

**ORIGINAL**

Decision No. 70267

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application )  
of )  
) )  
SAN MIGUEL TELEPHONE COMPANY OF )  
CALIFORNIA and THE REDWOOD EMPIRE )  
TELEPHONE SYSTEM )  
) )  
for authorization )  
) )  
(1) to merge THE REDWOOD EMPIRE )  
TELEPHONE SYSTEM into SAN MIGUEL )  
TELEPHONE COMPANY OF CALIFORNIA; )  
(2) to issue 3,099 shares of the )  
capital stock of SAN MIGUEL )  
TELEPHONE COMPANY OF CALIFORNIA )  
to effect such merger; )  
(3) to issue and sell 1,000 )  
additional shares of the capital )  
stock of SAN MIGUEL TELEPHONE )  
COMPANY OF CALIFORNIA; and )  
(4) for SAN MIGUEL TELEPHONE )  
COMPANY OF CALIFORNIA to borrow )  
\$279,000.00. )

Application No. 47801  
Filed August 11, 1965

Bacigalupi, Elkus, Salinger & Rosenberg, by Alvin H. Pelavin, for applicants; Ralph Hubbard, for California Farm Bureau Federation, interested party; and R. T. Perry and S. J. Webb, for the Commission staff.

O P I N I O N

This is an application for an order of the Commission authorizing (1) The Redwood Empire Telephone System to merge into San Miguel Telephone Company of California pursuant to an Agreement of Merger; (2) San Miguel Telephone Company of California to issue capital stock having an aggregate par value of \$40,990; and (3) San Miguel Telephone Company of California to execute an Amendment to its Loan Contract with the United States of America, acting through the Administrator of the Rural

Electrification Administration, and to issue mortgage notes in the aggregate principal amount of \$279,000.

After due notice, a public hearing in this matter was held before Examiner Valena in San Francisco, on November 22, 1965, at which time the application was amended to provide for an alternate form of notes, and the matter was taken under submission. The Commission has received no protests in the proceeding.

San Miguel Telephone Company of California is a corporation organized under the laws of the State of California on or about February 18, 1963. By Decision No. 68384, dated December 22, 1964, in Application No. 46009, the company, upon acquiring the public utility telephone system and properties of its predecessor, San Miguel Telephone Co., was granted authority to issue 3,480 shares of \$10 par value capital stock and, as evidence of borrowings from the United States of America, acting through the Administrator of the Rural Electrification Administration, to issue mortgage notes aggregating \$597,000. The utility is presently engaged in the business of rendering public utility telephone service in portions of San Luis Obispo and Monterey Counties. The record shows that Joseph S. Ray, President of the corporation, owns over 90 percent of its outstanding stock and that he is also the President and sole shareholder of The Redwood Empire Telephone System, a California corporation conducting public utility operations in parts of Sonoma County.

The evidence indicates that The Redwood Empire Telephone System has experienced an increased demand for telephone services and upgrading of such services. The utility asserts that it has been unable to satisfy such demands because of the

lack of sufficient current income and the unavailability of adequate amounts of financing through conventional channels. Exhibit C, attached to the application, shows that a condition for obtaining required funds from the Rural Electrification Administration is that San Miguel Telephone Company of California shall acquire the telephone system and business of The Redwood Empire Telephone System. In order to comply with such condition, applicants have entered into an Agreement of Merger whereby The Redwood Empire Telephone System will merge into San Miguel Telephone Company of California. Exhibit B, attached to the application, is a copy of said agreement which provides, among other things, that the separate corporate existence of The Redwood Empire Telephone System will cease upon such merger and that San Miguel Telephone Company of California shall succeed to all rights and property and shall be subject to all debts and liabilities of both companies.

San Miguel Telephone Company of California, as the surviving corporation, seeks permission to issue 3,099 shares of its capital stock having an aggregate par value of \$30,990 in exchange for the outstanding 2,500 shares of capital stock of The Redwood Empire Telephone System having an equivalent stated value. The evidence indicates that the resulting acquisition adjustment will be consistent with that which now exists.

