on a cost basis rather than a percentage of revenue basis.

After considering all of the evidence of record and the statements by the parties and giving weight to the indicated level trend in rate of return, it is found that a fair and reasonable rate of return for the future is 6.25 per cent and it is our finding and conclusion that an order should be issued increasing the rates of applicant in the over-all amount of \$11,100,000. Such increase is based upon the 1952 test year results as adopted herein and reflects the current federal income tax rate of 47 per cent. As previously noted, should the federal income tax rate applicable to 1954 be increased, applicant may seek relief by supplemental application.

The problem of rate level and spread is of major importance and we are not limited to the method proposed by the applicant of considering primarily the value of service for the purpose of rate prescription. In spreading rates we have considered many factors as heretofore indicated. The rate level and spread adopted gives practical consideration to subscriber views and the advantages of minimizing changes in basic exchange rate relationships.

With respect to toll rate increases, as well as the other increases, it should be pointed out that the recent reduction in federal excise taxes on telephone services from 25 and 15 per cent to 10 per cent undoubtedly more than offsets the aggregate increases in rates being authorized herein and obviates a need for allowing for any diminution in usage, if any, with the higher rates. The Commission hereby finds the changes in the rates provided by Appendix A herein are just and reasonable.

ORDER

The Pacific Telephone and Telegraph Company having applied to this Commission for an order authorizing increases in rates and



charges for telephone service, public hearings having been held, the matter having been submitted and being ready for decision,

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

IT IS HEREBY ORDERED as follows:

(1) Applicant is authorized to file in quadruplicate with this Commission after the effective date of this order, in conformity with the Commission's General Order No. 96, revised tariff schedules with changes in rates, charges, and conditions as set forth in Appendix A attached hereto, and, after not less than five days' notice to this Commission and to the public, to make said revised tariff schedules effective for service furnished on and after August 1, 1954.

(2) Applicant shall prepare a report listing the dial exchanges serving less than 2,500 stations in which the provision of selective ringing might be delayed beyond December 31, 1965, and the reason for such delay, and shall file such report with the Commission within sixty days after the effective date hereof.

(3) Applicant shall prepare a supplemental report relating to the provision of selective ringing on farmer lines as discussed in the preceding opinion and shall file such report with the Commission within ninety days after the effective date hereof.

(4) Applicant shall prepare and file with this Commission within forty-five days after the effective date of this order, a program for the provision of service to (a) all those with requests for new service on file with the applicant, and (b) all those with requests for regrades of service on file with the applicant, both as of June 30, 1954, segregated by exchanges.

(5) Applicant shall prepare and file with this Commission, within ninety days after the effective date of this order, a comprehensive report setting forth each and every major construction project completed or to be completed during the period July 1, 1953 through June 30, 1956 on which applicant considers that circumstances reasonably beyond applicant's control have required or will require applicant to resort to "uneconomic construction." Such report shall include (a) a brief description of the project, (b) the reasons for "uneconomic construction," (c) the budgeted cost of the project, (d) expenditures made, (e) requirements in design, construction, time, and capital to make such projects economic.

(6) Applicant shall file with this Commission, within one hundred twenty days after the effective date of this order, in accordance with this Commission's General Order No. 96, the following: (a) appropriate tariff schedules and contract forms covering services and/or facilities furnished for metering, supervisory control and miscellaneous signaling purposes, for the joint occupancy of individually owned poles, and for underground duct space, (b) three copies of all contracts with United States Armed Forces which contain classified matters and/or provide for service at other than filed tariffs; but where such contracts contain classified matters the location of such services and/or facilities may be omitted, and (c) three copies of all other contracts covering services and/or facilities furnished by applicant at other than filed tariffs.

(7) Within one hundred twenty days after the effective date of this order, applicant shall renegotiate traffic settlement agreements with connecting independent telephone companies covering interchanged intrastate message toll telephone traffic where such settlement is based on separated cost studies. The basis for the

renegotiated settlement shall be consistent with the findings set forth in the foregoing opinion with respect to the separation of Category A exchange plant. Applicant shall file, within one hundred twenty days after the effective date of this order, the following:

(a) a list of the companies with which revised settlement agreements have been made, (b) the estimated annual revenue effects of such revised settlements on each company, and (c) copies of the revised traffic settlement agreements.

(8) Applicant shall maintain memorandum records showing depreciation expenses with related depreciation reserves by accounts and subaccounts by calendar years commencing with January 1, 1954, computed according to the straight-line remaining life method, as contemplated by Exhibit No. 117 herein.

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

Dated at San Francisco California, this 6th day of July, 1954.

