

LEM

Decision No. 19748

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
PICKWICK STAGES SYSTEM, )  
a corporation, for an order author- )  
izing the issuance and sale of capi- )  
tal stock of the par value of three )  
hundred and twenty-five thousand )  
(\$325,000.00) dollars. )

**ORIGINAL**

Application No. 14121

In the Matter of the Application of )  
PICKWICK STAGES SYSTEM, )  
a corporation, for an order permitting )  
it to issue three hundred thousand )  
(\$300,000.00) dollars of equipment )  
trust certificates. )

Application No. 14122

Warren E. Libby, for applicant.

SEAVEY, Commissioner:

SECOND SUPPLEMENTAL OPINION

The Railroad Commission in Decision No. 19518, dated March 23, 1928, made its order setting aside the submission theretofore made in the above entitled matters and re-open<sup>ing</sup>/them for further hearing. Such hearing was held on April 19th and April 20th.

These two proceedings were brought before the Commission on October 4, 1927, by Pickwick Stages System for the purpose of obtaining the approval of the Commission of its proposed financing, through the sale of stock and equipment trust certificates, of certain auto stage equipment. In the original decision herein, No. 19105, dated December 6, 1927, the Commission authorized the corporation to issue and sell, at not less than par, \$325,000.00 of common stock, to execute and enter into an equipment trust agree-

ment and a lease agreement, and to assume or guarantee the payment of not exceeding \$300,000.00 of six and one half percent <sup>equipment</sup> serial/trust certificates, the issue and sale of which at not less than 95 percent of face value, was authorized. The order of the Commission provided, however, that the proceeds from the sale of the stock and certificates be deposited in a special bank account to be used by the company for the purpose of financing the construction cost of equipment, but only upon being authorized in supplemental orders to do so. In this connection Condition "1" of the order reads as follows:-

"1. To obtain supplemental orders authorizing the use of proceeds, from the sale of the stock and certificates, applicant shall first file with the Commission supplemental petitions containing certified statements showing in detail the actual cost of constructing the equipment to be financed through the use of said proceeds, and justify said cost."

Thereafter, applicant on December 14, 1927, filed a supplemental petition reporting that pursuant to said Decision No. 19105 it had issued and sold \$34,900.00 of stock and \$33,000.00 of certificates and had placed the proceeds in a special fund, as required by the decision. It asked for a supplemental order releasing the \$34,900.00 of proceeds obtained from the sale, at par, of the stock and the \$31,350.00 from the sale, at 95, of the certificates; a total of \$66,250.00, to finance the purchase price of five auto stages, and for such other and further relief as might be proper in the premises.

It appeared that the equipment had been manufactured by The Pickwick Corporation, and applicant in making its request to use the \$66,250.00 of proceeds, submitted as Exhibit "A" a certified statement in which it reported what purported to be the actual cost to that corporation of such equipment. The cost of the equipment, as shown on Exhibit "A", as compared with the proposed purchase price to be paid by Pickwick Stages System, is set forth in the Commission's decision on the supplemental petition as follows:-

Equipment	Reported cost to the Pick- wick Corpora- tion	Proposed purchase price by applicant.	Difference
<u>27-Passenger Stages:</u>			
Carat . . . . .	\$11,732.18	\$13,500.00	\$ 1,767.81
Scarab . . . . .	11,898.83	13,500.00	1,601.07
Tiger Eye . . . . .	11,694.92	13,500.00	1,805.08
Louisiana . . . . .	11,755.83	13,500.00	1,744.17
Sub-total.....	\$47,081.87	\$54,000.00	\$ 6,918.13
<u>26-Passenger Stage:</u>			
Wisconsin . . . . .	\$10,507.82	\$12,500.00	\$ 1,992.18
Total.....	\$57,589.69	\$66,500.00	\$ 8,910.31

Exhibit "A" contained no showing of costs in addition to the \$57,589.69 and in our opinion the company did not in its supplemental petition, justify the proposed cost, as required by the original decision, of \$66,500.00. Accordingly, the Commission's decision on the supplemental petition, No. 19232, dated January 10, 1928, authorized the use of only \$57,589.69 of proceeds, the reported cost shown on Exhibit "A". The decision provided that in the event applicant paid more than \$57,589.69 for the stages, it should charge any excess over \$57,589.69 to its corporate surplus account, and not to its plant and equipment or operating expense accounts.

