

ORIGINAL

Decision No. 9874

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of }
San Jose Railroads for an order }
granting permission to increase }
rates for the transportation of }
passengers on the line of the San }
Jose Railroads in the State of }
California. }

APPLICATION NO. 6414.

Wm. F. James and E. O. Edgerton, for Applicant.
Archer Bowden, City Attorney, for City of San Jose,
W. D. Wall, for Traffic Bureau San Jose Chamber of Commerce.

LOVELAND, COMMISSIONER:

O P I N I O N

In this application San Jose Railroads, a corporation, makes application for an order authorizing an increase in fares. In brief, these increases, as taken from Exhibit C attached to the application, are as follows:

- (1) Increase present 6¢ fare to 10¢ straight fare, or token fare of 7¢ at five tokens for 35¢.
- (2) Increase present fares on short extensions outside of San Jose to correspond with above.
- (3) Readjust 46-ride school commutation fares as follows:
 - Where now \$1.85 increased to \$2.22
 - Where now \$2.70 reduced to 2.63
 - Where now \$3.60 reduced to 3.48
- (4) Cancel 125-ride cash coupon fare and substitute 30-ride commutation fare at 20 times the one-way fare where this is in excess of 12¢.

As a reason for such increase in fares the application alleges that applicant's revenues "are insufficient to meet its fixed charges, operating expenses, taxes and depreciation", and further states it is necessary that its passenger rates and fares be increased in such amounts "that taking such increase, together with its present passenger revenue and revenue from all other sources, there will be returned to your petitioner a revenue at least sufficient to meet the annual fixed charges, taxes, and operating expenses". In Exhibit B, attached to the application, is shown a net loss of \$89,432.28 for the nine months ending September 30, 1920, this loss being as follows:

SUMMARIZED STATEMENT FOR NINE MONTHS
ENDING SEPTEMBER 30, 1920.

Operating Revenue	\$ 298,105.78
Non-operating Revenue	442.55
Total Gross Revenue	<u>\$ 298,548.33</u>
Operating Expenses	\$ 213,331.37
Taxes and Depreciation	21,840.33
Fixed Charges	147,073.46
Miscellaneous Debits	5,735.45
Total Expenses	<u>\$ 387,980.61</u>
 Total Expenses	 \$ 387,980.61
Total Revenues	<u>298,548.33</u>
Net Loss	<u>\$ 89,432.28</u>

It will be noted that the statement of expenses includes fixed charges and miscellaneous debts, the fixed charges being for the most part interest on funded debt.

Hearings were held at San Jose on March 1 and 2 and August 12, 1921. At the last hearing the matter was submitted, protestants, however, being allowed to submit a brief with the privilege of reply by applicant. A brief was filed but no reply made.

At the first hearing witness for applicant, during cross

examination in connection with Exhibit No. 2. explained that for the year 1920 there was a profit of \$75,000. net return that should be tested against the rate base as a measure of whether or not these properties were earning a fair return. It was therefore determined that a valuation should be made by the engineering department of the Commission, and an investigation made into the service and operating conditions of applicant. At the hearing held in August Mr. H. G. Weeks of the Commission's Engineering Department introduced a valuation of the properties of the San Jose Railroads and a report on service, operating and financial conditions of the San Jose Railroads and Peninsular Railway Company, the former being identified as Commission's Exhibit 1 and the latter as Commission's Exhibit 2.

The valuation is as of December 31, 1920 and the totals found are as follows. (Commission's Exhibit 1):

Class of Property	Historical Reproduction Cost	Condition Percent	Historical Reproduction Cost Less Depreciation
Operative Property	\$ 1,523,933	68	\$ 1,034,866
Non-operative Property	16,258	93	15,166
All Property	\$ 1,540,191	68	\$ 1,050,032

The valuation figures given do not include materials and supplies; they cover only such items as are properly chargeable to investment in road and equipment (Interstate Commerce Commission Account No. 401).

Applicant operates a street railway, giving passenger service exclusively, located partly within the city of San Jose, partly within the town of Santa Clara and partly in Santa Clara County, unincorporated.

The following tabulation shows the segregation of the 36.8 miles of track on the system:

City of San Jose	-	-	24.9 miles
Town of Santa Clara	-	-	2.6 "
Santa Clara County	-	-	9.3 "

The original cost of these properties cannot be ascertained because of the non-existence of earlier supporting detail records. Exhibit No.1, however, indicates that the investment in the physical properties is approximately \$1,300,000. The earlier bookkeeping did not follow prescribed rules and the total found, therefore, is not readily comparable with the historical reproduction cost predicated upon the present prescribed accounting.

No exception was taken to the valuation figures as presented, except in connection with the rate base, as will hereafter be mentioned.

