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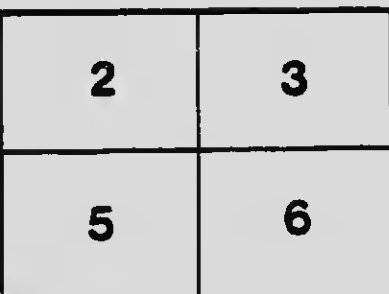
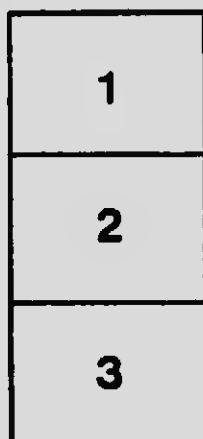
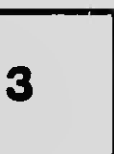
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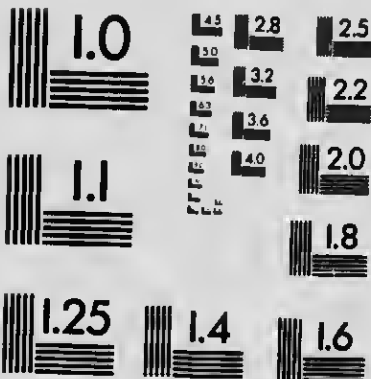
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# Memorandum

SUBMITTED BY APPELLANTS ON APPEAL  
TO GOVERNOR-GENERAL-IN-COUNCIL  
FROM ORDER PERMITTING THE BELL  
TELEPHONE COMPANY OF CANADA  
TO INCREASE ITS EXCHANGE TOLLS

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TORONTO - 1919

# Memorandum

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TORONTO - 1919

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1919

Relief pre-  
mised upon  
existence of  
an emergency.

Appellants  
deny existence  
of emergency.

Company's  
history  
prosperous.

Heavy reserves  
and surpluses  
accumulated.

The order appealed from allows the Company in addition to certain unopposed increases and readjustments, an increase of ten per cent. in exchange rates. It is this latter increase which is being opposed, an increase which means approximately \$900,000 a year in additional rates from the Company's subscribers.

The application to the Board was expressly made by the Company to meet an emergency and was so treated by the Board at the hearing and in its judgments. It was conceded by all parties that insufficient evidence was before the Board to enable it to fix permanent rates, but it was urged by the Company that existing conditions as to wages and cost of materials made it impossible for the company to await the time required to prepare adequate evidence, without a serious impairment of credit and service.

The relief granted by the Board is expressly based upon an acceptance of this hypothesis. This appellant on the other hand says that the financial position of the company as disclosed by its own statements entirely controverts this finding.

The company was incorporated in 1880 and has for some thirty years paid its bond interest in full and an eight per cent. dividend on its stock. It now has outstanding \$11,149,000 bonds and \$18,000,000 capital stock.

It has accumulated heavy reserves for every conceivable purpose and in addition a contingent reserve for purposes that the officials of the company were unable to specify at the hearing. It also has large undivided surpluses. These funds as of December 31st 1918, were as follows:—

#### RESERVE ACCOUNTS

31st December, 1918.

	Book value	Reserve Carried	Percent. of reserve to Book Value
Office furniture and fixtures ..	\$ 165,358.82	\$ 75,262.72	45.51%
Tools and vehicles.....	307,761.68	133,646.08	43.42
Directory Plant.....	37,727.44	14,257.68	37.79
Supplies.....	1,214,597.19	613,004.40	50.47
Accidents.....		75,332.54	
Fire loss.....		33,973.57	
Extraordinary repairs.....		160,845.61	
Deferred ordinary repairs....		96,645.81	
		<hr/>	
		\$1,202,968.41	
Accounts receivable.....	581,744.25	77,792.93	13.37
Plant.....	42,372,449.00	12,954,786.48	30.57
Contingent Reserve.....		3,132,436.08	
Surplus in Profit and Loss account.....		2,286,556.80	
		<hr/>	
		\$19,654,540.70	



Contingent  
reserve realty  
and surplus  
account.

