

ORIGINAL

Decision No. 59714

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
WESTERN CALIFORNIA TELEPHONE COMPANY,
a California corporation, for an
order of the Commission authorizing
it to increase certain rates and
charges for telephone service.

Application No. 41188

(Appearances and Witnesses are set forth in
Appendix B)

INTERIM OPINIONApplicant's Request

Western California Telephone Company filed the above-entitled application on June 1, 1959, seeking authority, pursuant to Sections 454 and 491 of the Public Utilities Code, to raise rates designed to increase annual local service revenues by approximately \$256,000, or by 26 percent, on the basis of the estimated test year 1959.

Applicant furnishes telephone service in four exchanges: Los Gatos and Morgan Hill principally in Santa Clara County, Novato in Marin County and Kenwood in Sonoma County. Dial service is provided in all exchanges. At the end of 1958 applicant served a total of 15,587 telephone stations and had in excess of \$6,100,000 invested in telephone plant.

Public Hearing

After due notice, public hearings were held on this application before Examiner Manley W. Edwards on July 28, 1959 in Novato, on July 29, 1959 in Los Gatos and on September 25, 1959 in San Francisco and before Examiner William W. Dunlop on November 18, 1959

in Los Gatos. The applicant through four witnesses presented 22 exhibits in support of its request.

Three protestants representing several groups in the Los Gatos exchange presented testimony and two petitions^{1/} objecting to the proposed increases in telephone rates. They cited that Los Gatos rates were already higher than those in San Jose for similar or better service and that many retired people on fixed incomes cannot pay higher rates, and would be forced to discontinue telephone service at the higher rates. Testimony was also presented by one subscriber in the Novato exchange who desired a wider calling area without payment of toll charges and by six subscribers in Los Gatos who objected to the increases in rates and who cited certain service problems. Applicant has filed a report with respect to each of the service problems.

The Commission staff took an active part in the proceeding, cross-examined witnesses and presented an independent study of applicant's operations through three witnesses. The application was taken under submission at the conclusion of the hearing on November 18, 1959 subject to the receipt of late-filed Exhibit No. 24. Such exhibit has been filed.

Applicant's Position

In justification for its need for rate increases, applicant claims that its present rates and charges have been in effect since 1951 in its Kenwood exchange, since 1952 in its Los Gatos and Morgan Hill exchanges, and since 1954 in its Novato exchange; that since the present rates were established, applicant has experienced substantial increases in plant, labor and material costs; that it is

^{1/} One petition, Exhibit No. 21, contains 137 signatures. The second petition, Exhibit No. 22, contains 124 signatures.

confronted with a construction budget exceeding \$1,240,000 for 1959 and in the next two years will be confronted with comparable growth in required plant investment; that such heavy annual plant investment can only be secured through issuance and sale of additional bonds and stock; that it realized a rate of return of 5.27 percent in 1958 and estimates its 1959 rate of return will be 4.99 percent under the present rates; and that it can only market the required large amounts of securities on favorable terms if its earnings are restored and maintained at a reasonable level. Applicant proposes rates that it claims will yield it a rate of return of 6.38 percent, will permit it to finance on reasonable terms, maintain a sound credit position in the future and satisfactorily meet all service demands.

Earnings Comparison for 1959

A comparison of the staff and company estimates relating to the year 1959 under present rates and using straight-line tax depreciation is set forth in the tabulation following:

SUMMARY OF EARNINGS TEST YEAR 1959 AT PRESENT RATES

<u>Item</u>	<u>Total Company</u>	<u>Interchanged Toll Portion</u>	<u>Exchange Portion</u>
<u>Applicant - Exhibit No. 1</u>			
Revenues	\$1,646,931	\$ 547,944	\$1,098,987
Expenses and Taxes	1,335,413	439,160	896,253
Net Revenue	\$ 311,518	\$ 108,784	\$ 202,734
Avg. Depreciated Rate Base	\$6,244,630	\$1,412,781	\$4,831,849
Rate of Return	4.99%	7.70%	4.20%
<u>Staff - Exhibit No. 23</u>			
Revenues	\$1,653,800	\$ 543,500	\$1,110,300
Expenses and Taxes	1,335,200	438,500	896,700
Net Revenue	\$ 318,600	\$ 105,000	\$ 213,600
Avg. Depreciated Rate Base	\$6,092,600	\$1,363,000	\$4,729,600
Rate of Return	5.23%	7.70%	4.52%