Inasmuch as Commission's Exhibit a (valuation of Peninsular Ry.) formed the basis of argument for both applicant and protestants, it will be convenient to quote the principal conclusions on the question of the rate of return. The engineering department finds the following figures for the San Jose Railroad:

	1920 Re-stated	1921 Estimated	Year to June, 1922
Gross Revenue	\$ 403,490.	\$ 406,633.	\$ 406,663.
Operating Expenses, incl. depreciation.	311,778.	314,264.	308,966.
Railway Operating Revenue	91,712.	92,399.	97,697.
Taxes	21,911.	23,138.	23,138.
Operating Income	69,801.	69,261.	74,559.
Additional Revenue and savings in operation exclusive of use of Birney cars.	-	-	16,043.
Net available for return	69,801.	69,261.	90,602.
Historical Reproduction cost as of December 31, 1920	\$1,523,933.	1,523,933.	1,523,933.
Return on above	4.58%	4.54%	5.95%

Exhibit No. 2 states:

"It will be noted that for the ensuing year it is estimated that, continuing the present 6¢ regular fare, but with certain additional revenue and as a result of certain economies in operations, a return of 5.95% can be earned. This compares with a maximum return earned of 7.08% in 1913 and an average return for the past nine years of 4.49%, as shown in Table 3 B.

"Applicant has requested authority (with other less important increases) to install a 10¢ straight fare with tokens at 7¢, estimating the result of this increase in fare at 8% of the present passenger revenue, or \$31,502. If this additional revenue is realized the rate of return on our historical reproduction cost valuation would be 8.01%.

"Because of the fact that our studies show that only 25% of the people leave the business district in San Jose during the rush hours in street cars, 75% using automobiles, we seriously doubt whether the increase in fare as requested will actually produce any more revenue. Again, since we have no data showing the result of an analogous second fare increase, as requested by the applicant, we do not feel willing to accept its estimate of an increase of 8% in revenue, particularly when this is considered along with the above statement regarding automobile traffic.

"Additional Revenue and Savings in Operation.

"The figure of \$16,043. above includes \$3,606 additional revenue estimated as resulting from our recommendation to route the Seventh Street Line along First Street, and savings in the cost of operation as follows:

Abandon Hobson Street Bus Line	-	\$ 5,759.
Abandon Santa Clara Depot Line		2,678.
Change to parallel parking in business district	-	4,000.
Total	-	<u>\$12,437.</u>

"On May 1, 1921 the company placed in operation a total of 22 Birney cars and radically changed its system of operation. The saving due to the use of these safety cars together with a reduction of power rate and revised system of operation is approximately \$15,000. per year and is included in Operating Expenses as stated in the last two columns of the above table."

San Jose Railroads is controlled through stock ownership by Southern Pacific Company and is operated by the same set of officers as Peninsular Railway Company, which is subject to the same control. The relation between the San Jose Railroads and

Southern Pacific Company is important, in that if the Southern Pacific did not exercise such control and elect to continue it, and assume the high interest charges resulting from a funded debt of \$2,423,000. par value of bonds outstanding against the historical reproduction cost of \$1,523,933., the instability of the financial structure would force financial reorganization. This is apparent from the fact that the maximum return of \$84,000., as will be developed, does not equal the annual interest charges accrued, which, for the year 1920, were \$118,108.91.

There are two bond issues on the properties of the San Jose Railroads, as follows:

	Date		Par Amounts as of Dec. 31, 1920.		
	<u>Issued</u>	<u>Due</u>	<u>Authorized</u>	<u>Issued</u>	<u>Outstanding</u>
1- San Jose Railroad first mortgage 5%	1910	1955	\$1,500,000.	1,416,000.	1,335,000.
2- San Jose and Santa Clara County R.R. first refunding 4 $\frac{1}{2}$ %	1906	1946	\$1,500,000.	1,250,000.	1,088,000.
			\$3,000,000.	2,666,000.	2,423,000.

Southern Pacific Company owns all of the San Jose Railroads' bonds and it seems extremely important to note that these bonds were issued after the Southern Pacific acquired control of San Jose Railroads, when there was already an issue approximately equal to the security and, further, that Southern Pacific Company, having both issued and retained possession of the bonds, is the only party interested in this issue. Of the San Jose and Santa Clara County Railroad bonds, the testimony indicates that all of these bonds are in the hands of the public. The interest charges at 4 $\frac{1}{2}$ % of the amount outstanding aggregate \$48,960.00 a year, or approximately 58% of the amount available for interest.

Applicant noted certain exceptions to the figures and statements above quoted and since these were directed in part toward

the return earned previously by applicant, the following figures from Table 3-B of this same exhibit will now be given:

Year Ending June 30	Valuation as of Dec. 31, 1920, Less Yearly Additions.	Net Available For Return	Rate of Return
1912	\$ 1,442,255.	\$ 57,996.	4.02%
1913	1,423,889.	100,855.	7.08%
1914	1,485,098.	92,698.	6.24%
1915	1,488,365.	78,037.	5.24%
1916	1,528,790.	68,983.	4.51%
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Year Ending Dec. 31			
1916	1,481,284.	56,889.	3.84%
1917	1,533,097.	31,917.	2.08%
1918	1,563,189.	43,145.	2.76%
1919	1,596,172.	71,710.	4.49% #
1920	1,523,933.	74,483.	4.89%
		Average --	4.492%

Fare increased 20% in August, 1918.

