

Decision No. 51271**ORIGINAL**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA GAS COMPANY for authorization under Section 851 of the California Public Utilities Code, to carry out the terms of an agreement to sell its radio telephone equipment and related facilities to The Pacific Telephone and Telegraph Company.

Application No. 35843

In the Matter of the Application of SOUTHERN COUNTIES GAS COMPANY OF CALIFORNIA, for authorization to carry out the terms of an agreement to sell its radio telephone equipment and related facilities to The Pacific Telephone and Telegraph Company under Section 851 of the California Public Utilities Code.

Application No. 35844

In the Matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, pursuant to Decision No. 50837, for approval of the agreements as amended between the Applicant and the Southern California Gas Company and the Southern Counties Gas Company of California, respectively, relating to the provision and maintenance of facilities for private mobile radio telephone systems.

Application No. 36551

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

INTERIM OPINION

By the above-entitled applications, filed respectively on October 6, October 6, and December 13, 1954, Southern California Gas Company (hereinafter sometimes referred to as Southern California) and Southern Counties Gas Company of California (hereinafter sometimes referred to as Southern Counties) seek authority to sell their radio telephone equipment and related facilities to The Pacific Telephone and Telegraph Company (hereinafter called Pacific) and Pacific seeks authority to furnish and maintain the same.

Also, the gas companies seek authority to enter into contracts with Pacific whereby they will lease the equipment from Pacific and continue to operate the radio systems, with Pacific providing maintenance and any new facilities that may be required.

Public Hearing

After due notice, three days of public hearing were held on these applications on December 1, 1954, and January 24 and 28, 1955, before Commissioner Ray E. Untereiner and Examiner M. W. Edwards, at Los Angeles, California. At the first day of hearing the City of Los Angeles made two motions seeking to include all or certain parts of the record under Application No. 33935 as a part of the record herein by reference.<sup>1/</sup> Another motion by the City of Los Angeles sought to have the proceeding dismissed because Pacific was not an applicant at the time of the first day of the hearing.

At the start of the second day of hearing, Los Angeles' motions were denied except for that one incorporating in this record certain portions of the testimony and record under Application No. 33935. The matters included in this record by reference are set forth in Exhibits Nos. 13-15 and 23-28 in this proceeding.

Between the first and second days of hearing Pacific, by filing Application No. 36551, became an applicant in this proceeding; thus eliminating the ground for dismissal urged by the City of Los Angeles. To meet an objection raised by the city that Pacific does not have sufficient funds to engage in this so-called "extra curricular" business without some injury to its

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<sup>1/</sup> Application No. 33935 was an application by The Pacific Telephone and Telegraph Company for an increase in telephone rates.

regular telephone subscribers, Pacific included in its Exhibit No. 15 reference to certain testimony and exhibits under its Second Supplemental Application No. 33935, on January 12 and 13, 1955, indicating an improved telephone held order situation and financial condition.

Position of Gas Companies

The gas companies take the position that their entire time and energy should be devoted to the gas business and that they should not become further involved in the highly specialized communications field. The gas companies seek authority to enter into this arrangement with Pacific on the grounds that Pacific's offer was the best one received, that Pacific is fully qualified to furnish and maintain the equipment needed in the mobile radio telephone system, that they will be relieved of the investment and hazards of loss that go with ownership and maintenance, that they will benefit from the technological developments of which Pacific is better situated to keep abreast, that they will no longer be faced with maintenance work which they must have performed by outside contractors, that they will keep full control of the system and will enjoy a broadened communication base, and that they will realize annual cost savings. From their point of view, the proposed sale and lease-back arrangement appears to offer substantial advantages.

Position of Pacific

Pacific takes the position that this is a straightforward business transaction in which the purchase price to be paid, that is \$358,000, is reasonable; that the terms of the lease-maintenance contracts are reasonable and that the compensation is adequate to cover the costs plus a return of 7 per cent on the capital employed.

Pacific also states that its accounting will be in accordance with the accounting requirements of the Federal Communications Commission, that the investment required will not interfere with the regular telephone construction program and that the proposed activity will not cast a burden on the public utilities operation of rendering general telephone service.

Principal Issues

The first principal issue involved in this proceeding is: Will the engagement of Pacific in the owning, leasing and maintenance of private mobile radio systems reduce the quality or availability of its regular public utility telephone service? Pacific alleges that it will not, and points out that it is now providing for the public a common carrier mobile service and has experts and facilities in this field that it can efficiently use in the provision and maintenance of systems here involved.

The extent of Pacific's operations with regard to private<sup>2/</sup> mobile systems is set forth in Exhibits Nos. 12 and 29. Exhibit No. 12 indicates that Pacific was furnishing facilities for 167 mobile stations to 35 private mobile telephone systems in California as of November 1, 1954. Exhibit No. 29 shows that Pacific, as of January 31, 1955, had purchased 8 private mobile telephone systems at a cost of \$33,646 and had an additional twenty offers outstanding at a total purchase price of \$1,351,457.