The showings of both the applicant and the Commission staff reflect interchanged toll revenues which yield to applicant its costs, including a rate of return of 7.7 percent on the plant devoted by applicant to such toll operations. Applicant obtains its toll revenues through settlement with The Pacific Telephone and Telegraph Company. A copy of the present toll settlement agreement was filed in this proceeding as Exhibit No. 9. Exhibit No. 16 reveals that Western's toll settlements for the year 1958 and the first half of 1959 were based upon the following rates of return:

	<u>1958</u>	<u>1959</u>
First Quarter	5.2%	7.8%
Second Quarter	5.8	8.9
Third Quarter	8.1	
Fourth Quarter	8.3	

We find for this applicant a rate of return for intrastate toll operations of 7.7 percent to be fair and reasonable. The ensuing order will reflect such a rate of return.

Exchange Operations

There remains applicant's exchange operations to analyze to determine applicant's need and justification for rate increases. A more detailed comparison of the earnings of applicant's exchange

operations under present rates and using straight-line depreciation for federal income tax purposes follows:

SUMMARY OF EXCHANGE OPERATIONS - TEST YEAR 1959

<u>Item</u>	<u>Applicant Exhibit 1</u>	<u>Staff Exhibit 23</u>	<u>Adopted Results</u>
<u>Operating Revenues</u>			
Local Service	\$ 980,500	982,800	982,800
Miscellaneous	120,970	129,600	129,600
Uncollectible	(2,483)	(2,100)	(2,100)
Total Revenues	<u>\$1,098,987</u>	<u>\$1,110,300</u>	<u>\$1,110,300</u>
<u>Operating Expenses</u>			
Depreciation Expense	\$ 422,542	\$ 436,700	\$ 436,700
Taxes - Other than Income	223,737	213,300	213,300
Income Taxes	179,858	160,800	160,800
	70,116	85,900	76,700
Total Expenses & Taxes	<u>\$ 896,253</u>	<u>\$ 896,700</u>	<u>\$ 887,500</u>
Net Revenues	\$ 202,734	\$ 213,600	\$ 222,800
Avg. Depreciated Rate Base	\$4,831,849	\$4,729,600	\$4,729,600
Rate of Return	4.20%	4.52%	4.71%

(Red Figure)

Los Gatos Extended Service
Settlement

The above estimates of both the applicant and the staff reflect settlements for Los Gatos extended service traffic in accordance with an agreement (Exhibit No. 10) between applicant and The Pacific Telephone and Telegraph Company. Considerable evidence is contained in this record concerning applicant's view that said extended service agreement produces inequitable results for applicant's customers. Applicant contends that a more equitable extended

service settlement will result in lower rates in Los Gatos than requested in the application.

Applicant in Exhibit No. 18 shows that 46.4 percent of the total cost of providing service in Los Gatos exchange is assignable to extended service operations, 19.7 percent to toll operations and only 33.9 percent to local operations. In Exhibit No. 19 applicant presented what it considered to be an equitable extended service settlement arrangement whereby it would receive some \$129,600 in extended service settlements from Pacific Telephone and, to that extent, not raise Los Gatos rates.

The testimony shows that applicant has endeavored over an extended period to negotiate a settlement which it considers to be equitable but has been unable to reach agreement with Pacific Telephone. By letter dated November 13, 1959 applicant gave notice to Pacific that said agreement will terminate 60 days from the date of notice, as provided by the agreement. According to the testimony, if applicant is unable to negotiate an equitable settlement applicant plans to file a complaint with this Commission against Pacific for a determination by the Commission of an equitable settlement. Applicant proposed that the results of a more equitable settlement, when obtained, be passed on to its customers. However, applicant claims that no other independent telephone utility in California has a more favorable extended service agreement with Pacific than the one contained in Exhibit No. 10.

It appears that the Commission has not approved such agreement (Exhibit No. 10) and we specifically refrain from passing upon such agreement at this time. Our action in this proceeding should not be construed in any way as approving such agreement.

In view of the large impact which the extended service settlement has upon applicant's Los Gatos operations and rates, and the current unsettled status of such matter, we will issue only an interim decision at this time. Applicant will be required by the order herein to keep the Commission currently informed of its progress in negotiating a new extended service settlement agreement with Pacific.