As to the contingent reserve above set out, not a cent has ever been withdrawn from the same on account of operation account since its inception, and only relatively small amounts on account of capital losses. The appellants' contention as to this fund theretore is that it is practically a surplus account.

The balance in the "surplus account" from 1912 has been as follows:

Heavy  
surpluses in  
war period.

December 31, 1912.....	\$429,189.93
" " 1913.....	907,882.01
" " 1914.....	1,000,000.00
" " 1915.....	1,249,139.80
" " 1916.....	1,647,955.21
" " 1917.....	2,181,025.25
" " 1918.....	2,286,556.80

1918 balance  
sheet shows  
profit.

The balance sheet for 1918 taken from the Company's 1918 report to their shareholders is as follows:—

Telephone revenue.....	\$12,227,545.33
Operation expense.....	\$5,463,818.24
Current maintenance.....	1,903,624.51
Depreciation.....	2,648,760.00
Taxes.....	534,256.93
Total telephone expenses.....	\$10,550,459.68
Net telephone earnings.....	1,677,085.65
Sundry net earnings.....	427,602.36
Total net earnings.....	\$2,104,688.01
Deduct interest.....	562,053.82
Balance.....	\$1,542,634.19
Deduct dividends, 8%.....	1,440,000.00
	<hr/> \$102,634.19

Depreciation  
allowance  
entirely  
arbitrary.

In connection with the above the appellant wishes to call special attention to the sum of \$2,648,760 set aside for depreciation. This is on the Company's own showing not based on experience but an entirely arbitrary amount and as the appellants have endeavoured to demonstrate entirely too high.

In 1918 actual  
cash balance  
nearly  
\$5,000,000.

While the appellant does not dispute the propriety of an adequate depreciation reserve it does wish to emphasize as bearing on the question of an emergency the fact that on the 1918 operations the company had a cash balance of \$4,753,448.01.

Where is  
emergency  
shown?

To prepare proper data for a rate increase application would have taken possibly about eighteen months. The appellant submits that to suggest that this company, in the financial position above disclosed, could not await this period is preposterous, and the Board itself could hardly

have had the courage of its expressed convictions as to the alleged emergency when the increase granted is postponed to July 1st, 1919, whereas the application was made on October 15th, 1918.

Wage  
increases.

The main ground on which the judgment of the Board is based is that the company will require in 1919 about \$1,500,000 above 1918 requirements to meet wage increases, and that this is the basis of the alleged emergency.

Serious error  
of Board.

Incidentally the Board have entirely overlooked the fact that about twenty-five per cent. or \$366,000 of this annual wage increase was absorbed in 1918 and yet the company had a substantial surplus.

Estimated  
year including  
all wages  
increases.

The evidence of the company's chief officials is definite that all wage increases were in force by November 1st, 1918. Therefore it is fair to take November and December as test months on which to premise a year's operations. The following statement gives the result:—

REVENUE AND EXPENSES—NOVEMBER AND DECEMBER, 1918	
Revenue	
Exchange.....	\$1,508,067.79
Toll.....	631,369.16
Miscellaneous.....	29,625.60
Expenses—	\$2,169,062.55
Operation.....	\$1,094,422.89
Maintenance.....	336,151.96
Taxes.....	77,242.73
	1,507,817.58
Balance.....	\$661,244.97
Or for one year an actual cash balance of.....	3,967,469.82
Add estimated new revenue on moving charges and long distance rates.....	165,000.00
	\$4,132,469.82
Deduct 8% dividends on capital stock and interest on bonds	1,997,450.00
Balance available for depreciation.....	\$2,135,019.82
Or 5.15% on depreciable property exclusive of salvage.	

#### SEVERAL POINTS ARE TO BE NOTED

Other revenue  
disregarded.

(1) No account is taken of dividends from outside investments although the Company in 1918 had an additional revenue of \$238,526.36 from this source.

War tax  
deducted.

