Decision No. 6827

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA.

ORIGINAL

In the Matter of the Application)
of Monticello Steamship Company)
to increase freight rates.)

Application No. 4257.

Sanborn & Roehl, for applicant.

L.B.Leavitt and J.P.Millett, for Central Labor Council of Vallejo, Protestants.

BY THE COMMISSION:

OPINION

The Monticello Steamship Company applies for an order authorizing the establishment of increased freight rates.

It is proposed to establish a schedule of class rates governed by the Western Classification in lieu of the commodity rates now in effect. Present commodity rates are some five hundred in number and where no specific rate is shown the charge is 12 cents per 100 pounds under an item for freight not otherwise specified. The commodity rates as now published are in cents per 100 pounds for shipments in small quantities, and in cents per ton of 2000 pounds for lots of 20,000 pounds or over.

The proposed rates in cents per 100 pounds are as follows:

Classes -	1	2	3	4	5	A	B	C	D	E
Rates -	18	15	11	8	6	6	6	6	6	6

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In addition to the class rates, applicant will publish a limited number of commodity rates, provide exceptions to the Western Classification and give rates materially lower than would govern were the straight Western Classification employed. These deviations are designed to prevent any radical increase against the commodities moving regularly in large quantities.

Petitioner operates only between San Francisco and Vallejo and is in competition with the Southern Pacific Company and Napa Transportation Company for traffic locally between these two points. It also does a joint business in connection with the San Francisco, Napa & Calistoga Railway in competitive territory north of Vallejo served in part by these same companies. This through traffic is nominal so far as freight is concerned and the joint rates are not to be increased.

On December 31, 1917, applicant's total fixed capital, as shown by the annual report, was $673,049.26. In the year 1918 the company purchased, in New York, a new steamer named Asbury Park, the accumulated cost of which to December 1, 1918 was $432,887.89, but before the vessel can be put into the local service it will require new boilers and certain alterations, making its total cost approximately $600,000.

Exhibit No. 1, a statement of valuation of property used in the service, includes the Steamer Sehome at $75,000. This vessel was sunk in the year 1918 in a collision with the General Frisbie, another of applicant's steamers. The Sehome carried marine insurance and there was also an amount in the depreciation fund to its credit; however, it will not be necessary to here go into the details of the re-adjustment of the capital account, as this subject will be referred to later.

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Applicant, by Exhibit No. 2, sets forth that its total freight revenue for the first ten months of 1918 was $60926.03 and that expenses chargeable directly to the handling of freight were $41025.75. thus showing a gain during this ten months period of $19900.28 above the out-of-pocket expenses. The overhead expenses common to both freight and passengers, not including depreciation, taxes, or interest on investment, during this ten months period was $186455.88. Of this amount applicant charged to freight the sum of $53139.94, which is 28½% (Exhibit No.5) of the overhead expenses and is based on the total space claimed to be reserved on steamers for the exclusive use of freight. By including the $53139.94, the claimed amount of common expenses for the handling of freight for the ten months period, the total expenses would be $94165.69, thus leaving a deficit of $33239.66. The boats engaged in this service are primarily for the transportation of passengers and it is therefore most difficult to determine just how much of the space on the boats is required to meet the exclusive demands of the freight traffic as distinguished from the passenger traffic. The vessels are of different sizes, their carrying capacity ranging from 400 to 2000 passengers. A representative of the Commission made a check of the four steamers employed in the service, but was unable to agree with the contention that 28½% of the deck space was necessary to the freight traffic. Apparently, the segregation of the decks can follow no fixed rule, but must be arbitrary, a matter of opinion and judgment.

Exhibits were introduced comparing the monthly costs of engine room labor for the ten months of 1917 and 1918; also the monthly cost for deck labor during the same period. Engine room labor costs increased $5756.80, or 32%, while the deck labor costs increased $12232.69, or 41%. The increase in the total of the payrolls was influenced, no doubt, to a greater or less extent, by the employment of additional men during the rush period in the year 1918 due to war activities, which made necessary the operation of special boats for the transportation to and from Mare Island of men connected with the United States Navy. It is fair to assume that special boats will not be required in the year 1919 with the operating schedules restored to normal.

