ds.

ORIGINAL

Decision No. 71417

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of DUCOR TELEPHONE COMPANY, a California corporation, for (i) an order authorizing it to increase its telephone exchange rates and charges; and (ii) an order authorizing additional borrowing secured by a mortgage on its assets as security therefor.	Application No. 48221 (Filed February 1, 1966; Amended June 9, 1966)

Bacigalupi, Elkus, Salinger & Rosenberg, by William G. Fleckles, for applicant.
California Farm Bureau Federation, by William L. Knecht, interested party.
R. T. Perry and K. K. Chew, for the Commission staff.

O P I N I O N

After due notice, public hearing in this matter was held before Examiner Emerson on June 9, 1966, at Porterville. The matter was submitted subject to the receipt of late-filed exhibits, two by applicant and one by the staff, with the latter being subject to written rebuttal should applicant so desire. Applicant having raised no objection to the late-filed staff exhibit, the matter stands submitted and is ready for decision.

Applicant seeks authority (1) to increase its rates for exchange telephone service in order to increase revenues by $4,290 annually, an increase of approximately 90 percent, and (2) to borrow an additional $10,000 on a long-term basis from General Dynamics Corporation in order to replace an equivalent amount of "interim" notes held by such corporation.

Ducor Telephone Company provides telephone service to about 125 subscribers in Tulare County. The exchange serves the unincorporated town of Ducor, with a population of 200, and is approximately 15 miles south of Porterville and 40 miles north of Bakersfield. Mr. Virgil A. Roome owns all of the outstanding shares of the telephone company and he, with a helper, performs all of the functions of management, construction, maintenance, repair and operations of the company. He personally owns the property, space, community dial office, equipment and materials storage, and a pole yard. In 1965, Mr. Roome received a salary of $9,600 and, in addition, an income of $2,592 from his rentals to the company. His prospective 1966 salary is $10,800.

A comparison of applicant's proposed rates with those presently in effect, is as follows. For 10-party residence service, applicant's proposed rate would equal the highest rate in California.

Class and Grade of Service	Monthly Rate	
	Present	Proposed
Business:		
1-party	$ 5.50	$10.00
2-party	4.50	8.00
4-party	3.50	7.00
10-party	4.00	7.50
Residence:		
1-party	3.50	7.00
2-party	3.00	6.40
4-party	2.50	5.50
10-party	3.00	6.00

As of December 31, 1965, applicant served some 24 business main stations, 7 of them being on 10-party lines. Of the 94 residence main stations served, 52 were on 10-party lines and 32 were on 4-party lines.[1/] The number of subscribers may be

1/ From Exhibit No. 3.

expected to increase very slowly, if at all, because large tracts of land cultivated as orchards, vineyards, or wheat and hay fields limit the likelihood of growth. With the large number of "suburban line" stations, a considerable upgrading of service would normally be expected. Applicant has taken no steps in such direction, however, and in view of the testimony that the local distribution plant is in exceedingly poor condition it seems understandable that subscribers might feel that they would gain nothing by taking one- or two-party service and hence make no requests for such upgraded service.[2/]

In connection with the condition of applicant's outside plant, we take official notice of Decision No. 52827 (issued in Case No. 5661 and Case No. 5691 on March 27, 1956), concerning this applicant, and of applicant's written report, filed in response thereto, that its three-year construction program for 1956, 1957 and 1958 would rehabilitate the major portion of "the company's deteriorated outside plant" and that routine reconstruction would "eliminate other substandard plant". It seems readily apparent, in the light of testimony in the present proceeding, that either applicant did not in fact correct such plant deficiencies or has subsequently allowed deterioration of local plant to a condition as poor as that prevailing in 1956. We are inclined to believe that the former has occurred.

2/ A Commission engineer testified (TR 144, 145, 150, 154) that the distribution plant is the poorest he has seen; contains long spans with huge and uneven sags; has potentially hazardous contacts with electric lines; has many wires intertwined, crossed, poorly insulated or having no insulation; and that "with the present condition of his local plant I can't see how he can fail but have many difficulties in any kind of wind or any kind of inclement weather"; such situations "have been accumulated over many years".

In 1963 applicant applied for authority to borrow $72,000, stating that "applicant has experienced an increasing demand for the telephone services provided by it and believes that the installation of additional dial and toll ticketing equipment is in the best interests of applicant and its customers" (emphasis added). Applicant further stated that the proceeds from said loan would be used for the procurement of the following:

"XY Addition - Ducor	$12,000.00
XY Toll Ticketing	22,000.00
Building	7,000.00
Outside plant material	21,000.00
Labor	10,000.00
	$72,000.00"

By Decision No. 65403 (issued *ex parte* in Application No. 45209 on May 14, 1963) the Commission authorized applicant to enter into a loan agreement, to execute mortgages and to issue notes in the aggregate amount of $72,000, as requested by applicant.

With the proceeds of such loan plus an additional $10,000 which it borrowed by issuing so-called "interim notes", applicant installed automatic toll ticketing equipment at Ducor and, in order to make such equipment usable, added some dial equipment and rebuilt 13 miles of its toll line between Ducor and Porterville, completing the job in January 1966. It did not expend funds for a building.[3/] It did purchase a special-purpose and costly motor vehicle with a portion of such funds. The automatic toll ticketing equipment, installed, cost approximately $33,000. The special truck cost $17,890. The balance was devoted to rebuilding the toll line and in increasing its capacity.