During the past year Pacific has substantially reduced its held orders for new telephone service; and it expects to be essentially on a current basis by the end of 1955. Our conclusion

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<sup>2/</sup> So-called "private" mobile systems are operated under special contracts, approved by the Commission, rather than under filed tariffs. That fact does not affect their status as public utility services.

on this issue is that at present it does not appear that the owning, leasing and maintenance of private mobile telephone systems by Pacific will interfere with the regular telephone service.

Gas Customer Burden

The second principal issue is: Will the authorization of the proposed arrangement burden the gas customers? The gas companies take the position that it will not, and state that they will realize an estimated annual cost saving of about \$41,664 and will sell their systems for about \$23,856 more than the original depreciated cost.

The Commission staff explored in some detail the annual cost saving estimated by the gas companies and the related problem of whether the purchase price of the facilities is adequate.

Staff counsel pointed out that the evidence presented by Southern California indicates that the original cost to it of the radio facilities, less depreciation, is \$231,905, for which Pacific offers to pay \$226,879. For Southern Counties, the original cost of radio telephone facilities, less depreciation, was shown to be \$102,482, in contrast to an offer of \$131,364. Thus, staff counsel concludes that Southern California stands to receive about \$5,000 less than the original cost, less depreciation, and Southern Counties stands to gain about \$30,000.

A witness for the staff computed the annual cost to the gas companies of the radio system at a figure nearly \$27,000 less than that shown by the gas companies. The tabulation below

shows the comparative cost computations together with the offer by Pacific.

Estimated Annual Costs - Mobile Radio System

Item	Exh.No.6 So.Counties: Gas Co.	Exh.No.10: So.Calif.: Gas Co.	Total Gas Companies:	Exh.No.31: Staff Estimate:
Maintenance	\$29,120	\$15,000	\$ 44,120	\$ 44,120
Depreciation	26,796	30,700	57,496	43,420
Ad Valorem Taxes	5,080	5,300	10,380	10,380
Income Taxes and Return	18,787	24,300	43,087	30,670
Other Costs	498	-	498	500
Total	80,281	75,300	155,581	129,090
Pacific's Offer	59,217	54,700	113,917	113,917
Difference	21,064	20,600	41,664	15,173

The above tabulation shows that Pacific's offer is an advantage to the gas companies even under the staff's computation. Our conclusion on this issue is that the proposed arrangement will not burden the gas customers from the standpoint of the annual operating costs and that the indicated capital loss to Southern California comparatively is so small that it will be compensated by the operating economy in a short period.

Telephone Customer Burden

The third principal issue is: Will the authorization of the proposed arrangement prove a burden on the telephone customers? Pacific insisted that it would not, but the Commission staff took a different view. The staff's view was that if the Commission approves the contracts for these radio facilities, the rate under the lease-maintenance agreement should be adequate to cover Pacific's full costs and a return in the approximate amount of 7 per cent annually if any burden to the regular telephone utility customers is to be avoided.

The staff questioned, as being too low, the approximate \$114,000 per year lease and maintenance charge agreed to by

Pacific on two grounds. First, the estimate was developed in the main on Cost Form 271-A which, the staff contends, Pacific no longer uses and which form tends to understate costs. Second, the estimate is based on a hypothetical investment which to the staff seems unjustified.

The staff requested Pacific to develop the annual costs on its new Form GE-100<sup>3/</sup> Exhibit No. 19, supplied by Pacific, shows the original computations and the computations requested by the staff. These may be summarized as follows:

Item	Original Computations	Calculations Requested by Staff	Difference from Original
Maintenance	\$ 36,000	\$ 36,000	\$ -
Depreciation	28,800	28,800	-
Administrative Expense	12,500	22,900	10,400
Income Taxes and Return	27,900	30,600	2,700
Other Taxes	9,300	8,100	(1,200)
Other Annual Charges	200	200	-
Total Annual Charges	114,700	126,600	11,900
	(Less)		

Based on this analysis, the staff took the position that the \$114,000 proposed charge by Pacific is not adequate to compensate the telephone company for its costs, including a 7 per cent return, and that such charge would result in shifting onto the general telephone ratepayers some part of the costs which the gas companies should be required to pay.

The staff also asserts that the proposed purchase price is based on a hypothetical investment representing the amount it would cost Pacific to buy new equipment to do the same job rather than based on the depreciated original cost of the properties it proposes to purchase. It points out that by coincidence such

<sup>3/</sup> This form is the one proposed by Pacific and currently used by it for calculating its costs of supplemental telephone equipment.

hypothetical investment approximates the \$358,000 figure developed by Pacific as representing structural value after deduction of existing depreciation. The staff had no quarrel with the use of structural value to determine the purchase price provided Pacific does not claim as an item in rate base in future rate proceedings more than the original cost to the gas companies, less depreciation.