Prior to January 1, 1919 applicant had a very favorable contract for fuel oil at 56 cents per barrel. Since the expiration of the contract it has been necessary to purchase the fuel oil in the open market at $1.63 per barrel. The average amount of oil consumed per annum is 63305 barrels and if the price of $1.63 per barrel is maintained during 1919 the increased annual cost will amount to $67,736.35.

Another exhibit shows that for the first ten months of the year 1918 the total expense in the operation of the dining rooms on the different vessels was $94,679.86. This amount included wages of stewards, cooks, waiters, the food and all supplies. During the same period $60,768.26 was received from passengers for meals served, leaving a deficit of $33,911.60, which the company arbitrarily charged to the expense for boarding the steamer crews. The boat crews' compensation includes their meals served from the regular restaurant department, but no segregation is made of their cost. It is claimed there is a considerable profit in the serving of meals to the public and that the cost to the company of furnishing food to the crews, were it not for this profit, would be greatly in excess of $33,911.60 and whatever profit there may be from the dining rooms is reflected in the reduced expense of feeding the labor employed on the boats.

Petitioner's principal earnings are derived from passenger traffic, as illustrated by the following tabulation:

	PASSENGER	FREIGHT
1913 -	$ 194,102.59	$ 50,866.88
1914 -	201,869.82	53,478.40
1915 -	222,076.14	54,226.17
1916 -	190.305.84	56,479.95
1917 -	279,656.28	62,929.48
1918 -	433,188.58	75,453.53

In the year 1918 approximately 70% of the gross earnings were received from passenger traffic, 12% from freight, 3% from baggage, express and special service, and 15% from the restaurant and concessions.

The last four years do not reflect normal business, for earnings were greatly augmented in 1915, due to travel incidental to the Panama Pacific International Exposition held in San Francisco; in 1916 they were reduced by a strike of the company's employees, which tied up operations for a period of time, while in 1917 and 1918 they were high because of the war activities at the Mare Island Navy Yard.

Since the case was submitted, January 6, 1919, our Auditing Department has made a complete check of applicant's financial condition beginning with the year 1906. From 1906 to 1912, both years inclusive, it was the policy of the company to make liberal charges to its surplus on account of depreciation, reducing its fixed capital accounts accordingly. During those years capital was depreciated $208388.55. In computing the capital investment this amount should be considered, less that which applies to the steamer Monticello $23189.94 and to the steamer Sehome $14450.80, the Monticello having been wrecked in 1913 and the Sehome sunk in a collision in 1918; also the sum of $11426.30 for abandoned improvements at El Campo, a resort in Marin County which the company attempted to conduct.

Beginning with January 1, 1913, the company's books have been kept in accordance with the classification of accounts prescribed by the Interstate Commerce Commission and adopted by this Commission.

From 1913 to 1918, inclusive, the capital investment, net earnings and percentage of earnings to investment, as shown by the company's books, were as follows:

	Capital Invested at Close of Year	Net Earnings	Percent Earnings to investment
1913 --	$649,862.50	$ 66,148.49	10.2%
1914 --	658,036.56	35,097.20	5.3%
1915 --	666,526.40	75,502.96	11.1%
1916 --	668,338.74	27,678.69	4.1%
1917 --	671,895.73	98,082.74	14.6%
1918 --	989,778.77	148,655.15	15. %

Certain items in connection with the purchase of the steamer Asbury Park, amounting to $66815.74 were charged as operating expenses. This amount belongs in capital investment and by adding it to the capital and deducting it from expenses there was, according to the company's own books as of December 31, 1918, a total capital investment of $1,056,594.51, net earnings of $215,470.89 and a percentage earning of 20.4, as against the net earnings of $148,655.15 and percentage of 15. shown in the above tabulation.

The company's plan of deducting depreciation from fixed capital account increased the percentage earnings on investment. By using the totals secured by our Auditing Department, which represent the actual fixed capital investment, we find the following results:

	Capital Invested at Close of Year	Net Earnings	Percent Earnings To Investment
1913 --	$797,667.03	$ 66,148.49	8.3%
1914 --	805,840.09	35,097.20	4.3
1915 --	814,330.93	75,502.96	9.4
1916 --	816,143.27	27,678.69	3.4
1917 --	819,700.26	98,082.74	12.
1918	1,204,399.04	215,470.89	17.9
Average-	876,346.77	86,330.16	9.9

The foregoing tabulation increases the company's total for fixed capital throughout the entire period by $147,804.53, which amount should be credited to depreciation reserve, being the sum by which the company reduced certain of its capital accounts prior to 1913. To the fixed capital is also added $66,815.74, account items charged to operations in 1918, which should have gone originally into the capital account.