In the first quotation it is noted that \$3,606. additional revenue is estimated as resulting from the recommendation to route the Seventh Street line along First Street. The General Manager for applicant, a witness, took exception to this and stated that in his opinion no additional revenue could be so obtained. The engineer responsible for this particular estimate explained how he had arrived at this figure and it was arranged that the matter should be jointly reviewed. As a result, it is estimated that \$1000. per year additional revenue could be expected.

Applicant also took exception to the estimated saving in the cost of operation by reduction in damage claims to result from a change to parallel parking of automobiles in the business district. From the testimony and after review of a report filed subsequently it is estimated approximately \$500. could be saved.

Witness for the Commission stated that since a street

railway collects its revenue daily in cash in advance nothing is included in the rate base for working cash capital, the historical reproduction cost being taken direct from the valuation without any additions or subtractions. Applicant contended that it is necessary at all times to have a certain amount of cash on hand, but made no statement as to what this amount should be. Although possibly some small amount should be added, it is negligible when contrasted with the amount of rate base and may be omitted in this proceeding.

The effect of consideration of these three exceptions changes \$16,043. in the first quotation above to \$9,937, the \$90,602. to \$84,496, and the possible return of 5.95% to 5.55%. The return, under proposed rates, of 8.01% becomes 7.61%. In other words, the best possible return with present fares is 5.55% and if applicant's increased fares produce the expected increase, 7.61%.

With these revised figures, to which there seems no possibility of further exception, the position of applicant may be considered.

Counsel for applicant took the position that even the estimated best return under present rate of fare of 5.55% is confiscatory and that with respect to the possibility of no increase in revenue from its proposed increases in fare contended that

"The right to take that risk, assuming now that the increase is justified on a proper rate base and won't produce unreasonably high earnings. So we want to frankly announce our position in that regard. We want to take the risk. We don't think it is risk, but if there is any we want to take it, and the company will suffer all the bad effects and the public none if we lose".

This is a doctrine to which the Commission cannot subscribe.

Counsel for protestants, City of San Jose and San Jose Chamber of Commerce, urge that no increase in fares be authorized.

taking a position contrary to that of counsel for applicant, and sustaining the Commission's conclusion that the proposed increased fares would not at this time increase applicant's revenue. Counsel for City of San Jose urged that this opinion is not casual, but based upon the facts as they exist in the city of San Jose, and supported his contention by the evidence of several witnesses, who are business men of San Jose. The testimony as presented was supported by a study of traffic and general industrial conditions, compiled by the Commission's Engineering Department, while on the other hand the applicant produced no evidence in support of its contention.

While there has been no apparent increase in business, this is, no doubt, a temporary condition. San Jose has a good record of growth in population, with no indication that such growth has been arrested. The number of passengers and revenues should increase; operating expenses, because of declining costs of labor and materials, should decrease. The estimated net income of over \$84,000., supra, is greater than any year except 1913 and 1914, before the general use of the private automobile. Returns in the future, then, should be greater and not less than 5.55%.

The increases estimated in net revenue, because of re-routing, abandonment of service, and changes in the automobile parking system, require the cooperation of the city of San Jose and while the record shows no opposition by the city to these changes counsel for the city stated he had not the authority to speak for the city on the subject.

Under these circumstances, it appears the best policy is to give applicant an opportunity to put into effect our recommended changes in service, the changes in the automobile parking system, the changes in intercompany accounting, to realize such additional revenue and economies as may result, to

allow a further study of operation under suggested changes, and to test our conclusion that the lack of increase of revenue which was apparent last summer was the result of only a temporary depression and that the revenues of this road will ^o continue to increase with the growth of the community.

It appearing that applicant's so-called financial requirements are not a proper basis for computing rates and that there is now under existing rates a substantial operating income, that certain operating economies are possible and should be instituted, together with certain relief which the city of San Jose could grant and that, considering also the likelihood of speedy recovery from the temporary depression of applicant's revenue, net earnings contributing a reasonable and fair return may be expected, I conclude that this application should be denied.

The efficient and reasonable regulation of public utilities certainly contemplates that consideration must be given to every important factor and the probable result of the action of this Commission upon the operations of the company and the effect upon the people. In a case where new rates are asked, certainly is such an important factor.

If, however, within a reasonable time it shall appear that the conclusions and estimates upon which this opinion is based cannot be substantiated by developments, the matter can again be considered by the Commission.

I recommend the following form of order:

O R D E R

San Jose Railroads Company having applied for permission to make specific increases in rates of fare, public hearings having been held and the matter having been submitted, for the reasons

stated in the foregoing opinion.

IT IS HEREBY ORDERED that the application be and it is hereby denied without prejudice.

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

Dated at San Francisco, California, this 29th day of November, 1921.

R. B. Brundage
H. D. Loveland
Erving Martin
Robert H. Powell
W. H. ...
Commissioners.