

Decision No. 61795

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
 KERN MUTUAL TELEPHONE COMPANY, a)
 California corporation, for author-)
 ity to increase rates for exchange)
 telephone service and message toll)
 telephone service, and for interim)
 relief.)

Application No. 42567

Orrick, Dahlquist, Herrington and Sutcliffe, by
Warren A. Palmer, for Kern Mutual Telephone
 Company, applicant.
Henry G. Baron, for City of Taft; Charles Carlstroem,
 for the County of Kern; Mrs. H. B. Frazier, for
 St. Lawrence Oil Co. and herself; Robert C. Freeny,
 for himself; John H. Sachs, for Valley Acres resi-
 dents; H. B. Jeffries, and Frances Selvidge, for
 Buttonwillow Chamber of Commerce; and Cecil Tracy,
 for himself, protestants.
Ralph Hubbard, for California Farm Bureau Federation;
Neal C. Wasbrook, for California Independent Tele-
 phone Association; and G. C. Parker, for Button-
 willow Chamber of Commerce, interested parties.
John Gibbons, Robert W. Beardslee and William C.
Bricca, for the Commission staff.

O P I N I O N

Nature of Proceeding

By the above-entitled application, filed on August 15, 1960, Kern Mutual Telephone Company requests authorization to increase its rates and charges so as to provide additional annual gross revenues of not less than \$147,565 based on the estimated year 1961. At the conclusion of two days of public hearing at Taft on September 28 and 29, 1960, before Examiner William W. Dunlop, applicant moved for an immediate interim rate increase of not less than \$97,313 to meet its estimated minimum requirements for the year 1961 pending completion of a thorough investigation by the Commission staff, further public hearings and final disposition of the proceeding.

Thereafter, on November 7, 1960, the Commission issued its Decision No. 61027 on applicant's request for immediate interim relief. Said decision authorized increases aggregating \$65,550, principally in business classifications, based on the level of operations for the year 1960, effective for service furnished on and after December 5, 1960.

Further public hearings were held in Taft on February 2 and 3, 1961, at which time the Commission staff presented the results of its independent study and investigation into the operations and earnings of applicant and cross-examined witnesses. Nine of applicant's subscribers representing the communities of Valley Acres, Derby Acres, Fellows and Buttonwillow testified concerning unsatisfactory service conditions. Several subscribers expressed opposition to a rate increase until service improvements have been accomplished.

Applicant also presented additional testimony and exhibits in support of its request and as to its plans for service improvements. At the conclusion of the hearing on February 3, 1961, the matter was taken under submission subject to the receipt of one late-filed exhibit. Such exhibit has been received.

Applicant's Operations

Applicant is a California corporation furnishing exchange and toll telephone public utility service through four dial exchanges located principally in western Kern County. Its principal exchange is at Taft. As of December 31, 1960, applicant reported approximately \$2,364,000 of telephone plant in service. Applicant also reported gross revenues of approximately \$784,600 for the year 1960. A total of approximately 8,200 telephones are connected to applicant's system.

Service Problems

One of the principal complaints respecting applicant's service to Valley Acres relates to the inherent difficulties in using 10-party suburban lines. Valley Acres is located within the Taft exchange some four and one-quarter miles northeast from the base rate area. Several subscribers indicated a desire for an upgrade to at least 4-party service. All existing facilities to the area are currently in use and applicant estimates that cable reinforcement would cost approximately \$40,000. Applicant proposes to make a complete commercial and economic survey of Valley Acres to determine the feasibility of providing graded service to the area either on the basis of a special rate area or suburban mileage.

With respect to service problems in the Derby Acres area applicant stated it would rehabilitate and rebuild outside plant in that area and has added this project to its 1961 construction budget.

In response to service problems at Fellows, applicant stated it had initiated a stepped-up maintenance program of the all-relay dial office in Fellows, and that if this does not remedy the situation applicant will replace the office with step-by-step equipment.

Applicant's action and plans respecting service problems at Buttonwillow are set forth in Exhibit 15. Certain of the difficulties appear to have been caused by temporary wiring and dust during installation of additional equipment both at the Bakersfield and at the Buttonwillow central offices. With respect to transmission difficulties, applicant states that some of the required facilities to remedy the transmission problems already have been installed and that the remaining required facilities are scheduled to be in service by the end of April 1961. A stepped-up routine

maintenance program recently has been instituted in Buttonwillow. Applicant's subscribers in this area who testified at the hearing acknowledged that service in Buttonwillow had improved substantially in recent weeks. Applicant's 1961 construction program includes an amount of \$4,700 for rural distribution cable in Buttonwillow exchange scheduled for completion during the third quarter of 1961 which is designed to improve the rural service in that exchange.