(2) War tax is deducted from operations as directed by the Board and the remainder of the item of taxes properly adjusted over the year.

Unusual costs  
should not be  
included.

(3) The appellants object to the inclusion of the items of war relief and influenza relief as expenses on two grounds (a) that they are exceptional and non-recurring and (b) they are properly chargeable to the contingent reserve. If these items are deducted the cash balance after payment of capital commitments will be \$2,529,341.62 or enough to pay the depreciation of 5.7% which the Board have allowed as proper to leave a surplus of \$146,257.34.

## DEPRECIATION

Importance of depreciation allowance.

Company's evidence inadequate.

Witnesses for appellants experts of wide repute.

Results prove Company's rate excessive.

Another serious mistake of Board.

Appellants' attitude on depreciation.

As is apparent the question of the proper allowance for depreciation is one of the most important factors in this case.

The company have been setting aside an annual sum about equal to 6.5% of the total plant depreciable and non-depreciable. The only evidence tendered in support of this allowance was that of Mr. Winter, Plant Superintendent, who testified that this was what he had been told was the practice of the American Telephone and Telegraph Company and that of Mr. Lash, Chief Engineer, whose evidence was that in certain specific cases in actual practice this allowance had not proven excessive.

On the other hand Prof. Bemis of Chicago, a telephone expert of wide American experience, Mr. Francis Dagger, telephone expert of the Ontario Railway and Municipal Board, and Mr. W. J. Hurdman, an electrical engineer with extended practical telephone experience, without the slightest collaboration with each other, gave the following as the proper annual rate upon the Company's equipment:—

Prof. Bemis.....	3.97%
F. Dagger.....	3.958%
W. J. Hurdman.....	4.04%

This evidence was supplemented by the evidence of Geo. J. Guy, Chief Engineer of the Manitoba Public Utilities Commission, who testified that, upon taking over the telephone system of Manitoba the Commission had adopted an annual rate of depreciation based upon the theories of certain Bell Engineers, but that this rate had proven excessive and on February 1st, 1918, had been reduced. Applying the present Manitoba rates of depreciation to the Company's plant the average annual rate would be 4.48% and Mr. Guy added that in his opinion this percentage erred if at all on the side of caution.

As indicating that the company have obviously been setting aside too much for depreciation, is the fact that their reserve now equals 30.57% of the plant. This is more than any American independent company and more than any of the 37 American Bell Companies save two. In fact the Board find that the normal ratio is 20%, which should be even less in a plant which has had a recent rapid growth.

Nor is this explained by the fact that replacements have been somewhat curtailed by the war. The chief reason why the calls upon this revenue have been under normal is that during the war, salvage became extremely valuable, a point entirely overlooked by Mr. Commissioner McLean which has caused him to make some very erroneous computations.

The submission of the appellants to the Board on the question of depreciation was "By adopting as an interim measure at least a rate of four per centum, considerably over a million dollars a year will be set free for other company purposes. We feel that four per cent. is enough as a permanent basis, but in any case no harm can accrue even if the company's distended depreciation reserve does shrink to that considered ample "other Bell Companies, and in the meantime the company can work out a scientific basis based on experience."

Board ignores evidence in favour of alleged American precedent.

The appellants feel that the manner in which Mr. Commissioner McLean has dealt with this question is most unsatisfactory. He has been at great pains to combat arguments as to obsolescence never put forward by the appellants, has referred to much material not in evidence, and has apparently finally taken refuge in the terms of an agreement between the Postmaster-General of the United States and the American Telephone and Telegraph Company.

This is the third occasion in this judgment where the learned Commissioner has apparently considered himself bound by an American precedent. Respect for these precedents being admitted, the appellants would nevertheless urge that such a course renders useless considerable time and preparation spent for the enlightenment of the Board, while the utility of the precedents is somewhat doubtful in view of the differing conditions under which the same were established.

In fact the appellants feel that the judgment of the Board as delivered by Mr. Commissioner McLean is properly subject to considerable criticism. No attempt will be made to deal with the judgment in detail—a few examples will suffice.