The company earned, on the corrected capital investment, 12 per cent in 1917 and 17.9 per cent in 1918.

It was applicant's belief, at the time of the hearing in this proceeding, that its revenue would rapidly decline, by reason of changed conditions at the Mare Island Navy Yard and in the city of Vallejo. The contrary, however, has resulted, and the passenger revenue has increased each month during the current year:-

	1918	1919	Increase
January -	$ 30,300.09	$ 31,508.85	$ 1,208.76
February-	28,429.12	32,000.00	3,570.88
March - -	30,027.99	33,067.59	3,039.60
April - -	29,611.89	31,451.83	1,839.94
TOTAL -	$118,369.09	$128,028.27	$ 9,659.18

The passenger revenue alone during the first four months of 1919 increased $9,659.18 over the corresponding four months of 1918. There is no report of the 1919 transportation expenses, but a comparison of 1917 with 1918 shows that while the total revenue increased from $430,639.71 to $629,074.23, or $198,434.52, the total expenses only increased from $332,556.97 to $413,603.34, or $81,046.37, while the net increased from $98,082.74 to $215,470.89, or $117,388.15.

The company has no bonded indebtedness and has not declared excessive cash dividends, but has followed the policy of using its earnings for development and capital expenditure. The new steamer, Asbury Park, os somewhat larger than normal conditions justify, but it will, no doubt, add to the comfort of the traveling public by providing good accommodations and also makes possible the handling of unusually large groups of people on special occasions without overcrowding. This vessel will be in service in the very near future and when completed will further increase the Capital Investment of the Company.

In Application No. 2928, decided November 19, 1917, (Vol. 14 Opinions and Orders of the Railroad Commission of California, page 521) the Commission denied an increase of 15% in these same freight rates, basing its conclusions upon the record that the company was then in a very satisfactory financial condition and also that it had failed to prove by any testimony or exhibit that the then existing freight rates were too low per se. The history of the company was reviewed in that decision and it is there shown that its growth had been favorable, and the net return from the property substantial during the period from 1905 to 1916 inclusive. The years 1917 and 1918 were by far the most prosperous in the history of the company, producing, as heretofore stated, net profits of 12 per cent in 1917 and 17.9 in 1918. Operating costs will increase to some extent in 1919 over 1918, especially for fuel, but the operating revenue shows a substantial increase in the first four months of the current year and will, no doubt, continue to increase.

The evidence in this case is clear and convincing that this company is making a fully adequate return on all of the business which it transacts. That is to say its freight and passenger revenues combined produce very much more than 8% net on the total investment in plant devoted to the public service.

This commission should be slow to increase public utility rates where it is conclusively shown that the utility company is making a reasonable return as a result of its operation. Of course it may be that even where increased earnings as a whole are not justified, nevertheless, a readjustment or reapportionment of the burden of producing the gross income should be had between various classes of service rendered by the utility where they are shown to be decidedly out of line. This proceeding does not present such a case. We are not asked here to readjust all of the rates of this utility so as to properly apportion the burden as between freight and passenger service but the sole request of applicant is that we increase freight rates with a resulting increase of profits. In fact, applicants vigorously contend that the Commission in this proceeding has no jurisdiction to change passenger rates.

We have considered those authorities which hold as to steam railroad operations that the freight business is a distinct and separate business and rates must be fixed therefor without modification because of the earnings of the passenger business. But we call attention to the obvious fact that in steam railroad operations the entire equipment for the handling of freight is separate and distinct from the passenger equipment and it is easily possible to segregate and directly allocate the larger part of the charges to each class of service. In the case before us there is no such separate and distinct character of freight business. The principal business of applicant is the carrying of passengers by boat and the freight business is admittedly an incident. If the freight business stopped entirely, the passenger business would without question continue. And on the other hand if the passenger business stopped there is no doubt but that the entire business would cease as the freight traffic is not sufficient to support the service.