Adopted Results - Exchange Operations

There is no significant difference between the two estimates as to revenues, except in the miscellaneous classification primarily for directory advertising. The staff's estimates, reflecting more recent information than used by the applicant, appear reasonable and will be adopted.

With respect to operating expenses, exclusive of depreciation and taxes, the principal difference in the estimates lies in the fact that the staff included the full year effect of wage increases awarded in March and April 1959, while the applicant reflected such wage increases for only a portion of the year. The staff's estimates appear proper and reasonable for rate-fixing purposes and, accordingly, will be adopted.

In the matter of depreciation expense, applicant's estimate for exchange operations exceeds that of the staff by \$10,437. This difference is primarily due to the lower accrual rate used by the staff for Ac. 232.1, Station Connections - Telephones, in Los Gatos and in Morgan Hill. The staff's accrual rates for this account were developed to maintain the assignable depreciation reserve to this account at approximately zero. We find \$213,300 for depreciation expense to be reasonable as to applicant's exchange operations for 1959.

Applicant's estimate of taxes other than income exceeds that of the staff by \$19,058 for its exchange operations. This difference results primarily from applicant's use of estimated fiscal 1959-1960 ad valorem taxes compared with the staff's use of one half of fiscal 1958-1959 plus one half of fiscal 1959-1960 ad valorem taxes. The staff's estimates appear reasonable for use in the 1959 test year and will be adopted.

As to income taxes, the record reveals that applicant has elected to use accelerated depreciation on its federal income tax returns for each of the years 1954 to 1958, inclusive. This practice has resulted in a reduction in federal income taxes of \$136,531 as of the end of 1958 and to an estimated average reduction of \$210,800 for 1959. It was the position of the applicant that, for this proceeding, such tax savings should be normalized by crediting these savings to a tax reserve. However, a company witness further stated that if the Commission did not allow this practice in this proceeding, applicant would discontinue the use of accelerated depreciation on all plant additions, past, present and future.

Applicant is placed on notice that the matter of the treatment to be accorded depreciation for tax expense purposes has not finally been determined by this Commission. It is appropriate, therefore, that applicant advise this Commission as to its election, under Section 167 of the 1954 Internal Revenue Code, for the 1959 tax year within 30 days after the effective date of this order, and yearly thereafter by January 15 of each year until final decision of this Commission in Case No. 6148.

For the purposes of this decision only, pending final decision by this Commission on the treatment to be accorded accelerated depreciation for rate-making purposes, the federal tax expense

for rate-making purposes herein will be determined on the basis of straight-line depreciation after crediting to the Federal Income Tax Account interest calculated on the reserve for income taxes at the rate of return on applicant's rate base herein adopted. Since approximately 77.6 percent of this reserve, or about \$163,600, is chargeable to applicant's exchange operations, the interest credit in this proceeding will be \$9,200.

After giving weight to the revenues and expenses being adopted herein and to the deferred tax reserve interest credit, an income tax figure of \$76,700 is computed for the test year 1959 which is found to be reasonable and is adopted.

The difference in rate base of \$102,249 for exchange operations is accounted for primarily by the staff's lower allowance for working cash and for materials and supplies, the staff's deduction of \$60,000 to offset the effect on rate base of the unusually early retirement of the Morgan Hill dial central office equipment, the inclusion by the applicant of two items of telephone plant acquisition adjustment and a difference in depreciation reserve. A complete analysis of the two estimates leads us to now find that the staff's estimate of rate base is reasonable. Accordingly, we find that on an average depreciated rate base of \$4,729,600 for exchange operations as estimated for the test year 1959, applicant under present rates will realize a rate of return of 4.71 percent. The evidence in this record indicates a level trend in rate of return.

Authorized Interim Rate Increases

Upon consideration of all of the evidence before us, including the status of the Los Gatos extended service settlement matter, we find that applicant is entitled without further delay to

some increase in rates on its exchange operations. No increases, however, will be authorized at this time in basic rates in the Los Gatos exchange.

Of the \$256,000 increase in annual revenues sought by applicant, approximately \$39,900 is applicable to a number of miscellaneous services including suburban and off-premises mileage, PBX equipment, key systems, supplemental equipment, joint user, moves and changes, service connections, foreign exchange and leased lines in all of its exchanges. We find applicant's proposed increases in miscellaneous rates to be reasonable and the order herein will authorize such increases.