The surviving corporation reports that it has negotiated with the Rural Electrification Administration to amend its Loan Contract in order to provide for a \$279,000 increase in its long-term indebtedness to a resulting aggregate principal amount of not to exceed \$876,000. The borrowing will follow the usual terms for loans made through the Rural Electrification Administra-

tion and will be evidenced by 35-year mortgage notes bearing interest at the rate of 2 percent per annum. The debt to be represented by said notes will be secured by the existing Mortgage of Realty and Chattels, as amended or supplemented. The note proceeds will be applied toward the acquisition and expansion of telephone plant relating to the Cazadero Exchange of The Redwood Empire Telephone System and to the retirement of open accounts or short-term debt incurred in connection with the acquisition or construction of such plant as set forth in the Master Telephone Budget, a copy of which is attached to the application as Exhibit D. None of the proceeds will be expended in connection with the Sea Ranch or Timber Cove areas, which The Redwood Empire Telephone System has been authorized to serve by decisions of this Commission rendered in 1964 and 1965. The surviving corporation contemplates filing a separate application, or applications, relative to obtaining Rural Electrification Administration financing pertaining to such areas.

Pursuant to a requirement contained in the Amendment to its Loan Contract, San Miguel Telephone Company of California proposes to obtain the sum of \$10,000 from the issue and sale of an additional 1,000 shares of its \$10 par value capital stock, at par, to Joseph S. Ray, which amount will be in the forms of cash and cancellation of short-term debt. It appears that the cash proceeds and the short-term debt to be repaid will be, or have been, used for plant expansion or the retirement of open accounts or other temporary loans for such expansion.

Applicants assert that the proposed merger and the combined operation and financing of their systems are in the best interests of the public and will result in more efficient service and economies in operations. According to the application, separate continuing property records will be maintained for each of the areas involved in the merger.

The Commission has considered this matter and finds that: (1) the proposed merger will not be adverse to the public interest; (2) the proposed notes and issues of stock are for proper purposes; (3) the money, property or labor to be procured or paid for by the issues of notes and stock herein authorized is reasonably required for the purposes specified herein; (4) such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income; (5) the proposed Supplemental Mortgages will not be adverse to the public interest; and (6) there will be no change in rates as a result of the proposed merger. On the basis of these findings we conclude that the application should be granted.

In issuing our order herein, we place the surviving corporation and its shareholders on notice that we do not regard the number of shares outstanding, the total par value of the shares nor the dividends paid as measuring the return the company should be allowed to earn on its investment in plant and that the authorization herein given is not to be construed as a finding of the value of the company's stock or properties nor as indicative of amounts to be included in proceedings for the determination of just and reasonable rates.

O R D E R

IT IS ORDERED that:

1. The Redwood Empire Telephone System may merge into San Miguel Telephone Company of California in accordance with the terms of an Agreement of Merger in the same form, or in substantially the same form, as Exhibit B attached to the application.

2. Pursuant to the terms of said agreement, San Miguel Telephone Company of California, as the surviving corporation under the merger, may issue not to exceed 3,099 shares of its common stock in exchange for all the outstanding shares of common stock of The Redwood Empire Telephone System and may assume all liabilities and obligations of the latter corporation.

3. San Miguel Telephone Company of California may execute and enter into an Amendment to its Loan Contract with the United States of America, acting through the Administrator of the Rural Electrification Administration, and may issue mortgage notes in the aggregate principal amount of not to exceed \$279,000, in the form and for the purposes described in the application.

4. San Miguel Telephone Company of California may execute and deliver such Supplemental Mortgages as are required under the terms of said Loan Agreement.

5. San Miguel Telephone Company of California may issue and sell an additional 1,000 shares of its common stock in compliance with the terms of said Amendment to its Loan Contract, and shall use the proceeds for the purposes specified in this proceeding.

