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ORIGINAL

Decision No. 60764

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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| In the Matter of the Application of JOSEPH S. RAY, an individual, for a certificate of public convenience and necessity to construct, maintain and operate a telephone exchange in and about the vicinity of Refugio, Santa Barbara County, California. | Application No. 41378 (Amended) |
| In the Matter of the Joint Application of JOSEPH S. RAY, an individual, and SEA-ISLAND TELEPHONE COMPANY, a California corporation, for (1) authority of Joseph S. Ray to assign and transfer to Sea-Island Telephone Company a certificate of public convenience and necessity to furnish public utility telephone service in and about the vicinity of Refugio and adjacent islands, Santa Barbara County, California, and (2) authority of Sea-Island Telephone Company to issue and sell its capital stock. | Application No. 41761 |
| In the Matter of the suspension and investigation on the Commission's own motion of exchange area expansion in the Santa Barbara Exchange of General Telephone Company of California, filed by Advice Letter No. 1055. | Case No. 6391 |

David Ginsburg and William Gumpert and Orrick, Dahlquist, Herrington & Sutcliffe, by Warren A. Palmer, for Joseph S. Ray and Sea-Island Telephone Company, applicants; and interested parties in Case No. 6391.
Albert M. Hart and A. Ralph Snyder, Jr., for General Telephone Company of California, protestant in Application No. 41378, interested party in Application No. 41761, and respondent in Case No. 6391.
Neal C. Hasbrook, for California Independent Telephone Association; and Harold Gold and Clyde F. Carroll, for United States Department of Navy, interested parties.
J. Calvin Simpson and Melvin E. Mezek, for the Commission staff.

## OPINION

### Nature of the Proceedings

The above-entitled matters involve two mutually-exclusive proposals for the establishment of exchange telephone service in an unincorporated mainland area in and about the vicinity of Refugio near Santa Barbara. One proposal is that of Joseph S. Ray, an individual, and Sea-Island Telephone Company (Sea-Island); the other is that of General Telephone Company of California (General). The proposal of Ray and Sea-Island also involves the establishment of exchange telephone service on four of the nearby Santa Barbara islands.

The basic issue in these proceedings is whether Sea-Island's proposal to serve the disputed mainland area and offshore islands with exchange and toll service is more compatible with and in the public interest than General's proposal to serve the mainland area with suburban extended service and to continue the present arrangements of serving the offshore islands with mobile radio and toll service.

Sea-Island's Proposal

Ray filed Application No. 41378 on August 5, 1959, and an amendment thereto on January 7, 1960. The application, as amended, seeks a certificate of public convenience and necessity to construct, operate and maintain five dial telephone exchanges as follows: one on the mainland to be designated as Cabrillo exchange and to include the localities of Refugio, Capitan, Tifiguas Ranch, El Capitan Ranch, Refugio Beach State Park and El Capitan Beach State Park, all in Santa Barbara County; and an exchange on each of the offshore islands of Anacapa, Santa Cruz, Santa Rosa and San Miguel.

On December 14, 1959, Ray and Sea-Island Telephone Company, a California corporation, jointly filed Application No. 41761, requesting authority for Ray to assign and transfer the certificate sought under Application No. 41378 to Sea-Island and authority for Sea-Island to issue and sell capital stock. Application No. 41378 and Application No. 41761 are, therefore, considered to be an integrated proposal to establish service to be provided by Sea-Island.

Under Sea-Island's proposal, as contained in the applications, subscribers in its Cabrillo, or mainland, exchange would have extended calling to telephones in the Woodland 7 (Goleta) office of General's Santa Barbara exchange. During the hearings Sea-Island offered an alternative proposal for the mainland, providing for local service only in the Cabrillo exchange without the feature of extended service into General's Woodland 7 office.

Exchange service would be provided by Sea-Island on each of the offshore islands. Island-to-island service and island-to-mainland service would be provided on a toll basis.

General's Proposal

Under Advice Letter No. 1055, dated November 9, 1959, General filed revised tariff sheets providing for expansion of its Santa Barbara exchange to add the same mainland area which Sea-Island proposes to include in its Cabrillo exchange. On December 1, 1959, the Commission suspended these revised tariff sheets and instituted Case No. 6391, an investigation to determine whether General should be authorized to expand its Santa Barbara exchange to include the contested area.