Following the issuance of said supplemental order, the company on January 28, 1928 filed a petition for re-hearing. A re-hearing was held on March 9, 1928, after which, Decision No. 19518, referred to above, was entered.

The petition for re-hearing contained certain allegations that findings and portions of the supplemental decision were not supported by the evidence introduced at the hearing of said proceedings, were contrary to the evidence introduced therein and were contrary to and/or not supported by any evidence or showing introduced or submitted in said proceedings.

However, it will be recalled that in the original decision herein the Commission provided that whenever the company desired to use stock and certificate proceeds to pay for equipment, it should file statements showing in detail the actual cost of construction and justify such cost. If reference be made to the supplemental petition it will be noted that Exhibit "A", which was the only exhibit or cost statement filed with the supplemental petition, shows construction expenditures of only \$57,589.69, so that the Commission necessarily in making its supplemental order, was limited in authorizing the withdrawal of proceeds to the only evidence submitted, that is, to the amount of \$57,589.69. In this connection it should be borne in mind that under Section 52-b of the Public Utilities Act the Commission is required to make a finding that in its opinion the money, property or labor to be procured or paid for by the issue of securities authorized, is reasonably required, and the purposes for which the proceeds are to be used are not in whole or in part, reasonably chargeable to operating expense or to income. If, in the Commission's opinion, the showing made is not of a nature to warrant it to make this finding it cannot, it seems to me, grant the authority requested.

Allegations were made, also, that the order of the Commission operates to deprive it of its property without due process of law and to deny it the equal protection of the law, that it is repugnant to the constitution, and that it is in excess of and beyond the jurisdiction of the Commission, and that in making it the Commission did not regularly pursue its authority. In respect to these allegations the company claims that by prohibiting it from charging to its plant and equipment or operating expense accounts any excess over the \$57,589.69 the Commission has denied it the right to earn a reasonable return on the fair value of the equipment, and to that extent its order is confiscatory, has denied it the right to include in its capital investment the reasonable and fair value of the equip-

ment, has ignored the evidence showing that the proposed purchase price was a reasonable and fair price, and has arbitrarily assumed the functions and duties of directors and officers of the corporation in regard to the determination of its business policies and its corporate management.

The authority granted can not deprive applicant of the right to earn a reasonable return on its investment and, in our opinion, is not confiscatory. The question of rates and return is not involved in these proceedings. In fixing rates it is not the practice of the Commission to use as a rate base the amount of securities outstanding, nor does it use as a rate base the figures carried in the fixed capital accounts on the utilities' books, unless such figures at the time the rates are fixed represent, in the opinion of the Commission, the reasonable value of a utility's property. The authority granted by the Commission to issue securities is permissive only and not in any way compulsory upon applicant or an assumption of the duties of directors and officers. The Commission, however, is authorized, by the terms of the Public Utilities Act, to attach to the exercise of any authority granted such condition or conditions as it may deem reasonable and necessary. Here, having found that the use of only \$57,589.69 of stock and certificate proceeds was reasonably required on the showing made, and was not in whole or in part reasonably chargeable to operating expense or to income, it seems also reasonable to provide that only such an amount should be charged to fixed capital. It should be noted that the Commission did not attempt to prohibit the company from paying more for the stages; it merely limited, in the exercise of the powers conferred and the duties imposed by the Public Utilities Act, the amount of securities that the company might use in acquiring such equipment. In making a condition that the company should charge a portion of the purchase price of equipment to surplus, the Commission merely was following a policy long since adopted by it. (See 12 C.R.C-485;

16 C.R.C. 799; 21 C.R.C. 858; 28 C.R.C. 585; 28 C.R.C. 625; 28 C.R.C. 361; etc.) It has on at least two occasions when authorizing this very applicant to execute lease and option agreements for the purchase of operative rights, directed that no payments thereunder be charged to any asset or operating expense account. Reference is here made to Decision No. 17585, dated November 8, 1926 (28 C.R.C. 785) and Decision No. 17078, dated July 3, 1926 (28 C.R.C. 361.)