John E. Mitchell  
President  
Justin J. Casner  
Kenneth Lott  
Gene Roggin

Commissioners

APPENDIX A  
Page 1 of 9

## RATES

The presently effective rates, charges, and conditions are changed as set forth in this appendix.

Schedule No. 4-TService in San Francisco-East Bay Extended Area

The following rates for business individual line message rate extended service are authorized to be made effective.

<u>Exchange</u>	<u>Rate per Month</u>		<u>Exchange</u>	<u>Rate per Month</u>	
	<u>Business Individual</u>	<u>Line Message</u>		<u>Business Individual</u>	<u>Line Message</u>
	<u>Rate Service</u>			<u>Rate Service</u>	
Campbell	\$5.25(80)		Mountain View	\$5.00(75)	
San Jose	5.25(80)		Palo Alto	5.00(75)	
Saratoga	5.25(80)		Redwood City	5.00(75)	
Sunnyvale	5.25(80)		San Carlos-Belmont	5.00(75)	
Los Altos	5.00(75)		San Mateo	5.00(75)	
Millbrae	5.00(75)		Woodside	5.00(75)	

Each exchange message over allowance 4.4¢.

## Condition:

Rates and conditions for business two-party flat rate extended service in the above-listed exchanges are to be cancelled when facilities become available to regrade those services to business individual line flat or message rate service within a two-year period after the effective date of this order.

Schedules Nos. 5-T and 10-TService in Los Angeles Extended Area

## Local Service Rates:

Rates and conditions applicable to local service are authorized to be cancelled on a programmed basis within a two-year period after the effective date of this order.

## Extended Service Rates:

Rates and conditions for business individual line flat rate extended service in Burbank-Sun Valley district area, Canoga Park, Crescenta, El Monte, and Reseda are authorized to be cancelled.

The following suburban line and farmer line extended service rates are authorized to be made effective.

Extended Service Rates - Each Primary Station

<u>Exchange</u>	<u>Suburban Line</u>		<u>Farmer Line</u>	
	<u>Residence</u>	<u>Business</u>	<u>Residence</u>	<u>Business</u>
	<u>Monthly Rate</u>		<u>Monthly Rate</u>	
Canoga Park	\$3.20	\$5.50	\$ -	\$ -
Compton - Compton D.A.	3.45	5.75	-	-
Compton - Gardena D.A.	3.20	5.50	-	-
El Segundo	3.20	5.50	-	-
Pasadena	3.20	5.50	1.40	2.75

- Service not offered.

## Message Rate Service:

Each exchange message over allowance 4-1/4¢.

APPENDIX A  
Page 2 of 9

Schedules Nos. 4-T, 5-T, and 9-T  
Service in Multi-Office Exchanges Outside Extended Areas

The following additional exchanges are classified as multi-office exchanges outside extended areas at the following rates:

Local Service Rates - Each Primary Station

Exchange	Residence Flat Rate Service			Business Flat Rate Service	
	Rate per Month			Rate per Month	
	1-Party	2-Party	4-Party	1-Party	2-Party
Anaheim	\$ *	\$ *	\$ *	\$8.75	\$6.75
Eureka	*	*	*	8.75	6.75
Lodi	*	*	*	8.75	6.75
Marysville	*	*	*	8.75	6.75
Merced	*	*	*	8.75	6.75
Napa	*	*	*	8.75	6.75
Petaluma	*	*	*	8.75	6.75
Suisun	4.30	*	*	7.50	6.00
Turlock	4.30	*	*	7.50	6.00
Ventura	*	*	*	8.75	6.75
Visalia	*	*	*	8.75	6.75
Watsonville	*	*	*	8.75	6.75

\* No change from present rate.

Local Service Rates - Each Primary Station

Exchange	Semipublic		Suburban Line		Farmer Line	
	Min. Charge: Monthly		Monthly Rate		Monthly Rate	
	Per Day	Rate <sup>a</sup>	Residence	Business	Residence	Business
Anaheim	\$0.24	\$1.00	\$ *	\$5.25	\$ -	\$ -
Eureka	.24	*	*	5.25	1.25	2.25
Lodi	.24	1.00	*	5.25	1.15	2.10
Marysville	.24	1.00	*	5.25	1.25	2.25
Merced	.24	1.00	*	5.25	1.15	2.10
Napa	.24	1.00	*	5.25	1.15	2.10
Petaluma	.24	1.00	*	5.25	-	-
Suisun	.22	1.00	*	5.00	1.05	1.80
Turlock	.22	1.00	*	5.00	1.05	1.80
Ventura	.24	*	*	5.25	-	-
Visalia	.24	1.00	*	5.25	1.15	2.10
Watsonville	.24	1.00	*	5.25	1.15	2.10

a. In addition to the daily guarantee.

