EP

Decision No. 66389

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for authority to establish extended service between its Morro Bay and Cayucos exchanges; and to withdraw message toll telephone service rates as applicable between said exchanges.	Application No. 44383 (Filed April 24, 1962)

Arthur T. George and Maurice D. L. Fuller, Jr., by Maurice D. L. Fuller, Jr., for The Pacific Telephone and Telegraph Company, applicant.

Ralph Hubbard, for California Farm Bureau Federation, interested party.

James G. Shields, for the Commission staff.

O P I N I O N

Hearing

This matter was heard at Morro Bay on October 30, 1962 and taken under submission on receipt of three late-filed exhibits received on November 15, 1962. Thereafter, on March 19, 1963 by order of the Commission, submission was set aside and the matter was consolidated for further hearing with Case No. 7409 and several other extended service matters. Petition for rehearing of the Commission's order of March 19, 1963 and motion to reconsider and rescind said order were filed on March 27, 1963. The Commission has issued its order rescinding in part said order of March 19 and this matter was resubmitted on October 1, 1963. This application now is ready for decision. Copies of the application and notice of hearing were served in accordance with the Commission's procedural rules.

At the hearing on October 30, 1962 applicant presented exhibits and testimony through three witnesses in support of its request. In response to requests by the Commission and its staff, the company produced data showing the results of a postcard survey of Cayucos subscribers[1/] and data showing estimated exchange earnings of 1.08 percent under proposed rates. Twenty-five witnesses representing various civic organizations, agricultural and community associations and individuals endorsed applicant's proposal. No one testified or appeared in opposition to the application.

Applicant's Request

Applicant requests, pursuant to Section 454 of the Public Utilities Code, authority to:

1. Introduce nonoptional extended area service between its Morro Bay and Cayucos exchanges.

2. File and make effective the rates set forth on Exhibit C attached to the application coincident with the establishment of the proposed nonoptional extended area service.

3. Cancel and withdraw rates for message toll telephone service between Morro Bay and Cayucos exchanges.

Present Service

Applicant presently is providing telephone service in Morro Bay and in Cayucos exchanges, both located in San Luis Obispo County. These exchanges are contiguous. Calls between them are now toll calls.

The relative size of these two exchanges as of the end of 1961 is indicated by the following:

Exchange	Telephone Stations	Area in Square Miles
Morro Bay	2,731	40
Cayucos	775	58

1/ A total of 680 post cards were sent out to Cayucos subscribers. There were 550 cards returned of which 408 favored applicant's plan at the rates it proposed and 137 who were not in favor in the plan.

Present and Proposed Rates

Toll charges now apply over the proposed extended service route. The day station initial period toll rate presently in effect between Morro Bay and Cayucos is 10 cents. Under applicant's proposal this toll rate would be canceled at the time nonoptional extended service is established.

The following tabulation compares the present exchange rates with those proposed by applicant for nonoptional extended service for the principal classifications of service.

Classification	Rate Per Month			
	Morro Bay Exchange		Cayucos Exchange	
	Present	Co. Proposed	Present	Co. Proposed
Business				
1-Party	$7.00	$7.00	$6.50	$7.30
2-Party	5.60	5.60	5.10	5.75
Suburban	5.10	5.10	4.85	5.30
Residence				
1-Party	4.40	4.40	4.15	4.60
2-Party	3.60	3.60	3.35	3.75
4-Party	3.00	3.00	2.75	3.05
Suburban	3.50	3.50	3.25	3.55

Findings

From the evidence, the Commission finds that consummation of the proposals of applicant, whereby extended service between the Morro Bay and Cayucos exchanges would replace existing toll charges between them, is in the public interest. Further, the Commission finds that (1) the increases in rates and charges for the telephone service authorized herein are justified and (2) the present rates and charges, insofar as they differ therefrom, will become unjust and unreasonable on such date as extended service is provided.

The rates, charges and conditions of service for the extended area type of service authorized herein are subject to the continuing jurisdiction of this Commission and may for good cause be altered, amended or discontinued by further order of the Commission in the lawful exercise of its jurisdiction.

The Commission takes notice of the fact that on August 30, 1963 the applicant filed Application No. 45726 to increase rates in this and other areas of the State. The rates requested therein for this extended area exceed the monthly rates authorized by this decision by up to 85 cents per month on residence service and up to $2.05 per month on business service. Therefore, the customers are placed on notice that the rates authorized herein are subject to increase or other revision in Application No. 45726 or other appropriate rate proceeding, should the Commission find such increase or revision justified.