The company further alleges that the order of the Commission does not permit it to operate under its equipment trust and lease agreements. The order herein is designed to take care of this objection.

I do not believe it necessary in this opinion to comment further on the allegations contained in the petition for re-hearing.

During the further hearing Mr. Theodore Stein, one of the Commission's accountants, introduced as the Commission's Exhibit No. 1 a report based on an examination of the records of The Pickwick Corporation, setting forth the cost of different units of equipment, as shown on such records, and as adjusted by him following his examination. These costs are reported in the exhibit as follows:-

Unit	Cost to Pickwick Corpora- tion	Adjusted Cost	Purchase price by Pickwick Stages System
Scarab, 33-passenger sedan	\$11,746.58	\$ 11,235.52	\$13,500.00
Tiger Eye, 33-passenger sedan	11,446.42	10,919.00	13,500.00
Wisconsin, 27-passenger sedan	9,631.05	9,515.05	12,500.00
Columbia, 25-passenger aisle sedan . . . . .	11,485.99	11,220.21	15,000.00
Niagara, 25-passenger aisle sedan	11,841.74	11,771.72	15,000.00
Cherokee, 28-passenger parlor observation car . . . . .	17,163.09	17,314.17	17,500.00
Osage, same as Cherokee . . . . .	15,189.32	14,806.41	17,500.00
Total.....	\$88,484.18	\$86,782.08	\$104,500.00

While some of the above units are not the subject of the supplemental petition herein, their costs were analyzed in an endeavor to ascertain the corporation's methods of recording such costs.

The \$88,484.19 includes as overhead costs an amount equal to fifty percent of the labor costs and seventy-five percent of the material costs. These percentages are estimates. Mr. Stein in his adjusted cost of \$86,782.08 distributed the overhead by using a productive hourly rate developed by him, of sixty-four cents, based on the actual expenditures for overhead items, as shown on the corporation's books.

In determining the sixty-four cent overhead Mr. Stein made an allowance for garage expense; maintenance of machinery and tools; depreciation on machinery, equipment and small tools; administrative and general officers' salaries; rent; postage; insurance; stationery; light; gas; power; water; telephone; interest on material purchases; obsolescence account stock material and traveling expenses. Equipment which, according to applicant, cost The Pickwick Corporation \$88,484.19 would be sold to applicant at \$104,500.00, or at 18.1 per cent more than the cost to the Corporation. If the adjusted cost of \$86,782.08 were accepted it would be sold to applicant 20.4 per cent more than it cost the Corporation.

Objection was made by applicant that the cost figures, as shown in said Exhibit No. 1, were incomplete in that no allowance was made for taxes, experimental and research work, losses and obsolescence in materials and equipment and return to The Pickwick Corporation on its investment. Mr. Stein testified, however, that in ascertaining the construction costs and in determining his overhead allowances he had taken all the expenditures he had found reported on the corporation's books, and in this connection Mr. C.F. Wren, applicant's president, alleged that the records were incomplete. If there were such costs in addition to those shown in Exhibit No. 1, they do not seem to be carried on the books of account of The

Pickwick Corporation, and the Commission has not been advised of their size or extent, except in the case of the item "Taxes", it appearing that during 1927 city and county taxes of between six and seven thousand dollars were paid, and that in addition a federal excise tax is payable, based on the selling prices of the stages. Mr. Wren, however, was unable to state definitely how the city and county taxes were paid and whether they were paid by Pickwick Stages System or The Pickwick Corporation. The record indicates that such payments do not appear on the books of The Pickwick Corporation and it occurs to me that if they were made by Pickwick Stages System, some duplication in the costs of that company would result if they were allowed here in connection with the cost of the stages. The federal excise tax, amounting to three percent of the selling price, was not paid in the past, Mr. Wren stated, due to a belief that it was not required, but that payments on such account now must be made.