\* No change from present rate.

APPENDIX A  
Page 3 of 9Schedules Nos. 4-T, 5-T, 9-T and 10-T  
Service in Single Office Exchanges Outside Extended Areas

The following schedule of rates for single office exchanges outside extended areas is continued in effect except that exchanges are grouped in accordance with the number of company stations as of January 1, 1954.

Local Service Rates - Each Primary Station

Group	Station Range	Residence Flat Rate Service			Business Flat Rate Service	
		Company Stations	Monthly Rate		Monthly Rate	
	1-1-54	1-Party	2-Party	4-Party	1-Party	2-Party
L	Ltd. Hrs. <sup>b</sup>	\$3.55	\$3.00	\$2.45	\$5.50	\$4.50
S	Seasonal <sup>c</sup>	4.05	3.50	2.95	6.50	5.25
A	0-500	3.80	3.25	2.70	6.00	4.75
B	501-4,000	4.05	3.50	2.95	6.50	5.25
C	4,001-8,000	4.30	3.50	2.95	7.25	5.75
D	Over 8,000	4.30	3.50	2.95	8.25	6.50

Local Service Rates - Each Primary Station

Group	Station Range	Semipublic		Suburban Line		Farmer Line <sup>a</sup>	
		Company Stations	Min. Charge	Monthly Rate	Monthly Rate	Monthly Rate	Monthly Rate
	1-1-54	Per Day	Rate <sup>d</sup>	Residence	Business	Residence	Business
L	Ltd. Hrs. <sup>b</sup>	\$0.19	\$0.50	\$2.95	\$4.25	\$0.65	\$1.00
S	Seasonal <sup>c</sup>	.21	.75	3.45	4.75	.85	1.50
A	0-500	.20	.75	3.20	4.50	.75	1.25
B	501-4,000	.21	.75	3.45	4.75	.85	1.50
C	4,001-8,000	.22	.75	3.45	5.00	1.00	1.75
D	Over 8,000	.23	1.00	3.45	5.00	1.15	2.00

- a. Exchanges where service is offered.  
 b. Exchanges where less than 24-hour service is furnished.  
 c. Exchanges in this group are Blairsden, Brockway, Homewood, Tahoe City, and Tallac.  
 d. In addition to the daily guarantee.

The following 7 exchanges are regrouped from Group L to Group A.

Bridgeville	Keystone	Nicasio	Valley Springs
Emigrant Gap	Michigan Bar	Trinidad	

The following 26 exchanges are regrouped from Group A to Group B.

Anderson	Firebaugh	Mojave	Simi
Atwater	Galt	Morro Bay	Soledad
Brentwood	Gustine	Rancho Santa Fe	Tehachapi
Calipatria	Half Moon Bay	Rio Linda	Truckee
Castroville	Ignacio	Riverbank	Winters
Cloverdale	Live Oak	San Andreas	Woodlake
Escalon	Lower Lake		

The following 12 exchanges are regrouped from Group B to Group C.

Antioch	Corona	Madera	Tracy
Auburn	Escondido	Oroville	Tulare
Colton	Fontana	Porterville	Ukiah

The following 3 exchanges are regrouped from Group C to Group D.

Chico	Pittsburg	Redding
-------	-----------	---------

Schedule No. 6-T  
Message Unit Service - Los Angeles Extended Area

Message Unit Rate:

All services other than semipublic coin box, public telephone, hotel private branch exchange and foreign exchange services

Each Message Unit

4-1/4¢

Schedule No. 6-T  
Message Unit Service - Los Angeles Extended Area

Schedule No. 7-T  
Message Unit Service - Northern California

Number of Message Units per Initial and Overtime Periods

Where the Air-Line : Toll Rate Mileage : Between Toll : Rate Centers Is <sup>a</sup> : Over : Including :	The Number of : Message Units : per Initial : Period Is :	The Initial : Period : Is :	The Number of : Units per : Overtime : Period Is :	The : Overtime : Period : Is :
0 - 10	2 message units	3 minutes	1 message unit	2 minutes
10 - 15	3 message units	3 minutes	1 message unit	1 minute
15 - 20	4 message units	3 minutes	1 message unit	1 minute
20 - 25	5 message units	3 minutes	1 message unit	1 minute
25 - 30	6 message units	3 minutes	2 message units	1 minute
30 - 35	7 message units	3 minutes	2 message units	1 minute
35 - 40	8 message units	3 minutes	2 message units	1 minute
40 - 50	9 message units	3 minutes	3 message units	1 minute
50 - 60	10 message units	3 minutes	3 message units	1 minute

a. Outside the local service area.