The fundamental issue of rate spread for extended service is not disposed of in this proceeding as it is at issue before the Commission in Case No. 7409 and Application No. 45726.

O R D E R

IT IS ORDERED as follows:

1. Applicant, after the effective date of this order and on or before July 1, 1965, is authorized to initiate nonoptional extended area service between its Morro Bay and Cayucos exchanges, to establish rates for such extended service in its Morro Bay and Cayucos exchanges as set forth in Appendix A hereof, to cancel rates for local service within its Morro Bay and Cayucos exchanges and to cancel and withdraw message toll telephone rates and service between its Morro Bay and Cayucos exchanges.

2. Necessary tariff schedule filings are authorized to be made in accordance with General Order No. 96-A and, after not less than ten days' notice to the public and to this Commission, such tariff filings shall be made effective coincident with the offering of non-optional extended service as set forth in ordering paragraph 1 hereof.

3. The authority granted herein will expire if not exercised by July 1, 1965.

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

Dated at San Francisco, California, this 26th day of November, 1963.

President

Commissioners

I dissent.
George G. Grover

I dissent.
Frederick B. Holoboff

APPENDIX A

RATES

Classification	Rate Per Month* Morro Bay	Cayucos
Business		
1-Party	$ 7.00	$ 7.30
2-Party	5.60	5.75
Suburban	5.10	5.30
Semipublic	.75 plus .21 per day	.75 plus .21 per day
PBX Trunks	10.50	10.75
Residence		
1-Party	4.40	4.60
2-Party	3.60	3.75
4-Party	3.00	3.05
Suburban	3.50	3.55

* Other rates, rules and regulations in accordance with exchange tariffs on file with or which may be authorized by the California Public Utilities Commission.

DISSENTING OPINION OF COMMISSIONER HOLOBOFF

I dissent.

A certain historical background is necessary. In Application No. 44201,[1] applicant proposed extended area service rates in the Auburn-South Placer area which were estimated to produce a rate of return of 0.38 percent. By Decision No. 64697, the Commission granted the sought authority upon condition that "...Pacific will not seek to recoup from ratepayers but will take from its profits any inadequacy in exchange revenues that may result in the Auburn-South Placer area under its voluntarily offered Plan A service and rates ..." This condition was imposed because it was the concern of the Commission that: (1) it would be unfair and unreasonable to subscribers in the Auburn-South Placer area if Pacific were to propose extended area service (EAS) at the rates set forth in its application, seek and obtain support of subscribers in the area for such plan and rates and then, following authorization and introduction of such service, seek increased rates to raise its rate of return in the area above 0.38 percent; and (2) it would be unfair and unreasonable to ratepayers in other areas of the State if, following authorization and introduction of service, Pacific were then to seek to impose higher rates upon such other ratepayers in order to make up for deficiencies in earnings in the Auburn-South Placer area.

By its petition for rehearing of Decision No. 64697, Pacific expressed its unwillingness to accept the aforesaid condition. While the petition for rehearing was being considered, it

1 In Application No. 44201 applicant sought to consolidate its Applegate and Auburn exchanges into an enlarged Auburn exchange; establish the Meadow Vista special rate area; consolidate its Loomis, Newcastle and Penryn and Rocklin exchanges into a single exchange to be called South Placer; file its proposed extended service rates for Auburn and South Placer; and cancel existing exchange, foreign exchange and toll rates.

was brought to the attention of the Commission that a similar problem existed in each of five other pending applications for extended area service in the State, including this one.[2] In order to avoid reaching inequitable results from a piecemeal handling of these six applications, the Commission, on March 19, 1963, granted rehearing of Decision No. 64697, and consolidated all six matters with Case No. 7409, its pending investigation of Pacific's overall operations in California. It was the Commission's opinion that Case No. 7409 was an appropriate proceeding within which to make a comprehensive examination of such rate relationships by areas and, in fact, Case No. 7409 does involve the issue of rate spread.

In this connection, it is interesting to note that counsel for Pacific also thought that Case No. 7409 was appropriate for this purpose. At the hearing on Application No. 44201 (Auburn-South Placer) at Tr. p. 806, he stated:

> "I think that this sort of a problem about relative exchange rates of return should be reserved for general rate cases where the Commission has before it the whole area of operation and can therefore decide this sort of an issue in context with that whole problem.
>
> "If you change it here, and then you get to monkeying with it in these various extended area service cases, you'll never get the thing straight. Whereas, the Commission now has before it a general rate case where the whole problem may be taken up and solved very neatly."