Affiliated Companies

Kern Mutual Telephone Company receives certain services from Central Western Company and rents equipment from Medusa Equipment Corporation. This record shows that a degree of affiliation exists between the three above-named corporations through common officers, by the fact that certain individuals are on the board of directors of each of the three corporations, and because of the fact that certain officers or members of the boards of directors own capital stock in each of the companies.

There is nothing inherently wrong in such an affiliation and it is possible that certain economies can result. But where one of its component members is a public utility enjoying a monopoly position, having an opportunity to collect from consumers rates that will yield, over and above operating expenses, a fair return on its investment, and is largely protected from competition in charging such rates, then the public interest makes it necessary to prevent such investments and expenses from being unreasonably inflated. In order to determine the propriety of the expenses and rate base of Kern Mutual, the transactions between it and Central Western and Medusa were carefully scrutinized by the Commission staff. We find applicant's recorded payments to its affiliates at this time, and for the purposes of this proceeding, to be reasonable. However, applicant is placed on notice that its

relationships with affiliated companies will continue in the future to be closely scrutinized by this Commission.

Results of Operations

A summary of the evidence respecting applicant's over-all rate of return related to an average depreciated rate base as presented by witnesses for applicant and for the Commission staff follows:

Year	Pre-Interim Rates		Rate of Return		Company Requested	
	Applicant	CPUC Staff	Interim Rates CPUC Staff	Interim Rates CPUC Staff	Applicant	CPUC Staff
Recorded 1959	3.61%	-%	-%	-%	-%	-%
Estimated 1960	3.41	4.95	6.7	6.7	7.65	8.86
Estimated 1961	2.80	4.32	6.1	6.1	6.94	8.26

Comparisons of the respective showings on applicant's over-all revenues, expenses, net revenues, rate base and rate of return for the estimated year 1961 follow:

Over-all Results of Operations, Estimated Year 1961

Item	Pre-Interim Rates		Company Requested Rates	
	Applicant	CPUC Staff	Applicant	CPUC Staff
<u>Operating Revenues</u>				
Local Service	\$ 289,710	\$ 293,000	\$ 429,275	\$ 432,400
Toll Service	466,640	481,500	474,640	490,500
Miscellaneous	43,634	46,800	43,634	46,800
Uncollectibles	(8,000)	(5,000)	(8,000)	(5,000)
Total Oper. Revenues	791,984	816,300	939,549	964,700
<u>Operating Expenses</u>				
Maintenance	187,394	175,400	187,394	175,400
Traffic	98,830	94,960	98,830	94,960
Commercial	85,053	80,550	85,053	80,550
Gen. Office Salary and Expenses	109,801	101,090	109,801	101,090
Other	88,714	102,530	88,714	102,530
Subtotal	569,792	554,530	569,792	554,530
Taxes other than Income	63,286	66,270	63,286	66,270
Income Taxes	981	14,340	76,713	95,430
Depreciation	109,427	107,450	109,427	107,450
Total Expenses	743,486	742,590	819,218	823,680
Net Revenue	48,498	73,710	120,331	141,020
Rate Base	1,733,437	1,707,500	1,733,437	1,707,500
Rate of Return	2.80%	4.32%	6.94%	8.26%

(Red Figure)

Witnesses for applicant and for the Commission staff not only presented the results for the over-all company but also presented the separated results for toll operations and for exchange operations. For the estimated year 1961, the separated results may be summarized as follows:

Rate of Return - Separated Operations
(Estimated Year 1961)

	<u>Over-all Company</u>	<u>Inter- changed Toll</u>	<u>Intra- company Toll</u>	<u>Remainder (Principally Exchange)</u>
Pre-Interim Rates				
Applicant (Exh. 4)	2.80%	10.57%	(11.26)%	(.63)%
Staff (Exh. 6)	4.3	10.1	(6.1)	1.8
Interim Rates				
Staff (Exh. 7)	6.1	10.1	(6.1)	4.5
Company Requested Rates				
Applicant (Exh. 4)	6.94	8.60	.40	6.37
Staff (Exh. 6)	8.3	10.1	2.3	7.6

(Red Figure)

The Commission staff also presented separated operating results assuming a cost toll settlement arrangement was in effect.