Under Advice Letter No. 1071, dated February 19, 1960, General undertook to file maps designating the four offshore islands as separate telephone exchanges. This advice letter was rejected on February 23, 1960, because the filing did not include the types and classes of service proposed to be rendered or the rates or conditions under which the service would be provided. Insofar as exchange telephone service by General is concerned, therefore, these proceedings are limited to a consideration of the proposal made under Advice Letter No. 1055, which relates only to the mainland area.

General's proposal provides for the mainland area to become a part of its Santa Barbara exchange, with extended service throughout the Santa Barbara extended area. General would continue to offer communications service to the offshore islands under its present radiotelephone tariffs.

Public Hearings

Public hearing in Application No. 41378 was held in Santa Barbara on September 22, 1959. Subsequently, Application No. 41378 was consolidated for hearing with Application No. 41761 and Case No. 6391, and combined public hearings were held on January 26, 27 and 28, 1960, in Los Angeles and on March 14, 15 and 16, 1960, in Santa Barbara. On the last-mentioned date, these matters were submitted, subject to the receipt of concurrent briefs which were filed with the Commission on June 10, 1960.

Proposed Exchange Areas and
Present Serving Arrangements

The contested mainland area is roughly rectangular and is 38 square miles in area. Its southern side fronts upon the Pacific Ocean for approximately nine miles, and the area extends inland about four miles. It is bounded on land by three exchanges of General's Santa Barbara district: Gaviota exchange to the west; Santa Ynez exchange to the north; and Santa Barbara exchange to the east. The southern half, for a distance of from two to two and one-half miles inland from the ocean shore, is used for agricultural purposes, principally cattle grazing. Beyond this distance, the terrain rises abruptly and the remainder of the area lies within Los Padres National Forest. There are a total of 74 habitable buildings in the area, 17 of which are unoccupied. The only commercial establishment in the area is a service station. General now provides toll station telephone service in the area, which is "unfiled", i.e., not included in the exchange area maps of the filed tariffs of any telephone utility. Existing telephone service is furnished through three magneto toll circuits. During January 1960, General was serving 17 subscribers and two public pay stations in the contested mainland area.

Anacapa Island is 700 acres, or slightly over one square mile in area, and lies approximately 12 miles southwest of Point Hueneme. The island is composed primarily of volcanic rock. There is no source of water on the island, and all supplies, including water, must be shipped in. A total of 538 acres, which is unoccupied and unattended, has been designated as a national monument. A Coast Guard station, staffed by eight men, occupies the remainder of the island. The station facilities include a lighthouse and radio beacon. The Coast Guard has its own radio communications to the mainland as well as a system for intercommunicating within the station.

Santa Cruz Island, the next island to the west of Anacapa, encompasses about 62,000 acres, or 96 square miles. There are two sheep ranches on the island, one of approximately 55,000 acres and one of 6,500 acres. Depending on the season, a total of from 11 to 17 men are employed on the two ranches. Each ranch has its own intercommunicating system, as well as radio communications to the mainland. There is no radio or wire communcations between the two ranches. In addition to the two ranches, the United States Navy maintains an installation on Santa Cruz. The naval installation is staffed by 17 personnel. The Navy maintains a radio system for communications with the mainland.

Santa Rosa, the next island to the west, is about 80 square miles in area. The island is owned by a Los Angeles cattle syndicate. In addition to the cattle-raising operations on the island, there is a United States Air Force installation staffed by 200 airmen. General provides two radiotelephone circuits from the Air Force installation to its Santa Barbara toll board. One circuit serves the Air Force station private branch exchange and the other serves seven pay stations located within the airmen's barracks. In addition, The Pacific Telephone and Telegraph Company (Pacific), in cooperation with General, provides a number of leased line circuits to the Air Force.

San Miguel Island, the furthest west of the four islands, has been removed from further consideration herein. Pursuant to a stipulation entered into by the parties to these proceedings, Sea-Island withdrew its request for a certificate to establish a telephone exchange on San Miguel Island. This stipulation followed a statement by counsel for the United States Navy to the effect that the Navy was giving consideration to objecting formally to Sea-Island's proposal for San Miguel Island.

Testimony of Public Witnesses

Approximately 20 public witnesses, 12 of them being subscribers to General's service, testified that they preferred the service and rates proposed by Sea-Island. All of the public witnesses expressed dissatisfaction with the toll-station service being provided by General. Their complaints concerned dissatisfaction with party-line service, waiting for the operator, non-dial instruments, service outages and non-selective ringing. The service difficulties complained of appeared to be typical of those generally experienced in rural areas where multiparty line magneto toll station service is provided. The expression of the public witnesses in favor of Sea-Island service clearly indicates that they desire urban service at urban rates. The fact that under General's proposal the local calling area would include Santa Barbara and Carpenteria, whereas these points would be subject to toll charges under Sea-Island's proposal, did not appear to offset the fact that under General's proposal urban service would entail the application of standard suburban mileage charges based on the distance the individual subscriber was removed from the Santa Barbara base rate area.