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2 Besides Application No. 44201 and this application, the four other applications and the estimated before and after EAS rates of return were: No. 44262 (Aptos-Watsonville), 2.04 percent before and 2.03 percent after; No. 44289 (Fort Bragg-Mendocino), minus 0.08 percent before and minus 0.29 percent after; No. 44383 (Morro Bay-Cayucos), 1.24 percent before and 1.08 percent after; No. 44899 (Eureka Area or Humboldt County), 3.02 percent before and 3.12 percent after.

Since the filing of these applications, Pacific has filed the following additional applications seeking establishment of extended area service: Applications Nos. 45397 (Merced), 45702 (Vacaville-Suisun), 45703 (Imperial), 45783 (Paso Robles), 45803 (Lodi, etc.), 45810 (Placerville), 45903 (N. San Diego), 45934 (Santa Rosa). The total amount of the additional gross revenues necessary to maintain the present rates of return in these matters, exclusive of Auburn-South Placer for which information is not available, appears from the applications or evidence to be in the order of $380,000.

The California Farm Bureau Federation, together with numerous other parties, moved the Commission to rescind its order of consolidation. The Commission, by its order dated October 1, 1963, reversed itself and severed these six matters for separate handling. No decision responsive to its grant of rehearing of Decision No. 64697 (Auburn-South Placer) has been issued as of this date.

By its order of consolidation, the Commission had recognized that there was a serious problem concerning rate spread and took a forthright and logical step looking toward its solution. By its order rescinding the consolidation and by the decision herein,[3] the Commission has yielded to local demand, and has resorted to a short-range expedient, an expedient which will make the necessary ultimate solution infinitely more difficult. Commissioner Grover and I dissented to the order rescinding consolidation and to the three decisions referred to in footnote 3.

The majority decision herein finds that the proposed rates are justified and reasonable. Yet, the decision states no basis whatever for such findings other than the fact that those members of the public who appeared at the hearings in the areas concerned endorsed applicant's proposal. The evidence of record, with the exception of the evidence of local support, all points to the unreasonableness of the proposed and authorized rates. The evidence in this and the three other similar matters since decided strongly suggests that a serious rate burden is and will be cast upon Pacific's subscribers elsewhere in California due to the low rate of return resulting from present and proposed operations.

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3 Three similar decisions were issued on November 26, 1963. They are: Decision No. 66387 in Application No. 44262 (Aptos-Watsonville), Decision No. 66388 in Application No. 44289 (Fort Bragg-Mendocino), Decision No. 66389 in Application No. 44383 (Morro Bay-Cayucos).

In this case, the majority opinion merely mentions the fact that under the proposed service the combined rate of return[4] for the exchanges involved was estimated by the Commission staff to be only 1.98 percent. Yet, it is this very evidence which is the measure of the revenue deficiency in these exchanges, a deficiency for which subscribers elsewhere in the State will be required to compensate through their exchange rate payments. The opinion does not mention at all the fact that the 1.98 percent return represents a decline from the 2.22 percent combined return resulting from operations under present service. In other words, the majority has determined that it is reasonable to authorize Pacific to provide a metropolitan type of service at noncompensatory rates in an area which does not adequately support even the existing exchange service. Parenthetically, it is interesting to note the disparate return relationships among the several exchanges involved. The staff's Exhibit 5 shows that under present serving arrangements the estimated ratios of balance net revenue to average plant and working capital for the 12 months ended June 30, 1961, were as follows: Napa 3.0 percent, St. Helena minus 0.12 percent, Yountville minus 0.46 percent, and Calistoga 0.49 percent, for a combined ratio of 2.22 percent.

To put the matter in more meaningful terms, the decline in the combined return from 2.22 percent to 1.98 percent represents a gross revenue deficiency of $29,000 (Tr. p. 64). This means that if EAS rates were to be authorized to yield the 2.22 percent being realized under present service, the rates authorized herein would have to be increased by about 14¢ per main station per month.[5]

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4 As measured by the ratio of balance net revenue to average plant and working capital (Exhibit 5).