Schedule No. 13-T  
Private Branch Exchange Trunk Line Service - Northern California

Exchanges Where Offered:

Trunk Rate:

Flat Rate Service:

Each trunk line - 150% of the individual line primary station flat rate rounded to the lower 25¢ multiple.

Schedule No. 14-T  
Private Branch Exchange Trunk Line Service - Southern California Exchanges

Exchanges and District Areas Within Los Angeles Extended Area:

Local Service:

Trunk Rate:

Rates and conditions applicable to local service are authorized to be cancelled on a programmed basis within a two-year period after the effective date of this order.

Extended Service:

Trunk Rate:

Rates and conditions for flat rate extended service trunks in connection with commercial manual and dial PBX, business key station dial PBX and order receiving equipment services are authorized to be cancelled.

Schedule No. 14-T - continued  
Private Branch Exchange Trunk Line Service - Southern California Exchanges

Exchange Message Rates:	<u>Rate per Exchange Message</u>
Commercial manual and dial PBX, business key station dial PBX, and order receiving equipment message rate service	4-1/4¢

## Exchanges Outside Extended Areas Where Offered:

## Trunk Rate:

## Flat Rate Service:

Each trunk line - 150% of the individual line primary station flat rate rounded to the lower 25¢ multiple.

Schedule No. 17-T  
Directory Listings

The increases in monthly rates set forth on page 46 of Exhibit A attached to Application No. 33935 are authorized.

Schedule No. 18-T  
Intercommunicating System Service

## Exchanges Within Los Angeles Extended Area:

## Trunk Rate:

Rates and conditions applicable to local business intercommunicating system service in San Pedro exchange and local residence intercommunicating system service in Alhambra, Glendale, and San Pedro exchanges are authorized to be cancelled on a programmed basis within two years after the effective date of this order and coincident with the establishment of extended service at the following rates for trunks:

<u>Exchange</u>	<u>Extended Service</u> <u>Rate per Month</u>		
	<u>Business</u>		<u>Residence</u>
	<u>First</u> <u>Two</u> <u>Trunks</u>	<u>Each</u> <u>Add'l.</u> <u>Trunk</u>	<u>Each</u> <u>Trunk</u>
Alhambra	\$ -	\$ -	\$6.75
Glendale	-	-	6.75
San Pedro	4.75	2.25	6.25

Rate per Exchange Message

## Exchange Message Rate - Los Angeles

## Extended Area:

Each exchange message

4-1/4¢

## Exchanges Outside Extended Areas Where Offered:

## Trunk Rate:

## Flat Rate Service:

Each trunk line - 150% of the individual line primary station flat rate rounded to the lower 25¢ multiple.



APPENDIX A  
Page 6 of 9Schedules Nos. 20-T and 21-T  
Joint User Service

Rates for joint user service are authorized in exchanges where the service is offered as follows:

<u>Joint User Service in Connection With</u>	<u>Rate per Month For Each Joint User Service</u>
1. Message Rate Service:	
a. Business individual line	\$1.50
b. PBX, order receiving equipment or I.C.S. service	2.00
2. Semipublic Service	1.50
3. Flat Rate Service:	

: : Rate per Month for Each Joint User Service : :		
:Where the Business: : In Connection With : :		
: Individual Line :	: Business Individual Line or : PBX, Order Receiving Equipment: :	
: Flat Rate Is :	: Party-Line Flat Rate Service: or I.C.S. Flat Rate Service : :	
\$6.00 or less	\$1.50	\$2.50
6.50 - 7.25	1.50	3.00
7.50 - 9.75	2.00	4.00
10.25 - 13.00	2.50	5.00

Exchanges and District Areas Within Los Angeles Extended Area:

Joint user rates and conditions in connection with local exchange service and extended flat rate service are authorized to be cancelled on a programmed basis within a two-year period after the effective date of this order.

In Schedule No. 20-T delete Condition No. 7 and add the following condition:

"In exchanges where both business flat rate and business message rate services are furnished, joint user service in connection with business flat rate service will not be furnished to a subscriber to business message rate service on the premises or in the same room where the business message rate service is provided, nor will joint user service in connection with business message rate service be furnished to a subscriber to business flat rate service on the premises or in the same room where the business flat rate service is provided."