Our conclusion on the third issue is that the proposed transaction, at the agreed charges, would result in a burden on the regular telephone customers of Pacific.

#### Utility Status

The fourth principal issue is: Is the proposed service a public utility service and should it be rendered under filed tariffs? Pacific conceded that the proposed arrangement is not substantially different, in its physical aspects, from certain phases of private line service which Pacific agrees is public utility in nature. The principal distinguishing feature here is the fact that the radio licenses will be in the hands of the operators rather than of Pacific. That, staff counsel contended, is a difference having no significance on the question of utility status. Regarding Pacific's statement that it does not intend to provide lease-maintenance as a utility service, staff counsel contended that this statement is controverted by testimony of Pacific's witness to the effect that Pacific will offer lease-maintenance in all cases where it is "feasible". The staff's position was that if a contract of the character involved in this proceeding is to be approved, it should be upon the condition that the service be recognized by Pacific as utility in character.

Our conclusion on this matter is that the proposed service will become a public utility service, whether or not it is so recognized by Pacific. Were it not, this Commission would have



no jurisdiction over it. However, conditions and costs may vary so much as between the different private systems that it may be burdensome to telephone customers to require that this business be handled under uniform filed tariffs. While Pacific now has 34 systems in the state and more may be added, California is a large and expansive state with widely varying terrain conditions from north to south and east to west. At this time there is insufficient experience to warrant the filing of tariffs. Pacific's entry into this field is still on an experimental basis, and it might be a disservice to its telephone ratepayers to require it to file tariffs and offer this service to all comers.

By Decision No. 50837 in Case No. 5570, dated December 7, 1954, this Commission ordered Pacific to file with it, and secure authorization for, any contracts by which it proposes to provide any special services outside its regular offerings under filed tariffs. It was in conformity with that order that Pacific filed its application in the instant case. The procedure provided in that order and followed here will adequately protect its telephone customers.

#### Position of Other Parties

The California Farm Bureau Federation took the position that the proposed arrangement would be beneficial to its members and urged the Commission to grant the applications.

The City of Los Angeles opposed the applications essentially on the grounds that this is not a proper operation for a telephone public utility, that this is not a public utility operation, that the financial ability of Pacific to expand into this field and still discharge its public utility obligations is not proved, and that the Commission should not undertake to regulate this business and substitute itself for the Federal

Communications Commission. It further proposed that the Public Utilities Commission should undertake an investigation of the whole broad policy involved in radio operations by public utilities, particularly by Pacific, under lease-maintenance arrangements. It voiced the thought that Pacific, with its monopoly privileges in the telephone field, would have an unfair advantage over its potential competitors if permitted to embark in a major way into the field of radio communications.

General Investigation Not Justified at Present

While we realize that there may be some cause for apprehension along these lines, we are not of the opinion that there is any present danger that would justify the proposed general investigation, nor that should exert a determining influence on our order in the instant proceeding. The record discloses that in the mobile radio communications field Pacific has competitors. In fact, the record discloses that the gas companies received a bid from Motorola and that RCA and General Electric have announced their intention to enter this field; so it appears unlikely that it could establish a monopoly even if it sought to do so. Being a regulated company, it has certain disadvantages not suffered by its competitors as, for example, the fact that it must, in the absence of filed tariffs, seek approval of this Commission for any contemplated contracts by which to extend its activities.

The record does not support the expressed fear of the City of Los Angeles that the telephone company will monopolize the field of mobile radio communications. However, should such monopoly eventuate, it would be regulated by this Commission, a situation which is not inconsistent with the established public policy of a regulated monopoly in the public utility field.

Technological Progress

We are convinced that it would not be in the public interest to prevent Pacific from following new lines of development in the communications field. That monopolies must be regulated with respect to rates and service does not imply that they must be barred from

contributing to and profiting from technological progress. We conceive it to be our duty to prevent them from taxing their ratepayers to finance experiments. But we do not conceive it to be our duty or consistent with our duty, as servitors of the public welfare, to prevent them from engaging in new projects at their stockholders' risk.

#### Possible F.C.C. Authority and Jurisdiction

As to the representation from the City of Los Angeles that this Commission should not undertake to regulate the mobile radio telephone business and substitute itself for the Federal Communications Commission, this observation must be made: whatever may be the authority and jurisdiction of the F.C.C., the parties cannot enter into the proposed arrangement without the approval of this Commission. If the F.C.C. does have authority and jurisdiction, the parties should pursue this matter before that Commission; but that necessity does not obviate the need for our approval as sought here.