6. San Miguel Telephone Company of California shall file with the Commission a report, or reports, as required by General Order No. 24-B, which order, insofar as applicable, is hereby made a part of this order.

7. As the surviving corporation under the merger, San Miguel Telephone Company of California may enter into and engage in the telephone business in the territory which The Redwood Empire Telephone System is authorized to serve.

8. Upon consummation of the merger, The Redwood Empire Telephone System is authorized to cease public utility operations in, and to withdraw from, the territory served by said company.

9. San Miguel Telephone Company of California shall file, within five days after the effective date of the merger, a notice of adoption of the presently filed tariff schedules of The Redwood Empire Telephone System.

10. The tariff schedules of The Redwood Empire Telephone System, now on file with this Commission, shall be refiled within thirty days after the effective date of the merger under the name of San Miguel Telephone Company of California, in accordance with the requirements of General Order No. 96-A, except that San Miguel Telephone Company of California may withdraw such rules and standard forms of The Redwood Empire Telephone System as are substantially identical with those of San Miguel Telephone Company of California, and the withdrawal of which will not result in increases in rates or more restrictive conditions than the presently filed tariffs of The Redwood Empire Telephone System.

11. San Miguel Telephone Company of California, after the consummation of the merger, shall maintain its records in such form as to provide a segregation of accounts relating to the plant investment and pertinent rate base items, as well as the revenues and expenses, of the system being acquired through merger.

12. Within sixty days after the consummation of the merger, San Miguel Telephone Company of California shall file with the Commission a copy of each journal entry used to record the merger on its books of account.

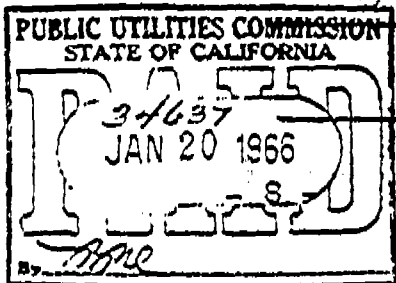
13. On or before the end of the third month after the consummation of the merger as herein authorized, San Miguel Telephone Company of California shall cause to be filed with the Commission, in such form as the Commission may prescribe, an annual report, or reports, related to the operations of The Redwood Empire Telephone System for the period commencing with the first day of the current year to and including the effective date of the merger.

14. This order shall become effective when San Miguel Telephone Company of California has paid the fee proscribed by Section 1904(b) of the Public Utilities Code, which fee is \$279.

Dated at San Francisco, California,  
this 18<sup>th</sup> day of JANUARY, 1966.

Frederick B. Hallock  
President  
George J. Hoover  
Augustin

*I will file a report*  
*Chas E. Mitchell*



Commissioners




A. 47801

CONCURRENCE

BENNETT, William M., Commissioner, Concurring Opinion:

While it is clear by virtue of my previous dissent that I would not have authorized the granting to Redwood Empire Telephone System the authority requested, we are confronted with a public utility unable to render public utility telephone service. It is plain that absent the financial capability to do so, expanded services and upgrading of such services cannot be expected, but the financial deficiency has been overcome in the proposed merger so that sufficient capital can be obtained to satisfy public utility obligations. I concur, therefore, in the order.

  
WILLIAM M. BENNETT  
Commissioner

San Francisco, California  
January 18, 1966

COMMISSIONER PETER E. MITCHELL DISSENTING:

The evidence contained in the record of hearing on this application indicates that neither the authorization of the Redwood Empire Telephone System (Redwood) and San Miguel Telephone Company (San Miguel) to merge nor the approval of San Miguel to issue mortgage notes amounting to \$279,000 would be in the public interest.