Schedule No. 26-T  
Mileage Rates

Revise Sheets 4, 5, 6, 7, 8, and 9 to indicate that such rates and conditions are applicable in connection with extension stations, private branch exchange stations, telephone answering equipment stations, order receiving equipment stations and key equipment stations, excluding secretarial lines.

Schedule No. 26-T - continued  
Mileage Rates

Add the following rates and conditions applicable to mileage rates for secretarial line service:

RATES

Secretarial Line Service	Rate per
Mileage Rates (and Flat Rates in Lieu of Mileage Rates)	<u>Month</u>

- a. Where the telephone answering equipment and the subscriber's primary service are within the same exchange area or zone:
- (1) Same Exchange Area or Same District Area:  
The following rates apply where the telephone answering equipment and the subscriber's primary service are within the same exchange area or zone except for those exchanges and zones divided into district areas, in which case the rates apply only where the telephone answering equipment and the subscriber's primary service are within the same district area:
- |  |        |
|--|--------|
| (a) Each secretarial extension station line or extension of a trunk line terminated on telephone answering equipment located in base rate area   | \$3.75 |
| (b) Each secretarial PBX station line terminated on telephone answering equipment located in base rate area  | 4.50   |
| (c) Each secretarial line terminated on telephone answering equipment located in suburban area:<br>Rate applicable for secretarial line within base rate area as shown in a. or b. above, plus the following suburban mileage rate:<br>Each 1/4 mile or fraction thereof | .50    |
- The suburban mileage rate applies to the air-line distance measured from the telephone answering equipment to the nearest point on the boundary of the base rate area.
- (2) Different District Areas of Same Exchange or Zone:  
The following rates apply where the telephone answering equipment and the subscriber's primary service are within an exchange area or zone divided into district areas and the telephone answering equipment and the subscriber's primary service are in different district areas of the same exchange area or zone:
- |   |     |
|---|-----|
| Rate applicable under a.(1) above plus the following mileage rate:<br>Each 1/4 mile or fraction thereof applied to the air-line distance measured between the rate centers involved | .50 |
|---|-----|
- b. Where the telephone answering equipment is located in an exchange area or zone contiguous to the exchange area or zone in which the subscriber's primary service is located, the rates under a.(2) apply.

Schedule No. 26-T - continued  
Mileage RatesRate per  
Month

- c. Where the secretarial private branch exchange station line is terminated on telephone answering equipment located in the San Francisco zone or in the East Bay zone and connected to a private branch exchange switchboard located in a different zone of the San Francisco - East Bay Exchange:  
Each secretarial PBX station line

\$175.00

CONDITIONS

- a. The mileage rates shown in RATES a. are applicable in connection with secretarial lines terminated on telephone answering equipment located in a different building from that in which the primary service is located and within the exchange area or zone, in addition to other rates applicable to secretarial lines.
- b. The mileage rates shown in RATES b. are applicable in connection with secretarial lines terminated on telephone answering equipment located in a different building from that in which the primary service is located and in an exchange area or zone contiguous to that in which the primary service is located, in addition to the other rates applicable to secretarial lines. The application of these rates is in accordance with the conditions governing foreign exchange service.
- c. The mileage rates shown in RATES c. are applicable in connection with secretarial PBX station lines terminated on telephone answering equipment located in the San Francisco zone or the East Bay zone and connected to a PBX switchboard located in a different zone of the San Francisco - East Bay exchange, in addition to the other rates applicable to secretarial PBX station lines.

Schedule No. 34-TForeign Exchange Service - Northern CaliforniaSchedule No. 35-TForeign Exchange Service - Southern California

The increases and changes in foreign exchange rates as outlined on pages 55 and 56 of Exhibit A attached to Application No. 33935 are authorized to be made, except as follows:

1. In computing business foreign exchange rates on a message rate basis where no message rate service is provided in the serving exchange, a rate of \$4.25 (65) is used in developing the foreign exchange rate.
2. The rate for joint user service, where offered, is one half of the business individual line rate before any message increment is added, plus the joint user rate, either individual line or PBX in the serving exchange rounded to the lower 50¢ multiple, plus the business additional listing rate.
3. Where local service rates are withdrawn extended service rates shall be filed where required.