We therefore do not believe that the authorities cited which involve steam railroad operation are controlling here. In any event we believe that the burden is upon applicant (where ample total earnings are admitted) to show by clear and convincing proof that the costs of handling freight are definite in amount and character and that the business of carrying freight is so distinct and separate from the business of carrying passengers that the two may not legally or economically be considered together.

A careful consideration of this entire record convinces us that no such showing has been made by applicant.

The exhibits and statements and the results from passenger traffic during the first four months of the current year clearly indicate that applicant will enjoy ample net earnings in 1919, probably in excess of 15 per cent.

We are of the opinion upon consideration of all the facts in this case, that petitioner has failed to sustain the burden placed upon it by the Public Utilities Act to justify the increase in the freight rates which it seeks to make and we shall, therefore, recommend that the application be denied.

We submit the following form of order:

O R D E R

The Monticello Steamship Company having filed its application for authorityto increase its freight rates between San Francisco and Vallejo, a public hearing having been held on said application, and the Railroad Commission finding that the showing made has not been such as to justify the increase in rates asked for,

IT IS HEREBY ORDERED that said application be and the same is hereby denied.

Dated at San Francisco, California, this 12th day of November, 1919.

Edwin O. Edgerton

Frank R. Devlin

H. D. Brundige

Commissioners.

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LOVELAND and MARTIN, Commissioners - Dissenting.

We dissent from the opinion and order in this case, signed by a majority of the members of this Commission, dismissing the application, upon the following grounds:

First: That the findings upon which the Order of Dismissal is predicated are not supported by the testimony, as shown by the record.

Second: That the findings do not conform to the law as announced by decision of the United States Supreme Court in cases where similar conditions and state of facts existed and where similar principles were involved.

The testimony, no part of which was controverted, shows, as stated in the majority opinion, applicant's business is primarily the transportation of passengers; that its freight business is "admittedly an incident"; that no attempt has ever been made by applicant to classify the freight carried or to make effective freight tariffs based upon methods usually employed by transportation companies; that the rates proposed to be advanced were established many years ago before the western classification was generally employed by steamship lines, and were fixed without any great consideration of the commodity to be transported, specific rates being published for only a limited number of articles, most commodities moving at a uniform rate under the caption "Freight not otherwise specified."

As applicant is engaged in the transportation of both freight and passengers, it is necessary, in passing upon the reasonableness of the rates for either service, to allocate to such services the proper share of expenses. Expenses incurred solely for either service are readily assigned to the service for which they were incurred, but certain general expenses of operation common to both services must be segregated and allocated equitably between freight and passenger service. No arbitrary rule has been or can be laid down for such segregation and allocation, as each case involving allocation of common expenses must be determined upon its own statement of facts. The United States Supreme Court, in reversing a decision of the North Dakota Railroad Commission, in a case where similar principles were involved, has definitely settled the question that the reasonableness and justness of rates cannot be established by a consideration of only the bare "out-of-pocket" cost of handling a particular class of traffic. (See Northern Pacific Railroad Company v. North Dakota, 236, U. S. 585) The North Dakota Commission held that it could impose a rate for the transportation of lignite coal which covered only "out-of-pocket" costs, provided the carrier's entire earnings of all classes of traffic yielded a fair return. In disposing of this contention, Mr. Justice Hughes said at pages 596 and 597,

> "******* We find no basis for distinguishing in this respect between so-called 'out-of-pocket' costs and 'actual' expenses, and other outlays which are none the less actually made because they are applicable to all traffic, instead of being exclusively incurred in the traffic in question. Illustrations are found in the outlays formaintenance of way and structures, general expenses and taxes. It is

"not a sufficient reason for excluding such, or other, expenses to say that they would still have been incurred had the particular commodity not been transported. That commodity has been transported; the common carrier is under a duty to carry, and the expenses of its business at a particular time are attributable to what it does carry. The state cannot estimate the cost of carrying coal by throwing the expense incident to the maintenance of the roadbed, and the general expenses, upon the carriage of wheat; or the cost of carrying wheat by throwing the burden of the upkeep of the property upon coal and other commodities. This, of course, does not mean that all commodities are to be treated as carried at the same rate of expense. The outlays that exclusively pertain to a given class of traffic must be assigned to that class, and the other expenses must be fairly apportioned. It may be difficult to make such apportionment, but when conclusions are based on cost the entire cost must be taken into account."