There is no showing that the merger of Redwood and San Miguel will contribute to the over-all benefit of the subscribers of the two companies. Indeed, the recent economic history of the two companies fails to support a merger. Table IV (Exhibit 5), the Economic Feasibility Study, introduced by the Commission staff at the hearing, reveals as follows:

## RECORD OF EARNINGS AND COMPARATIVE DATA

Net Earnings  
Source: Annual Reports

Year	San Miguel		Redwood	
	Before Fixed Charges	After Fixed Charges	Before Fixed Charges	After Fixed Charges
1960	\$ 9,444.60	\$ 6,059.14	\$ (592.02)	\$ (592.02)
1961	(6,562.52)	(12,075.63)	(468.16)	(468.16)
1962	(24,850.40)	(41,002.45)	(10,590.87)	(10,646.26)
1963	3,982.60	(20,153.57)	(4,461.96)	(4,914.01)
1964	(240.65)	(21,650.52)	(414.72)	(4,333.69)

(Red Figure)

Without detailing at great length other pertinent information submitted by the Commission staff, it is important to note that expenses per average station for both San Miguel and Redwood are con-

siderably higher than the mean of sixteen Class C telephone companies in California. The results of operation, based on so-called fifth-year estimated data, indicate that even for the future, the Cazadero exchange of Redwood will have a gross revenue deficiency of \$19,000.<sup>2/</sup>

The Commission is confronted with irrefutable evidence then that both San Miguel and Redwood have been operating at a loss for the last five years and apparently will continue to do so. But, in addition, the expenses of both companies are substantially higher than those of similar telephone companies operating in California.

The area coverage design report introduced by the applicant (Exhibit 1) describes the existing telephone system of Redwood as follows: "Although the present outside plant is not very old, much of it has suffered serious damage from storms and initial poor construction". It concludes that: "Because deterioration of the present outside plant and its inadequacy for the new systems, it must be entirely replaced". The central office equipment of Redwood will be replaced; most of the main stations will be replaced. In essence, the Redwood telephone system is to be completely rebuilt.

Succintly, both San Miguel and Redwood are losing money. Redwood must rebuild almost completely its Cazadero system and does not have the capability to do so. Redwood has other immediate commitments in areas not yet developed, to wit, Timber Cove and Sea Ranch, that can only be an additional drain on its financial position. Continuous deficit financing may or may not be the answer for the utility; it is not the answer for the residents of the areas

---

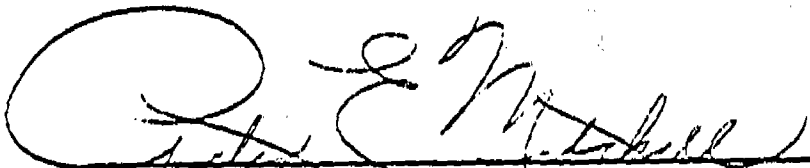
<sup>2/</sup> Based on 3.2% rate of return used where no specific rate of return previously established for REA financed companies.

certificated to the company. They expect immediate and adequate service at reasonable rates not just today but for the future. The time for the Commission to act is now - when it may be able to help the utility and its subscribers.

The \$279,000 received from the REA will be used to rebuild and expand only the Cazadero exchange of Redwood. The Commission has heretofore authorized Redwood to serve the Timber Cove area and the Sea Ranch. However, none of the funds authorized by the majority will be used for these two areas. Redwood must seek in the future additional financing from the REA.

There is nothing in the record to show any benefit to the subscribers of either San Miguel or Redwood. Indeed, San Miguel becomes subject to all debts and liabilities of both companies. It is obvious that the surviving corporation will eventually file for a rate increase based on the past history of operations.

Reviewing the operations of San Miguel and Redwood, their financial structures, and their future commitments, I cannot support the decision. It appears that extension of service by San Miguel into Timber Cove, Sea Ranch, or any new territory, will only further weaken its ability to provide adequate service at reasonable rates to the public.

  
Peter E. Mitchell, Commissioner

San Francisco, California

January 21, 1966