Schedule No. 53-T  
Message Toll Telephone Service

Two-Point Service California Schedule A:

		Rate						
		Day and Night and Sunday						
		Station Service			Person Service			
		Collect			Paid and Collect			
		First	Each Add.	Min.	First	Each Add.	Min.	
Air-Line	Paid	3	First	After	3	First	After	
Mileage	Initial	Overtime	Mins.	3	3	Mins.	3	3
0-8	.10-3m	.05-2m	.30	.10	.05	.30	.10	.05
9-12	.15-3m	.05-1m	.30	.10	.05	.35	.10	.05
13-16	.20-3m	.05-1m	.30	.10	.05	.40	.10	.05
17-20	.25-3m	.05-1m	.30	.10	.05	.45	.15	.05
21-25	.30-3m	.10-1m	.30	.10	.10	.50	.15	.10
26-30	.35-3m	.10-1m	.35	.10	.10	.55	.15	.10

		Paid and Collect									
		Day (Except Sunday)				Night and Sunday					
		Station Service		Person Service		Station Service		Person Service			
		First	Each	First	Each Add.	Min.	First	Each	First	Each Add.	Min.
Air-Line	3	Add.	3	First	After	3	Add.	3	First	After	
Mileage	Mins.	Min.	Mins.	3	3	Mins.	Min.	Mins.	3	3	
31-35	.40	.10	.60	.20	.10	.40	.10	.60	.20	.10	
36-40	.45	.15	.65	.20	.15	.45	.15	.65	.20	.15	
41-50	.50	.15	.75	.25	.15	.50	.15	.75	.25	.15	
51-60	.55	.15	.80	.25	.15	.50	.15	.75	.25	.15	
61-70	.60	.20	.90	.30	.20	.50	.15	.80	.25	.15	
71-85	.65	.20	.95	.30	.20	.55	.15	.85	.25	.15	
86-105	.70	.20	1.05	.35	.20	.60	.20	.95	.30	.20	
106-125	.75	.25	1.10	.35	.25	.65	.20	1.00	.30	.20	
126-150	.80	.25	1.20	.40	.25	.70	.20	1.10	.35	.20	
151-175	.85	.25	1.25	.40	.25	.70	.20	1.10	.35	.20	
176-200	.90	.30	1.35	.45	.30	.75	.25	1.20	.40	.25	
201-225	.95	.30	1.40	.45	.30	.80	.25	1.25	.40	.25	
226-250	1.00	.30	1.50	.50	.30	.85	.25	1.35	.45	.25	
251-275	1.05	.35	1.55	.50	.35	.90	.30	1.40	.45	.30	
276-300	1.10	.35	1.65	.55	.35	.95	.30	1.50	.50	.30	
301-330	1.15	.35	1.70	.55	.35	1.00	.30	1.55	.50	.30	
331-360	1.20	.40	1.80	.60	.40	1.00	.30	1.60	.50	.30	
361-395	1.25	.40	1.85	.60	.40	1.05	.35	1.65	.55	.35	
396-430	1.30	.40	1.95	.65	.40	1.10	.35	1.75	.55	.35	
431-470	1.35	.45	2.00	.65	.45	1.15	.35	1.80	.60	.35	
471-510	1.40	.45	2.10	.70	.45	1.20	.40	1.90	.60	.40	
511-550	1.45	.45	2.15	.70	.45	1.25	.40	1.95	.65	.40	
551-590	1.50	.50	2.25	.75	.50	1.25	.40	2.00	.65	.40	
591-630	1.55	.50	2.30	.75	.50	1.30	.40	2.05	.65	.40	
631-685	1.60	.50	2.40	.80	.50	1.35	.45	2.15	.70	.45	
686-740	1.65	.55	2.45	.80	.55	1.40	.45	2.20	.70	.45	
741-795	1.70	.55	2.55	.85	.55	1.45	.45	2.30	.75	.45	
796-850	1.75	.55	2.60	.85	.55	1.50	.50	2.35	.75	.50	
851-905	1.80	.60	2.70	.90	.60	1.55	.50	2.45	.80	.50	

Conference Service:

Rates and conditions applicable to conference service are authorized to be revised to the extent necessary by the authorized changes in two-point service.

APPENDIX B  
Page 1 of 3

LIST OF APPEARANCES

For Applicant: Pillsbury, Madison & Sutro, A. T. George, Francis N. Marshall, and John M. Hall.