Inasmuch as the Commission is authorizing new foreign exchange rates for applicant, it follows that affected foreign exchange rates filed by connecting companies should be revised so as to be consistent therewith. Such connecting companies should request authority of this Commission, by advice letter procedures, to make the necessary tariff filings to reflect the increase authorized in the serving exchange by the order herein.

Applicant also proposed to restrict the offering of Schedule No. A-6, Farmer Line Service, Schedule No. A-9, Key Branch Exchange System Service, and Schedule No. A-11, Key System Service to existing subscribers. There appear to be no new demands for such services and applicant's request will be granted.

Expansion of the base rate area for Los Gatos, Morgan Hill and Novato exchanges was proposed by applicant resulting in a reduction in annual revenues of \$17,600. Such expansion of the base rate area for Morgan Hill and for Novato was made effective by regular tariff filing procedure subsequent to the filing of this application. In lieu of applicant's proposal to expand the Los Gatos

base rate area, the Commission staff recommended that the Glen Una special rate area be expanded as shown on Chart 1-E of Exhibit No. 23. The interim order herein will reflect the expansion of the Morgan Hill and the Novato base rate areas resulting in a reduction in annual revenues of \$16,400. Since we are not authorizing any changes in basic rates in Los Gatos exchange by the interim order herein, the question of the expansion of the Los Gatos base rate area will be held for the final order.

Applicant proposed increases in basic rates for business and residence telephone service to yield approximately \$233,700 of additional annual revenues. No increases in basic rates were requested for Kenwood exchange and none will be authorized for such exchange. Applicant's proposed increases in basic rates for Morgan Hill and for Novato appear reasonable and will be authorized by the order herein. Increases in basic rates also were requested for Los Gatos but none will be authorized at this time pending further developments with respect to the extended service settlement matter. The increases in basic rates being authorized are estimated to yield \$74,400 of additional annual revenues.

A comparison of present, company proposed and authorized rates for principal classifications of basic service in Morgan Hill and in Novato exchanges follows:

<u>Item</u>	<u>No. of Services 10/31/58</u>	<u>Rate Per Month</u>			
		<u>Present</u>	<u>Company Proposed</u>	<u>Authorized Rate</u>	<u>Increase</u>
<u>Morgan Hill Exchange</u>					
Business - 1-Party	153	\$ 7.00	\$10.50	\$10.50	\$3.50
2-Party	46	5.75	8.50	8.50	2.75
Suburban	23	5.25	7.75	7.75	2.50
PEX Trunk	7	10.50	15.75	15.75	5.25
Residence 1-Party	170	4.30	5.80	5.80	1.50
2-Party	190	3.75	4.85	4.85	1.10
3-Party	481	3.20	4.10	4.10	.90
Suburban	371	3.70	4.70	4.70	1.00
<u>Novato Exchange</u>					
Business 1-Party	309	6.50	9.75	9.75	3.25
2-Party	92	5.25	7.75	7.75	2.50
Suburban	13	4.75	7.00	7.00	2.25
Residence 1-Party	474	4.05	4.85	4.85	.80
2-Party	326	3.50	4.30	4.30	.80
4-Party	1,643	2.75	3.55	3.55	.80
Suburban	572	3.20	3.80	3.80	.60

We find that the rates authorized by the interim order herein will increase applicant's annual gross revenues by \$97,900 and applicant's annual net revenues by \$44,300 resulting in a rate of return of 5.65 percent on a depreciated rate base of \$4,729,600 devoted to exchange operations. Such rate of return on exchange operations is estimated to result in a rate of return of approximately 6.1 percent on applicant's total depreciated rate base, after taking into consideration a rate of return of 7.7 percent on the portion of applicant's depreciated rate base devoted to interchange toll service. We find such results to be reasonable at this time pending further developments in the Los Gatos extended service settlement matter.

Business Message Rates

At the request of the Commission staff, applicant prepared a study showing the effects of providing business message rate service in lieu of business flat rate service in Los Gatos exchange.

The results of applicant's study are summarized in Exhibit No. 15. Since basic rates in Los Gatos exchange are not being disturbed by the interim order herein, we will hold for the final order herein disposition of this issue on business message rates in Los Gatos.

Service Matters

Several Los Gatos subscribers complained that the requirement to dial an access code "nine" to place calls to San Jose, Saratoga or Campbell unduly complicated the subscriber's use of the service. Applicant showed that elimination of such access code would require a \$34,000 annual payment to Pacific under its extended service agreement. The staff's position was that the amount of service improvement does not justify such a substantial increase in payments and that elimination of the access code should be delayed until it has been determined that an equitable extended service settlement agreement is in effect. Applicant should continue its efforts to reach a reasonable solution to this problem.