5 Based upon 17,452 main stations per Commission records.

But, since such higher rates were neither proposed nor authorized, and since the Commission has not seen fit to impose a condition such as it did in Decision No. 64697, the $29,000 deficiency in gross revenues sooner or later will have to be made up by subscribers elsewhere. It should be emphasized that the foregoing is a measure of the additional support which subscribers elsewhere will be required to provide as a result of this decision. That substantial support is already being provided by subscribers elsewhere is seen from the fact that for the year 1961, applicant's statewide, separated exchange earnings were in the order of 6.5 to 7 percent (Tr. p. 65). A reasonable measure of this support can be derived from the evidence to the effect that, if rates were authorized to yield even a 6 percent return, they would have to be sufficient to produce $478,000 of gross revenues over and above the gross revenues estimated to be produced at the rates authorized by the majority decision. (Tr. p. 65) This increase would be equal to $2.28 per main station per month, using the same number of main stations previously mentioned.

But decline in rate of return provides only a partial measure of the extent to which subscribers elsewhere will be required to support the EAS here authorized. There would be an additional burden imposed on subscribers elsewhere even if the rates were designed to yield 2.22 percent. This comes about as a result of growth in rate base. The EAS here authorized will require plant changes which will increase exchange net plant and working capital by an estimated $98,000 and this is generally true of all these EAS proposals.[6] When the rate base is thus increased, the

6 The total increase in net plant and working capital after EAS for the thirteen matters mentioned (Auburn-South Placer excluded due to lack of information) appears from the applications or the evidence to be approximately $7,687,000.

company's overall revenue requirements are correspondingly increased i. e., more dollars of revenue must be produced to achieve any given rate of return for its overall operations. Now, if the revenues to be produced from these exchanges after EAS are not to be any greater than result from application of the same rate of return as before EAS, the subscribers in these exchanges will not have shared in proportion to other exchanges in satisfying such increased revenue requirements. The resulting deficiency must therefore be made up by subscribers elsewhere. Thus, there is imposed on such subscribers a greater burden of supporting these exchanges after EAS than before.

Viewed in isolation, the problem presented by this case, or even all of the cases mentioned, may not seem imposing. It is significant to note, however, that the problem is located in an area of the company's operations which is already deficient in meeting its overall revenue requirements. An example of this is seen in the fact that about 23 percent of the company-claimed $2,054,000,000 intrastate rate base devoted to exchange operations earns about 3.13 percent. This 23 percent is comprised of all exchanges other than exchanges in the three metropolitan extended areas of San Francisco-East Bay, Los Angeles and San Diego.[7] The action taken here and in the matters since decided can have no other effect than to aggravate this situation.

At this point it should be observed that ratemaking requires a reconciliation with certain regulatory facts of life. Among them is the fact that we must tolerate support of areas that could not afford service at fully compensatory rates by areas that produce higher than reasonably compensatory revenues. The alternative would be to tolerate denial of necessary public utility

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7 Calculated from Pacific's Exh. 115 in Case No. 7409.

services which would result from prohibitively high rates.[8] Where we have a service area the size of Pacific's, the wide variances in population densities and other service conditions make it impossible for every exchange or even every conveniently delineated geographic area to pay its way fully. As already mentioned, for example, the rates authorized herein would have to be increased about $2.28 per main station per month in order to yield a 6 percent return and it is doubtful whether these subscribers would find their need for this service so great as to impel them to pay such an increase. Thus, in order that essential telephone services be provided throughout the entire State at reasonable rates, the more densely populated areas must be required to support the more sparsely populated rural areas. Even so, it is one thing to accept the need for such support but quite another thing to determine how much is in the public interest. My concern is with the latter.

When the Commission had before it these six applications involving a common problem, it had before it the question of how much of such support is in the public interest. This problem cannot be resolved without considering the effect of these applications on subscribers elsewhere. By referring to the fact that the Commission may in the future adjust these rates upward either as a result of Pacific's pending rate applications or as a result of the spreading of rates in Case No. 7409, the majority admits that the solution to the problem lies in a comprehensive examination such as Case No. 7409 affords. Case No. 7409 is now pending before the Commission but the majority, in taking this action, has determined that the issue need not be dealt with now.