Protestants: City of San Leandro, by Arthur M. Carden; City of Oakland, by John W. Collier and Loren East;<sup>1/</sup> Cities of Gustine, Hollister,<sup>2/</sup> Ceres, Modesto, Roseville,<sup>2/</sup> Orange Cove, Jackson, Sunnyvale, Los Banos, Fortuna, Turlock, Taft,<sup>2/</sup> and Stockton and the counties of Sierra,<sup>2/</sup> Nevada,<sup>2/</sup> and Merced, by Bruce McKnight; City of Stockton, by William Biddick Jr., San Lorenzo Valley Property Owners Association, San Lorenzo Valley Chamber of Commerce, Mt. Herman Association and Business and Professional Women, by Alice Earl Wilder; City of Soledad,<sup>2/</sup> by Donald H. Smith; City of Fresno, by Christian Ozias; Woodland Hills Chamber of Commerce, by William L. Carpenter; City of Compton, by A. Leroy Aylmer; California State Hotel Association, by Carl I. Wheat and William C. Robinson; Alameda County Building and Trades Council, by J. L. Childers; City of El Segundo, by C. W. Woodworth; Cities of Anaheim, Colton, El Cajon, Monterey Park and National City, by Frank L. Kostlan and Clarence A. Winder; California Retailers Association, by Adrian A. Kragen; California Farm Research and Legislative Committee, by Grace McDonald; California State Grange, by George Sehlmeier; Lincoln Heights Coordinating Council of Churches and Citizens of Lincoln Heights, by William Rogan; Aptos Chamber of Commerce, Seacliff Park, Inc., Rio Del Mar Improvement Association, Inc., and Aptos Terrace Improvement Assn., Inc., by Alvin W. Wendt; City of Glendale, by C. E. Perkins, J. H. Lauten and Henry McClerman; City of San Diego, by J. P. DuPaul, John Jonas, Floyd C. Leach, Helen Negrin, Robert J. Cliphant, Myrtle Taylor, Richard M. Nilsson and Captain G. C. Waldin, in propria personae.

Protestants and Interested Parties: City and County of San Francisco, by Dion Holm and Paul L. Beck; General Services Administration United States of America, by Maxwell H. Elliott, Clarence W. Hull and Herbert K. Hyde.

Interested Parties: City of Los Angeles, by Roger Arnebergh, T. M. Chubb, Alan G. Campbell and Blase A. Bonpane; California Independent Telephone Association, by F. V. Rhodes; Order of Repeatermen and Testboardmen, by H. R. Kaiser; City of Albany, by Edward R. Plotner; City of Long Beach, by Henry E. Jordan; Communication Workers of America, C.I.O., by E. J. Follis, John L. Crull, Jce M. Deardorff, Louis B. Kneckt, James Murray and Clarence M. Good; County of San Diego, by James Don Keller; Cities of Pasadena, San Diego, El Monte, Burbank, South Pasadena, Chula Vista and Coronado and County of San Diego, by Frank A. Kostlan and Clarence A. Winder; Reche Canyon Improvement Association, by Herschel L. McGraw; City of Burbank, by Archie L. Walters; City of Colton, by Martin C. Casey; City of Piedmont, by Clair W. MacLeod and J. Marcus Hardin; California Farm Bureau Federation, by J. J. Deuel, Eldon Dye and Edson Abel; Cities of Fairfield and Suisun City and County of Solano, by K. I. Jones; City of Sacramento, by Everett M. Glenn; City of Riverside, by A. H. Ford and H. M. Dougherty; County of Santa Cruz, by C. B. Harts; Santa Cruz Chamber of Commerce,

<sup>1/</sup> Resigned from position with City of Oakland and withdrew before matter was submitted.

<sup>2/</sup> Withdrew appearance or changed to neutral position during course of the proceeding.

APPENDIX B  
Page 2 of 3

Gordon M. Boyes; City of Santa Cruz, by R. N. Klein and George N. Penniman; Monterey Bay Water Company and Soquel Business Men's Association, by John C. Luthin; San Lorenzo Valley Unified School District, by Ted Rolff; Soquel Community Service Club, by H. Y. Stuart; Aptos Terrace Improvement Association, by Ernest B. Price; Seacliff Park, Inc., by H. E. Sandoval; City of Berkeley, by Fred C. Hutchinson and Robert T. Anderson; City of Lodi, by H. D. Weller; City of Alameda by Carl Froerer and J. P. Clark; City of Modesto, by C. M. Annan; United Telephone Exchanges, Inc., by Jack W. Hardy; Telephone Answering Services of California, Inc., Gordon, Knapp and Gill, by Wyman C. Knapp; Proxy Telephone Service Co., by Burt M. McCormick; Cities of Newman, Modesto, Oakdale and Woodland, by Bruce McKnight; Alameda County Building and Construction Trades Council by J. L. Childers; City of Selma, by Miles J. Hansen and S. E. Haseltine; and Thornton Davis for himself.

Other Appearances: Bay Radio Incorporated, by S. A. Cisler; City of Fortuna, by Collis P. Mahan; Highland Area Chamber of Commerce, by Harry D. Schultz; City of Richmond, by John Ormassa; Mrs. Edwin S. Bulen, in propria persona.