This also finds direct support in the decision of United States Supreme Court in the Minnesota Rate Case, Simpson v. Shepard, 230 U. S. 352, 57 L. ed. 1511, where the court was passing upon the segregation and allocation of expenses as between intrastate and interstate business.

In the case at bar applicant's total business is admittedly profitable. If we accept the uncontroverted testimony of witnesses for applicant its freight business is conducted at a loss. To demonstrate this it is necessary to first charge the freight business with expenses incurred solely for the freight traffic, and then to allocate the expenses common to both freight and passenger traffic between those two services and charge the freight business with its proper share, thus showing the total expenses of conducting the freight business, which total expenses must be compared with the total earnings on the freight business. Such comparison shows whether the rates for the transportation of freight are compensatory or not. In this case this was done, as set forth in exhibits and testimony found in the record.

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The following reference to exhibits material to this opinion may be helpful:

EXHIBIT NO.1 relates to the financial condition of applicant, and needs no extended reference further than the brief mention made elsewhere herein.

EXHIBIT NO.2 shows that the total freight revenue for the first ten months of 1918 was $60,926.03, and the expenses chargeable directly to the handling of freight were $41,025.75. The majority opinion claims that this shows a gain of $19,900.28 over "out-of-pocket" expenses; this is technically correct but misleading for the reason that only "out-of-pocket" expenses are considered. No part of the expenses common to both freight and passenger service, depreciation, taxes or interest on investment is taken into account. That which the majority opinion calls a gain on freight operation is converted into a substantial loss when the share of common expenses, properly assignable to the freight traffic, is considered, to say nothing of depreciation, taxes or interest on investment.

EXHIBIT NO. 3 and testimony of witnesses (Trans. pp. 9 and 10) shows that the expense chargeable wholly to freight service was $41,025. 75. We are convinced that this statement was fair, for, as the witness stated, deck hands' wages were only figured at the regular pay of $90.00 per month and the item of overtime allowed deck hands was not considered at all.

EXHIBIT NO. 4 shows that the expenses common to both freight and passenger service amount to $186,455.88, which amount included no charge applicable exclusively to either freight or passenger service and, as said of Exhibit No. 2, it does not include anything for depreciation, taxes or interest on investment.

EXHIBIT NO. 5 shows the segregation and allocation of expenses common to freight and passenger service in the manner above described and the loss of $33,239.06, at which applicant's freight business was conducted.

RECAPITULATION

Total expenses of operation chargeable to both freight and passenger service		$186,455.88
28½%, properly chargeable to freight alone, as shown by testimony	$53,139.94	
Expenses wholly chargeable to freight	41,025.75	
	$94,165.69	
Total freight revenue	60,926.03	
Loss on freight operations	33,239.66	

The majority opinion contains a statement with reference to the total expenses of the dining rooms on the different vessels, from which a wrong inference can be drawn. The total expense of running same was $94,679.86 and the revenue from meals served passengers was $60,768.26, leaving, as the majority opinion declared, a deficit of $33,911.60, which the company arbitararily charged to boarding the crews. It is plainly wrog to call this a deficit because to constitute a deficit it would be necessary to ignore entirely the cost of feeding the crews, which, in common justice and from the very plain evidence, cannot be done.

An investigation by the Commission's Auditing Department, made subsequent to hearing, reports that but 22¾% of expenses, common to both freight and passenger traffic, should be charged to freight expense instead of 28½% as shown by Exhibit No. 5. This report of the Auditing Department also makes a correction in applicant's capital account, increasing it by something over $200,000. due to the fact that before being advised by the Commission's Auditing Department in 1913 as to how its books should be kept, applicant deducted its depreciation from capital account instead of adding it to surplus. While this report is mentioned in the majority opinion, it is clearly evident that it was not used as a basis for that opinion, and I refer to it only to call attention to the significant fact that by accepting our Auditor's apportionment of common expenses the freight operations of applicant are still conducted at a substantial loss.