The staff's estimate of total operating revenues for 1961 exceeds the estimate of applicant by \$24,316 at present rates and by \$25,151 at the requested rates. This difference results primarily ^{from} the estimate of toll revenues. The staff used the present basis of toll settlement between applicant and The Pacific Telephone and Telegraph Company augmented by \$8,500 to give effect to free toll calls given to employees of applicant and to Central Western Company although not provided for in applicant's tariff schedules. Applicant states that its toll revenue estimate is based on a proposed cost settlement for toll traffic interchanged with The Pacific Telephone and Telegraph Company. However, applicant's witness acknowledged that applicant had not yet negotiated a toll cost settlement agreement with Pacific; that its present prorata type toll settlement

agreement is still effective; that neither Pacific nor applicant had given notice of intention to cancel the present settlement agreement; but that it was applicant's intention to negotiate a toll cost settlement agreement within perhaps ninety days. A toll cost settlement would reduce applicant's 1961 gross revenues by approximately \$30,000 based upon the staff's cost estimates at a 7.7 per cent rate of return on intercompany toll business.

The staff's estimates of operating expenses for 1961 give effect to more recent experience than the estimates of applicant. It is significant that applicant's estimate of expenses, exclusive of taxes and depreciation for 1960, total \$537,360 compared with applicant's actual 1960 expenses for such items of \$514,498.

The staff's rate base for the estimated year 1961 is \$25,937, or 1.5 per cent, less than applicant's. This difference is primarily accounted for by the staff's lower allowance for materials and supplies and working cash capital. Applicant's allowance for materials and supplies includes materials for both construction and maintenance purposes, whereas the staff allowed materials to operate and maintain the system. The difference in working cash allowance results from the fact the staff offset the gross working cash requirement by one half the income tax accruals and the company did not.

Staff Recommendations

Five specific recommendations were advanced by the Commission staff as follows:

1. Applicant continue its check of service in the Buttonwillow area and be required to furnish periodic reports on the speed of operator answer at the toll board in Taft, and the available transmission levels in decibels loss between applicant's exchanges and between Taft and Bakersfield.

2. The Commission establish, as required, such permanent rate increases that will not result in unusually large differentials over pre-interim rates for any class of service.

3. Applicant file an appropriate tariff governing its policy regarding concession toll charges to its employees.

4. Applicant use group accounting in computing the depreciation accrual in lieu of unit accounting.

5. Applicant, in negotiating any new cost toll settlement agreement with The Pacific Telephone and Telegraph Company, seek to include applicant's intracompany as well as intercompany toll operations in such cost toll settlement agreement.

Applicant expressed its willingness to comply with the staff's first recommendation. With respect to the third recommendation, applicant stated it had discontinued, as of February 2, 1961, its prior practice of allowing free toll calls to its employees. Applicant was not in accord with the staff's fourth recommendation claiming that its present depreciation practice produces more accurate and reasonable results. With respect to the staff's fifth recommendation applicant stated it had endeavored to negotiate such a cost toll settlement but that no other cost settlement in California of an independent telephone company included the intracompany toll operations and applicant had so far been unsuccessful in negotiating such a cost settlement arrangement.

Findings and Conclusions

After considering all of the evidence of record, the Commission finds and concludes that further increases are warranted and for the purposes of this opinion and order the staff's revenue estimates based upon the presently effective toll settlement agreement, as well as the staff's expense and rate base estimates for 1961 are appropriate and reasonable to use to test applicant's need for rate increases. This proceeding will be reopened to consider the

effect on operating results should applicant in fact negotiate a new toll settlement agreement with Pacific Telephone within a reasonable period.

The Commission further finds and concludes that an order should be issued authorizing increases in rates in the amount of approximately \$24,000 over and above the interim rate levels. Such increase will produce annual gross revenues approximating \$906,020, which, when related to reasonable operating expenses and rate base shown in the following tabulation, will yield a fair and reasonable rate of return to applicant and will produce reasonable earnings on the common stock equity capital.

Estimated Year 1961

Operating Revenues	\$ 906,020
Operating Expenses before Depreciation and Taxes	554,530
Depreciation	107,450
Taxes other than on Income	66,270
Income Taxes	63,370
Total Expenses and Taxes	<u>791,620</u>
Net Revenue	114,400
Avg. Rate Base (Depreciated)	1,707,500
Rate of Return	6.7%

We find the above-tabulated revenues, expenses, rate base and rate of return to be fair and reasonable in the light of the entire record in this proceeding. The rates hereinafter authorized are designed to produce such an indicated result.

In our first interim opinion and order herein increases in rates were authorized primarily in business classifications. No increases, however, were authorized at that time in primary residence rates. Applicant's primary residence rates in certain exchanges have been unchanged for many years and are low in comparison with the residence rates generally in effect elsewhere in California. Increases are being authorized only in primary residence rates in Buttonwillow, McKittrick and Taft exchanges.

For typical classes of primary residence service there is set forth in the tabulation following the present rates together with the rates requested by applicant and the rates being authorized by the order herein.