It has also been urged that the difference between the cost of building the respective stages, as shown by the records of The Pickwick Corporation and the price at which it is proposed to sell the same to the Pickwick Stages System represents only a reasonable manufacturer's profit. In this connection attention might be called to the fact that The Pickwick Corporation owns substantially all of the outstanding stock of Pickwick Stages System. It can scarcely be said that the stages in question are either constructed or purchased under competitive conditions. It has not been the practice of this Commission, in the event that utilities construct their own properties, to allow the addition to the actual construction costs of what might be termed a contractor's or manufacturer's profit. The Commission has recognized, as it does in this proceeding, overhead costs and depreciation on equipment used in the construction of the properties. We feel that the record in these proceedings does not permit us to recognize more than \$12,000.00 as a reasonable cost for the cars named "Carat", "Scarab", "Tiger Eye" and "Louisiana" and \$11,000.00 for the "Wisconsin". If the Pickwick Stages System pays



more for the equipment, the excess cost should be charged to surplus. The \$12,000.00 and \$11,000.00 we believe includes all adequate allowances for the usual overhead expenses. No additional allowance should be made for a return on any investment of Pickwick Corporation or manufacturer's profit.

The original applications herein contemplated the financing of some stages of types different from those referred to in the supplemental petition. When, and if, these stages are the subjects of future supplemental petitions, I believe that the Commission should then follow the same policy expressed in this decision in authorizing the use of securities or security proceeds to provide their costs. The evidence now before the Commission would indicate that for the 27-passenger aisle parlor sedan intercity type stages, equipped with lavatories and toilets, about \$12,250. should be allowed, and for the 28-passenger observation parlor buffet semi-double deck stages, an allowance of about \$16,000. These figures, of course, are subject to adjustment, depending on additional evidence that might hereafter be presented to the Commission.

I herewith submit the following form of order;-

THIRD SUPPLEMENTAL ORDER

A further hearing having been held in the above entitled matters, and the Railroad Commission being of the opinion that the order in Decision No. 19232, dated January 10, 1928, should be amended, as indicated herein, and that the money, property or labor to be procured or paid for by Pickwick Stages System, through the use of not exceeding \$59,000.00 of the proceeds obtained from the issue and sale of the stock and equipment trust certificates authorized by Decision No. 19105, dated December 6, 1927, is reasonably required for the purpose specified herein, and that the expenditure of not exceeding \$59,000.00 is not, in whole or in part, reasonably chargeable to operating expense or to income;

IT IS HEREBY ORDERED that the order in Decision No. 19232, dated January 10, 1928 reading as follows;-

" IT IS HEREBY ORDERED, that Pickwick Stages System be, and it hereby is, authorized to use not exceeding \$57,589.69 of the proceeds obtained through the issue and sale of the stock and certificates authorized by Decision No. 19105, dated December 6, 1927, for the purpose of financing the cost of acquiring the five automobile stages referred to in the foregoing opinion, namely: the "Carat", "Scarab", "Tiger Eye", "Louisiana" and "Wisconsin", provided that in the event applicant pays more than \$57,589.69 for said stages it shall charge any excess over \$57,589.69 to its corporate surplus account",

be, and it hereby is, amended so as to read--

IT IS HEREBY ORDERED that Pickwick Stages System be, and it hereby is, authorized to use not exceeding \$59,000.00 of the proceeds obtained through the issue and sale of the stock and certificates authorized by Decision No. 19105, dated December 6, 1927, for the purpose of financing the cost of acquiring the five automobile stages referred to in the foregoing opinion, namely the "Carat" "Scarab" "Tiger Eye" "Louisiana" and "Wisconsin", or to deliver at 95 not exceeding \$29,000.00 of the equipment trust certificates, and at par, \$31,450.00 of the stock authorized by said Decision No. 19105, for the purpose of financing the cost of said stages, provided that in the event applicant pays more than \$59,000.00 for said stages it shall charge any excess over \$59,000.00 to its corporate surplus account.

IT IS HEREBY FURTHER ORDERED that the order in Decision No. 19105, dated December 6, 1927 and the order in Decision No. 19232,

dated January 10, 1928, shall remain in full force and effect, except as amended by this Supplemental Order.

The foregoing supplemental opinion and order are hereby approved and ordered filed as the supplemental opinion and order of the Railroad Commission of the State of California.

DATED at San Francisco, California, this 11<sup>th</sup> day of May, 1928.

Leon Whitall

W. J. Seavey

Wm. W. [unclear]

Thos. S. [unclear]

M. J. [unclear]

Commissioners.