One public witness, representing the owner of a cattle ranch on Santa Cruz Island, testified as to the desirability of Sea-Island's proposal for providing exchange telephone service to the offshore islands.

Discussion of Sea-Island's Proposal

Sea-Island's proposal would permit virtually all potential telephone subscribers to receive urban grades of service, i.e., individual- and two-party line service, without mileage charges or line extension charges. Sea-Island achieves this form of rate treatment, which is highly acceptable to the subscriber, through the device of designing its proposed base rate areas to include all prospective subscribers for its service without regard to the normal engineering and economic considerations of base rate area design, such as subscriber density and distance from the central office. On the mainland, the resulting base rate area is extended and asymmetrical, and, on the offshore islands, the base rate areas are circular with one base rate area to each and every subscriber.

The proposed rates for principal grades of Sea-Island service are shown in the tabulation below:

| Exchange | Class and Grade of Service | Rate Per Month: Extended Service* | Rate Per Month: Local Service |
|---|---|---|---|
| Cabrillo (Mainland) | Business | | |
| | Individual Line | $9.00 | $8.10 |
| | Suburban Line | 8.50 | 7.50 |
| | Residence | | |
| | Individual Line | 7.00 | 6.30 |
| | Two-Party Line | 5.00 | 4.50 |
| | Suburban Line | 4.50 | 4.00 |
| Offshore Islands | Business | | |
| | Individual Line | - | 9.00 |
| | Residence | | |
| | Individual Line | - | 7.00 |

* To Woodland 7 office of General's Santa Barbara exchange.

The rates shown above for extended service form the basis upon which Sea-Island solicited applications for service from residents of its proposed Cabrillo, or mainland, exchange. On the last day of hearing, Sea-Island introduced an alternative proposal providing for local service only in the Cabrillo exchange without the feature of extended service into the Woodland 7 office of General. The record does not show that prospective subscribers to Sea-Island service were apprised of this latter proposal.

The proposed level of exchange rates is not of great significance in making an estimate of the results of Sea-Island's operations. Under Sea-Island's extended service proposal, less than 20 percent of its revenues would come from exchange operations, since over 80 percent of its revenues would, according to its own separations study, have to come from interchanged toll. Under Sea-Island's alternative local service proposal, only 10 percent of its revenues would come from exchange operations and 90 percent would have to come from interchanged toll. The following tabulation, taken from Exhibit

No. 12, shows Sea-Island's estimate of the level of its separated earnings at the end of the first year of operation on an extended service basis:

| | Interchanged Toll | All Other | Total |
|---|---|---|---|
| Revenues | $ 39,981 | $ 7,231 | $ 47,212 |
| Expenses | 28,742 | 6,323 | 35,065 |
| Net Revenue | 11,239 | 908 | 12,147 |
| Rate Base | 145,947 | 29,951 | 175,908 |
| Rate of Return | 7.70% | 3.03% | 6.91% |

Sea-Island's estimate of nearly $40,000 in toll revenues results from the application of an assumed 7.7% rate of return to a toll rate base of about 83% of Sea-Island's total plant investment. According to Sea-Island's own figures, based on an estimated development of 100 stations and an estimated annual originating toll usage of $140 per station, its total toll billing to customers would be only $14,000 per year. Sea-Island assumes that the telephone utility with which it would interchange toll traffic would be required by this Commission to "make it whole", i.e., to pay to Sea-Island the difference between the actual toll billing to its customers and its full toll operating costs plus a rate of return of 7.7%. By Sea-Island's estimate, this difference would amount to $26,000 per year.

This Commission, in Decision No. 56652, dated May 6, 1958, in Application No. 39309, found a 7.7% rate of return to be reasonable for traffic interchanged between independent companies and Pacific. Said decision, however, made no determination as to the rate of return for traffic wholly over the lines of independent companies.

Without commenting on the applicability of the 7.7% return to any toll traffic Sea-Island might interchange with Pacific, the evidence in this case shows that over 60 percent of Sea-Island's toll traffic would be interchanged with General. The evidence also shows that General is not earning a 7.7% return on the operation of its Santa Barbara County toll routes. If the Commission were to require General to compensate Sea-Island on the basis of full cost plus a 7.7 percent rate of return, it is possible that General, in turn, would require compensation. This compensation might ultimately have to come either from General's own ratepayers or from toll users throughout the State of California.