Observer: John R. McCullough of the Oregon Public Utility Commission.

For the Commission Staff: Boris H. Lakusta, Frayman Coleman, Charles W. Mors and William W. Dunlop.

LIST OF WITNESSES

Evidence was presented on behalf of applicant by: H. R. Bickett (Western Electric Company earnings and accounting); S. W. Campbell (new capital needed); M. Chandler (rate of return, capital structure, and pay-out ratios); F. D. Chutter (rate of return); Dr. Joel Dean (reasonableness of Western Electric Company return); J. O. Einerman (license contract service and costs); R. G. Elliott (plant and expense effects of withdrawing local service in Los Angeles extended area); A. E. Ellison (inflation effects on Pacific Company); G. L. Harding (alternative costs of short term financing - secretary treasurer department activities); A. D. Harper (rate of return); W. L. Hiscox (comparison of Western Electric Company Prices with prices of general trade supplies); R. W. Jastram (license contract); Carl Joos (telephone answering service rates); R. E. Kent (Western Electric Company - manufacturing company vs. regulated utilities); H. L. Kertz (supply contract, license contract services and costs); Dr. J. K. Langum (inflation, regulatory problem and solution); M. W. Latimer (reasonableness of pension plan and pension financing); J. R. Marden (depreciation); C. S. Mason (results of total operations, uniform system of accounts, and pension plan); R. W. Mason (rate of return); O. C. Richter (reasonableness of pension costs); J. M. Riddle (inflation - impact on California intrastate operations); W. L. Schaffer (correct accounting of pension accruals); W. C. Schweizer (inflation of telephone rates, proposed rate charges, and proposal to provide extended message unit service to all customers in Los Angeles area); T. A. Taylor (construction program); F. D. Tellwright (advertising).

Evidence was presented on behalf of the protestants and interested parties by: J. J. Deuel, F. S. Clough, G. Sehlmeier, K. C. Bean, R. B. River, J. K. J. K. MacIntosh, T. M. Chubb, R. W. Russell, B. McKnight, Dr. L. W. Thatcher, C. A. Winder, P. W. Barton, E. S. Bulen, W. L. Carpenter, J. L. Childers, E. C. Craig, C. T. Hanson, S. E. Haseltine, J. W. Healy, J. Jonas, L. C. Leach, H. L. McGraw, R. J. Oliphant, H. D. Schultz, P. J. Shacknove, M. Taylor, G. C. Weldin, S. D. Lynch, Helen Negrin, Martin C. Casey, Glenn Francis De Grave,

APPENDIX B  
Page 3 of 3

E. F. Dibble, Marie A. Manton, H. R. McCarroll, Ray R. McCombs, Webster C. Reed, Robert R. Scrim, Mary S. Sisson, George L. Steelman, Walter B. Townsend, Sydney Wingert, Charles Edgett, P. Dale Johnson, John McCrackin, Fred S. Orth, Bud W. Polley, Frances Rapetti, James Skang, Gordon M. Boyes, C. B. Harts, R. N. Klein, John C. Luthin, George N. Penniman, George Peterson, Ernest B. Price, Ted Rolff, H. E. Sandoval, Alvin D. Wendt, Alice Earl Wilder, Robert J. Schulte; W. Hogan; S. D. Lynch, Lew Lauria, H. A. Burroughs.

Evidence was presented on behalf of the Commission staff by: J. B. Balcomb (operating revenues, maintenance, traffic and commercial expenses); H. G. Butler (proper rate base); W. J. Cavagnaro (volatility of earnings); J. F. Donovan (balance sheet, income statement and clearing accounts); J. J. Doran (general and other operating expenses, taxes, summary of earnings, review of pension plan, revenues, expense, rate base adjustments to total California operations); W. W. Dunlop (adjustments for directory advertising rate increases, timing of telephone conversations, and selective ringing program); S. B. Hansell (report on actuarial analysis of Pacific Company pension plan and development of service pension accrual rate); N. C. Hasbrook (separated results); D. F. La Hue (costs allocable to California operations for service furnished by American Telephone and Telegraph Company); M. E. Mezak (service in Reche Canyon); R. T. Perry (fixed capital and rate base, rate bases adjustments, purchases from Western Electric Company adjustments); C. Unnevehr (depreciation reserve, straight-line remaining life determination method and remaining life depreciation accruals); S. Weber (adjusted intra-operating results, area of operations, financial and administrative organization, history and present operations of the Pacific Company).