Contrary to applicant's statement that the loan was needed to meet the increasing demands for telephone service by its patrons,

3/ Mr. Roome constructed the building with personal funds and now rents it to the utility.

and in apparent disregard of the poor condition of its local plant, the proceeds of the $82,000 in loans was used to permit direct-distance dialing of toll calls with local number identification and an easier billing procedure for applicant. The toll tickets which the automatic equipment prepares, replace a service which previously had been provided by The Pacific Telephone and Telegraph Company. Both the staff accounting witness and the staff engineering witness considered the automatic toll ticketing project and the special truck excessive investments for this utility.[4/] The staff pointed out, however, that from the standpoint of the applicant such toll investment may have some long-term financial advantage because of applicant's cost basis of toll settlement with Pacific Telephone.

In light of the long history of plant and service deficiencies, and past difficulty in obtaining capital (of which we as above stated take official notice) and of the testimony respecting the present condition of outside plant, it seems abundantly clear that the money spent for applicant's automatic toll ticketing project could far better have been spent for the construction of <u>needed</u> plant than for the mere convenience of automatic toll ticketing.

While accepting applicant's investment in the special truck, with its elevated basket, as being useful because he "couldn't in good conscience ask a man to climb some of those poles", counsel for the California Farm Bureau Federation made a motion that the investment in automatic toll ticketing equipment be disallowed as an element of rate base on the grounds that such investment was imprudent and that any service improvement obtained therefrom was of no benefit to the customers.

4/ Together these two items total over $50,000, or about 1/3 of the total plant cost and represent over $300 per main station.

Plainly, funds have not been expended where most needed. Even the truck may be of little future use. Mr. Roome now talks of a complete rebuilding of local plant, by direct burial, at a presently estimated cost of $120,000. Where funds for such future undertaking may come from, representing an additional investment of about $800 per station, can only be imagined. In this light, the staff recommends that no future loans be authorized until this utility makes a meaningful study of its future plant requirements and adopts an overall financial plan designed to meet the same - a course of action upon which this Commission will insist.

In this proceeding applicant presented certain financial data, as exhibits attached to the application, in support of its request for increased rates. Its showing for the year 1964 indicates an overall rate of return of 4.98 percent; for the year 1965, a rate of return of 3.65 percent and for the estimated year 1966, a rate of return of 1.44 percent, the latter fully including the costs of the automatic toll ticketing equipment. The actual results of operations, reported by applicant's accounting witness as having been taken directly from applicant's books, for the calendar year 1965 are at variance with the foregoing and are as follows:

Year 1965 Actual, Present Rates

Item	Amount*
Local Service Revenues	$ 7,850
Toll Service Revenues	21,622
Miscellaneous and Uncollectibles	196
	29,668
Maintenance Expenses	5,710
Traffic Expenses	107
Commercial Expenses	1,919
Directory and Accounting Expenses	479
General Expense	6,406
Rental	2,592
Pension Expense	58
Depreciation	4,084
Taxes	2,492
	23,847
Net Revenue	5,821
Rate Base (depreciated)	124,608
Rate of Return	4.67%

* From Exhibit No. 3

With respect to future earnings, applicant's showing for the estimated year 1966 is distorted and, like its original 1965 showing, is unreliable. It was predicated on a loss of subscribers, whereas on cross-examination Mr. Roome testified that there would in fact be a small gain in subscribers. The staff showing for the estimated year 1966, including full allowances for Mr. Roome's increased salary, the automatic toll ticketing equipment, and the special construction truck, developed a rate of return of 2.46 percent on a depreciated rate base of $126,796. If the imprudent investments are eliminated therefrom (but excluding any revenue or expense adjustments), the staff-derived estimate for 1966 would show a rate of return of approximately 3.7 percent on a rate base of $85,000.

With respect to applicant's request that it be authorized to borrow an additional $10,000, the evidence discloses that

$9,689.65 of such amount has already been borrowed and that, in fact, applicant's long-term borrowings now total $81,689.65. The Commission has authorized applicant to borrow not more than $72,000. As hereinabove mentioned, applicant obtained the added funds by issuing "interim notes". Such notes on casual examination might appear to be "demand" notes of short duration, but when such interim notes and the loan agreement with Stromberg-Carlson are examined together, it is abundantly clear that they are in fact long-term borrowings, intended for a term of 20 years. We view their use as nothing more than a means to circumvent the provisions of the Public Utilities Code and to escape regulation of applicant's finances by this Commission.

Whether deliberate or not, applicant has misinformed this Commission; first, with respect to the rehabilitation of its deteriorated and substandard plant; second, with respect to the purposes for which its loan funds were to be expended and third, with respect to the long-term aspects of its so-called "interim" notes. Although testimony was offered in an attempt to show some mitigating circumstances, the facts are that applicant's plans were made some two years prior to obtaining this Commission's authority to finance them; that upon obtaining the funds, expenditures thereof were not made in accordance with the authority granted and that applicant made no disclosure of its attendant difficulties until, during the course of this proceeding, examination of applicant's operations forced such disclosure into the open. Mr. Roome's lack of forthrightness is apparent, as is his imprudent management. He apparently expects applicant's subscribers to rescue it by paying twice what their service is worth. A rate increase is not a remedy for unsound financing, imprudent investments, poor management or deficient performance.

Applicant will collect sufficient revenues under present rates to meet all operating expenses and will receive more than $3,000 in net operating revenues.

Furthermore, applicant's cash flow will be sufficient to meet interest and principal payments on the currently outstanding indebtedness. In view of the evidence, the Commission finds that increased rates and the authorization of additional debt are not justified.

The Commission concludes that the application herein should be denied.

ORDER

IT IS ORDERED that Application No. 48221 is hereby denied.

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

Dated at San Francisco, California, this 18th day of OCTOBER, 1966.

President

Commissioners