While this Commission subscribes to the proposition that independent telephone utilities should be adequately compensated for their interchanged toll operations, and that the full cost plus reasonable rate of return formula generally affords an equitable means of providing adequate compensation, an examination into the unusual nature of Sea-Island's proposed operations gives conclusive indication that the application of such a settlement formula to Sea-Island would not be in the public interest.

Included in Sea-Island's total plant investment of $176,000 is an investment of some $88,000, exclusive of station equipment, in a microwave system to be used to serve the offshore islands. Sea-Island has allocated this investment entirely to toll. Initially this microwave system would be used to serve four prospective subscribers. This would amount to an investment of $22,000 per station. Giving credence to Sea-Island's optimistic estimate of 33 island stations, which includes future military stations, the investment per island station would still exceed $2,600. Looking at Sea-Island's over-all proposed operations, it is seen from Exhibit No. 12 that $176,000 in plant investment would be required to serve a total of 100 stations. This amounts to an investment greater than $1,700 per station, exceeding by several times the statewide average investment per station for all telephone utilities.

Exhibit No. 45 lists the 56 telephone companies in this country having less than 500 stations which reported to the United States Independent Telephone Association in the year 1958 and all Class C and D telephone utilities in California. This exhibit shows the highest investment per station of any of these companies to be $860, with over 90% of them having an investment per station of less than $500, as contrasted with Sea-Island's proposed investment of over $1,700.

Of the telephone companies listed in Exhibit No. 45, the highest annual toll revenue per station in 1958 was $167, and over 90% of all the listed companies had toll revenues per station of less than $89 per year. Using Sea-Island's station estimate of 100 stations, the $40,000 of toll settlement revenues which Sea-Island would require in order to earn a 7.7% rate of return equates to around $400 per station.

Discussion of General's Proposal

Under General's proposal the mainland area would become "Suburban Zone No. 2" of the Santa Barbara exchange with dial extended service throughout the Santa Barbara extended area, including the Carpenteria exchange. Suburban line service would be offered at the same level as applies to Carpenteria. Urban grades of service would be offered at the Santa Barbara monthly rates with applicable mileage charges. The rates applicable to the principal classes and grades of service under General's proposal are as follows:

| | Rate Per Month | |
|---|---|---|
| Class and Grade of Service | Exchange Charge | Mileage Charge Per 1/4 Mile |
| Business Service | | |
| Individual Line | $9.90 | $0.75 |
| Two-Party Line | 8.20 | .50 |
| Suburban Line | 9.50 | - |
| Residence Service | | |
| Individual Line | 5.85 | 0.75 |
| Two-Party Line | 4.60 | .50 |
| Four-Party Line | 3.80 | .35 |
| Suburban Line | 4.55 | - |

With respect to the offshore islands, General would continue to offer fixed and mobile radiotelephone service from its Long Beach system to the non-military population on the islands. It would continue to provide radio communications to the military installations on the islands in cooperation with Pacific.

Comparison of Proposed Rate Treatment

Both proposals provide for dial exchange service for the contested mainland area, the basic difference being that under Sea-Island's proposal the base rate area would be so elongated and so configurated that practically no subscribers to urban grades of service would pay suburban mileage charges, whereas under General's proposal subscribers to urban grades would pay mileage charges from the Santa Barbara base rate area boundary. These mileage charges would vary according to the subscriber's location and grade of service and would range from about $9.00 to $45.00 per month. Under General's proposal, however, suburban-line dial service would be available without mileage charges.

General's proposal provides a greater extended calling range than does Sea-Island's. Under General's proposal, subscribers would have calling access, at no additional charges, to all stations in Santa Barbara and Carpenteria. Under Sea Island's local service proposal all calls to stations outside the Cabrillo exchange would be toll; under Sea Island's extended service proposal, subscribers could call the Woodland 7 office of the Santa Barbara exchange without additional charges. The evidence indicates, however, that residents of the proposed Cabrillo exchange do not have a high calling rate to the Woodland 7 office but that, instead, their community of interest is directed toward the more central areas of Santa Barbara exchange.