Commissioner McLean's mistakes in calculations vitiate his conclusions.

(a) His analysis of the operations of October, November and December, 1918, and his conclusions thereon are quite erroneous and misleading.

The monthly figures furnished by the Company for depreciation and taxes for the year 1918 were as follows:—

	1919	
	Depreciation	Taxes
January.....	\$207,500.00	\$35,809.47
February.....	207,500.00	36,041.04
March.....	207,500.00	36,370.42
April.....	207,500.00	35,888.40
May.....	207,500.00	35,833.48
June.....	207,500.00	38,399.98
July.....	207,500.00	40,213.50
August.....	207,500.00	47,758.18
September.....	207,500.00	49,208.84
October.....	325,220.00	58,200.25
November.....	227,180.00	59,473.38
December.....	228,860.00	61,059.99
	<u>\$2,648,760.00</u>	<u>\$534,256.93</u>

No adequate explanation was tendered by the company of the "loading" of the last three months of the year especially the \$117,720.00 added to depreciation in October, but it was discovered and pointed out to the Board by Col. Gordon, auditor for the appellants, and a corrected statement filed which has been ignored in the judgment.

(b) Although the Board on the objection of the appellants refused to permit the Company to file statements for January and February 1919 unless the appellants should have an opportunity of scrutinizing the same with their auditors, nevertheless the Board apparently have permitted the company to file such statements after the hearing and have used the same as a basis for judgment, a procedure which the appellants cannot help regarding as improper in a judicial tribunal.

Board has based judgment upon evidence rejected at hearing.

Board has travelled outside record.

Much of appellants' case ignored.

Unusual attitude of chairman.

"Melon-cutting" by Company.

Final submission of appellants.

(c) Considerable other material on which this judgment purports to be based was not presented in evidence to the Board, e.g. the alleged fact that the Northern Electric Company has passed its dividend which may or may not be due to reduction of profits.

(d) Not a word appears in this judgment relative to the past surpluses of the company or to the contingent reserve, although the appellants and other contestants at the hearing laid considerable stress upon the same.

The appellants would like to refer to certain remarks of the chairman of the Board during the progress of this case.

In a considered judgment delivered on December 5th, 1918, and concurred in by the Board the Chairman said:

"There has been an immense increase in the cost of materials since the last detailed investigation was held by the Board, which covered the Montreal territory and took place in 1911. At the time of that investigation it was found that the company made but 8.28 per cent. on its Montreal investment and the rates were therefore sustained.

"In all probability, were an appraisal taken to-day it would be found that the value had increased at least forty per cent. and if Montreal be taken as a typical point (the results would be, of course, not absolutely the same in all municipalities) the general result would be an increase of forty per cent. in telephone rates."

Again at the hearing on January 22nd, 1919, at Ottawa, the Chairman said: "Something must be done in connection with relief to the company, something of necessity has to be done by way of percentage increases."

Both of these observations were made before the contestants had given any evidence. But the chairman makes very evident the superfluity of such evidence as far as he is concerned by his remarks in giving judgment.

"I was obliged to be in the West while this case was in progress, consequently did not hear the argument and was not present when much of the evidence was given.

"With a wage increase of approximately one and one-half million dollars a year, and having no reference whatever to increased cost of supplies, which may come down, it was evident that the company required relief."

The appellants would deem it not out of place to point out that immediately after the delivery of the judgment appealed from the company announced an issue of \$4,500,000 capital stock at par to its shareholders although its stock even through the depression engendered by the war never sold under 130. The appellants would respectfully suggest that such bonuses to stockholders should not be permitted and that if public utilities are to be regulated such regulation should be complete and include control of stock issues.

However on the present appeal the appellants respectfully submit that the increases granted by the Board should be rescinded

- (1) because obviously no emergency exists.
- (2) because the errors of calculation made by the Board vitiate its conclusions.
- (3) because the judgment is not founded on the evidence submitted.