With respect to the testimony of one Novato subscriber who expressed a desire for extended service, the record reveals that applicant is presently engaged in a joint study with Pacific Telephone to determine the feasibility of extended service for Novato. Applicant stated such study would be completed in the early part of 1960 and that if such study indicated that extended service would be feasible, application would be made to the Commission to provide such service. Applicant will be required to file a copy of such study, when completed, with the Commission.

The recommendation of the staff with respect to the Los Gatos mountain area and a separate telephone directory for Los Gatos does not appear warranted at this time.

Over-All Conclusion

We hereby find as a fact that the increases in rates and charges authorized herein are justified and that present rates and charges, insofar as they differ from those herein prescribed, for the future are unjust and unreasonable.

INTERIM ORDER

Public hearing having been held in the above-entitled matter and the Commission being informed therein,

IT IS ORDERED that:

1. Applicant is authorized to file in quadruplicate with the Commission, on or after the effective date of this order, and in conformity with the provisions of General Order No. 96, revised tariff schedules with rates, charges and conditions modified as set forth in Appendix A attached to this order and, on not less than five days' notice to the public and to this Commission, to make said revised tariffs effective for all service rendered on and after April 1, 1960, excepting that increases in installation, service connection and move and change charges shall be made effective on applications received by the utility on and after April 1, 1960.
2. Applicant shall advise this Commission in writing as to its election, under Section 167 of the 1954 Internal Revenue Code, for the year 1959 within thirty days after the effective date of this order, and yearly thereafter by January 15 of each year until final decision of this Commission in Case No. 6148.
3. Applicant shall file monthly with this Commission, until agreement is reached or until further order herein, a report concerning its negotiations with The Pacific Telephone and Telegraph Company relating to settlements for Los Gatos extended service traffic. Such report shall include a resume of such negotiations as are held during

the period, a summary of any offers made and of their impact upon applicant's operations, a copy of any agreements reached and of their impact upon applicant's operations. The initial report shall be filed within twenty days after the effective date of this order and shall include information for the period from November 13, 1959 through January 31, 1960. Subsequent reports shall be filed within twenty days after the close of the month.

4. Within six months from the effective date of this order, applicant shall file with this Commission a copy of its extended service study relating to the Novato exchange, together with applicant's recommendations thereon.

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

Dated at San Francisco, California, this 25th day of FEBRUARY, 1960.

 President

[Handwritten Signature]

[Handwritten Signature]

[Handwritten Signature]
 Commissioners

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

APPENDIX A

RATES

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

Changes as set forth in Exhibit E attached to the application are to be made except that:

1. Increases in basic rates for service within the Los Gatos exchange as set forth on page 1 of Exhibit E are not to be made.
2. The expansion of base rate area or special rate area within the Los Gatos exchange is not to be made.

APPENDIX B

LIST OF APPEARANCES

FOR APPLICANT: Warren A. Palmer, Robert A. Keller, and Orrick, Dahlquist, Harrington and Sutcliffe.

FOR PROTESTANTS: Walter Serum, for Loma Prieta Area, Melody Woods Area and Highland and Hester Creek; Mrs. Paul Hinchcliffe, Jr., for Paradise Valley Homeowners; R. L. Popham, for himself and numerous neighbors.

FOR INTERESTED PARTIES: William Knecht and Ralph Hubbard, for California Farm Bureau Federation; Neal C. Hasbrook, for California Independent Telephone Association; Franklin T. Laskin, for San Jose City Manager and for the City of San Jose.

FOR THE COMMISSION STAFF: William C. Ericca, James M. McCraney and L. L. Thormod.

LIST OF WITNESSES

Evidence was presented on behalf of applicant by:

Robert C. Abrams, Robert A. Lindsay, Lynden Farwell, and Harold O. Davis.

Evidence was presented on behalf of protestants and interested parties by:

Francis James Picchi, Mrs. H. E. Grove, Walter Serum, Harold Hagedorn, Clyde Williamson, Mrs. Paul Hinchcliffe, R. L. Popham, George H. Argall, Mrs. George O. Henderson and Frances Coleman Cleveland.

Evidence was presented on behalf of the Commission staff by:

P. E. Valena, R. J. Nielsen, and L. A. Blom.