Exhibit No. 25 is a study of the subscriber monthly billing effect of Sea-Island's proposal as against General's proposal. The exhibit shows that, based on calls made during the month studied, under Sea-Island's proposal, the present subscribers to toll station service would have paid a total of $242.80 in exchange and toll charges for individual-line service with free calling locally and to the Woodland 7 office. Under General's proposal these same subscribers would have paid a total of $177.15 in such charges for suburban-line service with free calling throughout the Santa Barbara and Carpenteria exchanges. For individual-line service, however, General's total charges would have been appreciably greater than Sea-Island's, because of the effect of mileage charges.

Comparison of Ability to Serve

Sea-Island does not now, and has not previously, operated a telephone system. It estimates that it will take from nine months to one year for its proposed system to become operative. Sea-Island will be managed by an outside service company with day-to-day commercial services being conducted by the operator of a local gasoline station. Its financial plans are not crystallized. It hopes to finance its plant investment with a 90% Rural Electrification Administration (REA) loan at 2% interest. It has, however, no commitment from the REA for such a loan. If the REA loan is denied, Sea-Island would attempt to finance with 100% common equity. Neither Sea-Island, nor its promoter, offered a balance sheet or other financial statement in evidence. Sea-Island itself is a corporation without present assets.

The financial success of Sea-Island, and hence its ability to provide adequate and dependable telephone service to the public, appears to depend completely upon its being guaranteed a 7.7% rate of return on its toll operations by contracting to have either General or Pacific pay it $26,000 each year more than the revenues generated by Sea-Island's subscribers. Sea-Island does not have such a contract, nor does it have a contract for another utility to perform, as it contemplates, the timing and ticketing of subscribers' toll calls and the handling of special service calls such as information and repair service.

Sea-Island's plan for providing service to the area appears to ignore engineering and economic realities. Boiled down to its essence, Sea-Island proposes to offer high cost exchange service at non-compensatory rates and intends to make up the resulting deficit through the provisions of a guaranteed rate of return settlement contract with another telephone utility. The evidence does not show that Sea-Island could, in fact, be made whole through the operation of such a settlement contract. The separations study upon which Sea-Island based its earnings estimate contains obvious major infirmities, and it was not fully and properly supported by Sea-Island's witness on separations. Rather than being an objective and accurate separations study, it appears to be a device introduced into the proceedings for the purpose of making Sea-Island's proposal appear economically practicable. Further doubt is cast upon Sea-Island's earnings estimate by its station development forecast, which is clearly shown by the evidence to be too optimistic. Considering the low level of revenues which could reasonably be expected to be generated from its subscribers, in the light of the large plant investment required, Sea-Island's proposal is seen to be unrealistic.

On the other hand, General's service and financial capabilities are a matter of record with this Commission. General now serves the area surrounding the contested mainland area, and it presently owns toll station facilities in the area, which can be utilized at low cost to provide dial extended service to the Santa Barbara exchange. General states that the modifications necessary to provide such service can be provided within a maximum of two weeks.

General's differential and cost effects of providing Santa Barbara extended service in the contested area are shown in Exhibit No. 32, which indicates that General's proposed serving plan will produce revenues sufficient to meet the estimated full costs of providing such service.

With respect to the offshore islands, the evidence shows that the cost of providing exchange service would be prohibitive in view of the gross disparity between the plant investment which would be required and the revenues which could be realized from the small prospective station development. The record indicates that the present serving arrangements for the islands are meeting all present requirements of the military, and that radio communication is now available to the very limited civilian activities on the islands.

Findings and Conclusions

The Commission finds and concludes that Sea-Island's proposal is purely speculative and would be adverse to the public interest and that, therefore, the applications of Joseph S. Ray and Sea-Island Telephone Company should be denied.

The Commission further finds and concludes that the public interest requires General Telephone Company to expand its Santa Barbara exchange to include the contested mainland area as provided in its Advice Letter No. 1055 and attached revised Cal. P.U.C. Sheets Nos. 8168-T through 8175-T, inclusive.

ORDER

Public hearings having been held, evidence having been received, and the matters submitted for decision,

IT IS ORDERED:

1. That Application No. 41378, as amended, and Application No. 41761 be and they hereby are denied.

2. That Case No. 6391 be and it hereby is discontinued and the orders therein dated December 1, 1959 and March 29, 1960 be and they hereby are vacated; the suspension is lifted and the rates filed by the General Telephone Company of California under Advice Letter No. 1055, Revised Cal. P.U.C. Sheets Nos. 8168-T through 8175-T, inclusive, are accepted and shall become effective on the effective date of this order.

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

Dated at San Francisco, California, this 20th day of SEPTEMBER, 1960.

President

Commissioners