We cannot agree with the majority opinion that this Commission should be slow to adjust the rates of a public utility on some parts of its traffic, if found to be unreasonably low, where its total operations are found to be profitable. No better example of the inequity of a decision based upon that rule need be sought than the case we are considering. Applicant's total operations are unquestionably profitable; but if the case is to be decided upon the uncontroverted testimony found in the record, we must admit that its freight operations are conducted at a loss. Do these facts not clearly establish a further fact, to-wit, that applicant's patrons in its passenger business are being discriminated against by being required to make up its losses resulting from its freight operations? The majority opinion recites that the Commission is not asked to readjust all of the rates of this utility and states that "in fact applicant vigorously contends that the Commission, in this proceeding, has no jurisdiction to change passenger rates." We agree with the majority opinion that we are not asked, in this application, to adjust all of the rates of this company, but we believe that, it having been shown by undisputed testimony that applicant's freight rates are too low and it being common knowledge that its total operations are profitable, it is the duty of the Commission to take such action as will result in the regulation and adjustment of all of applicant's rates. The necessity for this is further shown by the following statement found in the majority opinion:

> "The exhibits and statements and the results from passenger traffic during the first four months of the current year clearly indicate that applicant will enjoy ample net earnings in 1919, probably in excess of 15%."

A careful analysis of the testimony and exhibits in this case creates a doubt in my mind that applicant will realize 15% on its investment in 1919. It is admitted in the majority opinion that the cost of fuel oil in 1919 will subject applicant to increased cost of $67,736.35, but nowhere in the majority opinion is there any recognition of this fact in estimating the probable future earnings of the company. It seems hardly necessary, but reference may be made to the fact also of a general advance in everything that pertains to the operation of this and other transportation companies.

It is also admitted, in the majority opinion, that the last four years do not reflect normal business for applicant, due to the fact that earnings of the company were greatly augmented by travel incident to the Panama-Pacific Exposition in 1915 and while the earnings were lower in 1916, due to a strike of employees, it is admitted that the earnings of 1917 and 1918 were high because of war activities at Mare Island. The Commission did not accept applicant's confidently espressed opinion that the activities at Mare Island would be greatly diminished and yet it is apparent that the abnormal earnings of the company during three of the last four years should not be taken as a criterion upon which to base probable earnings of applicant in normal times.

The majority opinion also refers to the decision heretofore rendered by the Commission upon application No. 2928, wherein this applicant was denied permission to increase its freight rates on the ground that "the company was then in a very satisfactory financial condition" and "also that it had failed to prove by testimony or exhibit that the then existing freight rates were too low per se." Commissioner Loveland concurred in that decision but a different condition is presented in this case. The applicant company is still deservedly prosperous but the freight rates have been proven non-compensatory by uncontroverted testimony and should be adjusted.

We cannot agree with the majority opinion that the operations of applicant's company are so different from those of steam railroad operation as to render inapplicable principles, rules and decisions promulgated and announced by courts and commissions in cases involving the allocation of expenses common to freight and passenger business. True, steam railroads, particularly the larger systems, have equipment devoted entirely to each class of traffic. They also have departments, the activities of which are entirely devoted to either the freight or passenger business. But it is equally true that as to investment in constructions, upkeep, rent of offices, salaries of general officers, part of taxes, etc. etc. expenses and investment are common to both classes of traffic and must be allocated. This is usually done upon a car mile, per ton of earning basis. Such investment where expenses are common often far exceed in value the amount of investment in equipment devoted to particular traffic.

In the operation of many of the smaller steam road systems, locomotive equipment, office expenses, etc. are common to both freight and passenger business. The segregation 72 of such expenses is as difficult, if not more so, than the reasonable allocation of common expenses in the present case.

We cannot escape the conviction that the case we are considering is very simple and that the duty of the Commission is very plain. Can we require applicant to conduct its freight business at a loss because its total business is admittedly profitable? The Supreme Court has said we cannot. (See case cited supra) Should we then disregard the fact that the loss suffered through non-compensatory freight rates must be and is being made up by the rates charged in applicant's passenger business, and dismiss the application, as decided by the majority opinion? We cannot agree with this finding and therefore dissent. We hold that the Commission should adjust the freight rates of applicant by placing them upon a reasonable and compensatory basis and immediately, upon the Commission's own initiative, call applicant's passenger rates into question and adjust them on a reasonable basis, taking into consideration the fact that applicant's freight rates had been adjusted and made compensatory.

Commissioner

Commissioner

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