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8 The extent to which such support has been claimed to be required is found in Pacific's Application No. 39309, wherein it sought rates which would have resulted in the following rates of return by areas: San Francisco-East Bay Extended Area, 8.78 percent; Other Northern California Exchanges, 3.74 percent; Los Angeles Extended Area, 9.24 percent; San Diego Extended Area, 4.94 percent; Other Southern California Exchanges, 3.30 percent. (Exhibit 87)

While inconsistent, such a position might be palatable if it did not involve acting unfairly toward the subscribers affected by this decision. It is exactly this that the Commission sought to avoid in Decision No. 64697 (Auburn-South Placer) when it said:

> "It would be unfair and unreasonable to subscribers...for Pacific to voluntarily propose introduction of Plan A (EAS) at the level of rates set forth in its application, seek and obtain support of subscribers in the area for such plan and rates, and, following authorization and introduction of service, for Pacific to then seek increased rates ..."

But here, and in the three other similar matters since decided, the majority apparently does not hold the concern about fairness to the subscribers that was expressed in Decision No. 64697. It should be noted that the Commission's concern as expressed in the aforesaid decision has already been confirmed by Pacific's pending application for rate increases, in which it is proposed that the rates authorized herein be increased by as much as $1.80 per month for business subscribers and 85¢ for residential.

The unfairness to the subscribers is highlighted by the majority's heavy reliance upon local support for this EAS proposal. The subscribers here have been offered a Cadillac at Volkswagen prices so that their enthusiastic support is understandable. But are they aware that at some indefinite time in the future they may be required to pay the Cadillac price? And do they realize that at that time, they will not even have a choice in the matter, for EAS is nonoptional? Once EAS is authorized, as it now has been by the majority decision, the individual subscriber does not have the choice of going back to the old serving arrangements. I wonder how enthusiastic the support would be if the proposed rates were designed to yield even a 4 percent return. Under the circumstances, public support is an unreliable yardstick of the need for the service and when the majority bases its authorization thereon, it merely inveigles the public.

From the applicant's standpoint, it is of course advantageous to expand its EAS operations. Broad use of EAS does two things for applicant: First, EAS stabilizes the company's revenues by substituting flat rate revenues for the more variable toll revenues, and second, it expands the earnings bases because of the required plant changes. The sure way of selling EAS to the subscribers is to propose low rates at the beginning so that the subscribers will think they are getting something for nothing. "Extended area service" and "toll free calling" are terms often used to promote this kind of service. Both terms are beguiling misnomers. Extended area service eliminates toll service at existing toll rates and substitutes a service at an increased rate which becomes the basic monthly charge paid by all subscribers. Subscribers who have heavy toll usage in the area benefit; those who have little or no toll usage and those whose existing exchange service and access to toll facilities are adequate for their needs (quite often the majority of subscribers), must pay at increased rates for a service which they have no option to refuse and which is often of no substantial benefit to them. Thus, EAS provides no new service not already available; essentially it is a different method of paying (more accurately, of collecting) for the same service through a higher flat rate per month rather than through toll rates.

The nonoptional feature of EAS is the thing that will make an after-the-fact solution of this problem difficult. If, upon a comprehensive examination of rate relationships, it is found that the reasonable limit of rate support by other areas has been reached, the only available alternative will be to increase these EAS rates in order to satisfy the company's revenue requirement. The problem

of avoiding the imposition of unreasonably high rates on some subscribers may be formidable indeed. Individual handling of these matters provides no accurate indication of what their cumulative effect will be when the day of reckoning comes. On this record alone, there is no way of telling whether the authorized rates are reasonable as measured by their relationship to rates elsewhere. All the indications are that the rates are unreasonably low.

/s/ Frederick B. Holoboff
FREDERICK B. HOLOBOFF, Commissioner

Dated December 27, 1963
San Francisco, California

A.44363 Dissent NB

I concur in the dissenting opinion prepared by Commissioner Holoboff. It is gratifying that he has taken the time and the care to explain the problems involved in these cases and the reasons for his vote. The bare-bones boilerplate of the majority opinion presents a striking contrast.

Equally striking is the difference between this current style in majority opinions and the former willingness, even of the majority, to publish explanations. Not too long ago such things as cost, traffic volumes, community of interest factors, and other relevant elements were discussed in decisions on this subject. (See Decision 62689 in Application 43151, Case 7047, Case 7092, 59 Cal PUC 134; Decision 62657 in Application 43430, 59 Cal PUC 133; Decision 61868 in Application 42978, 58 Cal PUC 639.) In contrast, the latest orders on extended service are decidedly tight-lipped.

/s/ George G. Grover
GEORGE G. GROVER, Commissioner