#### Conclusions and Findings

Based on the evidence of record in this proceeding, it is our conclusion that the proposed arrangement would be beneficial to the gas companies and their customers, but not fully compensatory to Pacific. It would, therefore, burden the telephone customers; and we cannot approve the contract in its present form.

This Commission has no desire to usurp any of the functions of management--to make the business decisions or dictate the terms of the contracts of the companies we regulate. If it were the practice of Pacific to segregate the properties, costs and revenues of its special contract operations from those performed under filed tariffs, the risks from such undertakings as here proposed would fall on the stockholders and not on the ratepayers, and we would have little cause for concern. That is not the case.

These properties, if acquired, will go into Pacific's rate base. It will expect a fair return on them. If the contract with the gas companies does not yield such a return, it will expect to obtain it from its telephone customers. Hence, we can approve such transactions as this only if convinced that they will yield a fair return over and above all of the costs involved.

We have no doubt that Pacific has carefully calculated the incremental costs involved in this proposed transaction and that the terms it offers will yield a fair return, above such incremental costs, on its proposed investment in the gas companies' systems. But Pacific has made a number of offers for mobile radio telephone systems, and apparently desires to enter extensively into this field. Additional business might require a substantial enlargement of maintenance facilities, personnel, and overhead. This is by far the biggest of such contracts that Pacific has negotiated to date, and it may well set the pattern for future contracts. It would be a serious error to set the precedent of computing the costs on anything but a full cost basis. We accept the calculations submitted by the staff, which indicate that the proposed annual payments by the gas companies will not yield to Pacific a fair return over the full costs, and that it would have to have revenue of at least \$126,600 a year from these properties to avoid any burden on its general telephone users. The savings to the gas companies would justify their paying at this rate.

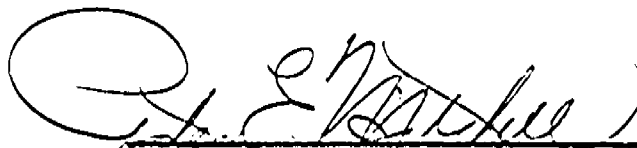
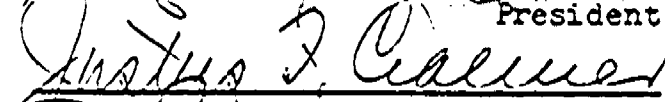
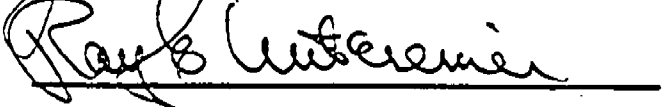
INTERIM ORDER

Public hearings having been held on the above-entitled applications, the matter having been submitted for decision, and the Commission being of the opinion that the authority requested should not be granted until such time as the proposed annual charge is increased from \$113,917 to approximately \$126,600; therefore,

IT IS HEREBY ORDERED that final decision in this matter be held in abeyance for an interval not longer than ninety days after the effective date hereof, pending further negotiations by the parties and notice to the Commission of the results thereof. Should the parties desire to enter into the arrangement on the basis of an annual charge that will be fully compensatory to Pacific, and on the basis that the rate base to be used by Pacific will not be in excess of the original cost less depreciation, amendatory applications will be entertained by the Commission.

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

Dated at San Francisco, California, this 14th day of March, 1955.

  
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President  
  
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Commissioners

Commissioner Matthew J. Dooley, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

LIST OF APPEARANCES

Applicants: Southern California Gas Company by T. J. Reynolds and Harry P. Letton; Southern Counties Gas Company of California by Milford Springer and Frederick G. Dutton; The Pacific Telephone and Telegraph Company by Arthur T. George and Alexander R. Imlay.

Interested Parties: City of Los Angeles by Roger Arnebergh, Alan G. Campbell, T. M. Chubb, Arthur C. Holmann and Robert W. Russell; California Farm Bureau Federation by J. J. Deuel; Dumont Communications by Robert Mohr, Jack G. Stewart and Dick Clark; California Public-Safety Radio Association by K. V. Keeley; City of San Diego by J. F. DuPaul by Aaron W. Reese; Robert Donald Miller and William E. Whiting in propria personae.

Commission Staff: Boris Lakusta, Charles Mors and Theodore Stein.

LIST OF WITNESSES

Evidence was introduced on behalf of the applicants by: Guy W. Wadsworth, Jay Davis, Jr., Jerrold Q. Abel, Harvey A. Procter, H. C. Hammond, Lawrence G. Fitzsimmons, Jr., Ward C. Schweizer, C. S. Mason, and S. W. Campbell.

Evidence was introduced on behalf of the Commission staff by: Chester O. Newman and Donald E. Stegar.