<u>Residence Service</u>	<u>Per Month</u>			<u>Per Month</u>		
	<u>Present Rate</u>	<u>Requested Rate</u>	<u>Author- ized Rate</u>	<u>Present Rate</u>	<u>Requested Rate</u>	<u>Author- ized Rate</u>
	<u>Buttonwillow Exchange</u>			<u>McKittrick Exchange</u>		
1-Party	\$2.75	\$4.75	\$3.55	\$2.75	\$4.50	\$3.55
2-Party	-	-	-	2.25	3.75	2.85
4-Party	2.00	3.25	2.35	2.00	3.10	2.35
10-Party Suburban	2.25	3.60	2.60	3.20	3.60	3.20
	<u>Taft Exchange</u>					
1-Party	3.25	5.00	4.05			
2-Party	2.75	3.95	3.35			
4-Party	2.25	3.40	2.60			
10-Party Suburban	3.45	3.60	3.45			

- Service not offered.

No increases were requested in basic residence rates in Cuyama exchange and none are authorized by the order herein for that exchange as these rates generally are at a higher level than for the above exchanges.

The order herein will require applicant to prepare and file a complete commercial and economic survey of Valley Acres and Dustin Acres to determine the feasibility of providing graded service to such areas. Applicant also will be required to file bimonthly reports of progress in completing its improvement programs for Derby Acres, Fellows and Buttonwillow and in carrying out the staff's first recommendation as previously set forth herein.

Applicant's discontinuance of its practice in providing concession toll charges to employees adequately takes care of the staff's third recommendation.

With respect to the staff's fourth recommendation, the Uniform System of Accounts prescribed by this Commission for Class A and Class B telephone utilities provides for the use of group accounting in computing the depreciation accrual. Departure from such procedure may not be made except upon application to and authorization by this Commission.

With respect to the staff's fifth recommendation, it is clear that if Pacific Telephone owned the toll lines between applicant's exchanges, then both Pacific's and applicant's costs in handling toll traffic between applicant's exchanges would be reflected in the toll costs underlying the general California intrastate toll rate schedule. It should be pointed out that if applicant is successful in negotiating a cost toll settlement agreement which includes both intercompany and intracompany traffic, the Commission would not be adverse to such an arrangement.

We find, therefore, that the increases in rates and charges authorized herein are justified, that the rates and charges authorized herein are reasonable, and that the present rates and charges, in so far as they differ from those herein prescribed, are for the future unjust and unreasonable.

O R D E R

Based on the evidence of record and on the findings and conclusions set forth in the preceding opinion,

IT IS ORDERED as follows:

1. Kern Mutual Telephone Company is authorized to file in quadruplicate with this 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 and charges 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 furnished on and after May 1, 1961.

2. Within one hundred twenty days after the effective date of this order applicant shall file with this Commission the results of a complete commercial and economic survey of Valley Acres and Dustin Acres together with applicant's recommendation thereon as to the feasibility of providing graded service to such areas on the basis of a special rate area or otherwise.

3. Applicant shall conduct at least monthly checks of the quality of service being furnished in the Buttonwillow area, of the speed of operator answer at the toll board in Taft, and of the transmission levels between its exchanges and between Taft and Bakersfield for a period of at least six months from the effective date of this order. Bimonthly reports of the results of such checks shall be filed with this Commission starting seventy-five days after the effective date of this order.

4. Applicant shall complete its 1961 improvement program for Derby Acres, Fellows and Buttonwillow by no later than September 30, 1961 and shall file bimonthly reports of progress in completing such program until such program has been completed starting thirty days after 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, 4th day of April, 1961

[Signature]
President
[Signature]
[Signature]
[Signature]
Commissioners

APPENDIX A

RATES

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

Schedule No. A-1,
Flat Rate Exchange Service

The following monthly residence service rates are authorized:

<u>Residence</u>	<u>Flat Rate Per Month - Each Station</u>			
	<u>Buttonwillow</u>	<u>Cuyama</u>	<u>McKittrick</u>	<u>Taft</u>
Individual Line	\$3.55	\$4.50*	\$3.55	\$4.05
2-Party Line	-	-	2.85	3.35
4-Party Line	2.35	3.10*	2.35	2.60

* Presently effective rate.
- Service not offered.

Schedule No. A-S,
Suburban Service

The following monthly residence service rates are authorized:

<u>Residence</u>	<u>Flat Rate Per Month - Each Station</u>			
	<u>Buttonwillow</u>	<u>Cuyama</u>	<u>McKittrick</u>	<u>Taft</u>
10-Party Line	\$2.60	\$3.60*	\$3.20*	\$3.45*

* Presently effective rate.